Volume 1

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STATE OF NEW HAMPSHIRE

DEPARTMENT OF STATE BUREAU OF SECURITIES REGULATIONS

No. C-2011000036

In the Matter of:

Local Government Center, Inc., et al.

BEFORE DONALD E. MITCHELL, ESQUIRE
PRESIDING OFFICER

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REPORT OF PROCEEDINGS

April 30, 2012

9:46 a.m.

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New Hampshire State Archives and Genealogical

Public Research Room

71 South Fruit Street

Concord, New Hampshire 03301

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I N D E X

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

THE PRESIDING OFFICER: My name is Donald Mitchell and I'm the hearing officer in this matter. This matter is docketed as Local Government Center -- In The Matter of Local Government Center, Inc.; Local Government Center Real Estate, Inc. -- that's incorporated; Local Government Center HealthTrust, a limited liability company; Local Government Center Property-Liability Trust, a limited liability company; HealthTrust, Incorporated; New Hampshire Municipal Association Property-Liability Trust, Incorporated; LGC HealthTrust, a limited liability company; the Local Government Center Workers' Compensation Trust, limited liability company; and the following individuals were named: Maura Carroll, Keith Burke, Stephen Moltenbrey, Paul Beecher, Robert Berry, Robert MacDonald, Peter Curro, April Whittaker, Timothy Ruehr, Julia Griffin, and John Andrews.

Since the initial filing, some of these respondents have had the charges against them as stated in the complaint withdrawn. And so as we enter the merits, we have all of the aforementioned business entities; and remaining as individual-named respondents, we have Ms. Maura Carroll and we have Mr. Peter Curro.

The docket number is C-2011000036.

First announcement -- first correction of the day, as of this point in the proceedings, we still have Mr. Andrews as a named representative, but we anticipate motions that -- or a named respondent. We anticipate motions that will change that status.

I've addressed you about phones. And let me say this. Because of the statutes in the State of New Hampshire, any observers here today who are carrying firearms openly that I cannot see or are concealed, I request that you leave the building now, secure the firearm elsewhere. I'll reserve your seat and you can come back and take your seat. But there are no firearms in this building unless you are a sworn law enforcement officer.

No food is to be ingested, no beverages, all right? You'll notice that there are pitchers of water; but that is for the counsel, witnesses, and other speakers, if you will, who will be at this process for some eight or nine hours today.

The lady in front of me is taking a stenographic record of these proceedings. And this is paramount to the rights of every party who is involved in this litigation. Anything can disrupt her despite her efforts to concentrate. So once again, I will say any disruptive behavior will be addressed immediately.

Witnesses will appear here during the course of this -- of this hearing. The story that they have to tell will be the facts that are crucial to a determination of this case. They are not to be disturbed. We need to hear everything they have to say.

To the media, please do not act in any hectic manner or scurry around, as you may in public hearings. The line of demarcation we're approaching in this direction is the last row of tables. Do not use any flashes or other disruptive devices.

To the party witnesses -- to the parties' witnesses. You are not under any sequestration order. So you're free to remain in this room. If you feel a desire or need to retreat for any period of time, just please inform someone on your team, if you will, and we have a holding room for witnesses where you can wait until you are called. The streaming, however, does not feed into there.

Also, for some of the witnesses, this may be a new experience for you. Others of you have spent as much time in courtrooms as many of the lawyers here. But please keep this in mind at all times. And I'm speaking mostly to the witnesses.

I am the person who in the end will be charged with making a determination in this matter. And so it is of utmost importance that not only can the stenographer hear what you're saying, but that I hear it and understand what you're saying. So anytime I may just interject quickly to keep your voice up, please don't be embarrassed or taken off your stride by that. My responsibility also is to protect the record in the event of an appeal.

When your attorneys have completed their questioning and cross-examination has been completed, I may have a question of the witnesses. Put no special significance to that. I am generally asking for two reasons.

One, for matter of clarification because I may have missed something as it went by. And secondly, I may ask a question because I have a responsibility to keep the record as complete as possible. And to do that, if I believe that there's a gap in that record and I need that fact, I will ask you of that. If there's any counsel from your lawyers, I'm sure they'll interject at that time.

To the counsel. I remind you of the previous protective orders in this case having to do with certain management aspects, certain aspects having to do with medical identifying evidence.

I will say to the public that there was an orientation session for counsel here on Friday, which there were some informal agreements, if you will. And I do want to change one of those. And that is that if you are -- if you wish to approach me, please ask leave to do so. If you wish to approach the witness, feel free to do so without any prior request. We wouldn't want to trip you up and make you adopt any new rules. I will keep my eye on you.

The conduct, as I have said from the outset, is something that I'm very sensitive to. And I will also say that these lawyers have been at a very difficult task for what, for some, may seem a short time. But you know, it's been eight months at a minimum. And for those that were involved in the initial investigation, it's longer than that. They have shown not only their durability, but their patience at dealing with at times highly-charged issues. And we've made it to the evidentiary phase. And for that again I'm appreciative of all the cooperation and courtesies that have been extended, if you will, to the tribunal here.

Also, with respect to counsel, the Rules of Evidence, as you know, do not apply strictly here. That is not to say that I am not familiar with them. However, in an administrative proceeding, know that all evidence that I believe is relevant/material/reliable will be heard. I have the discretion and I will exercise it to accord the appropriate weight to whatever testimony or exhibits there are that one or more of you are objecting to. But this proceeding hopefully can be facilitated by moving forward.

Weight is more easily given as the case proceeds because there's a relativity factor that comes in to play. However, someone has to go first. And to the best of my ability, I will keep that strike zone at the same place, to borrow a sports analogy, for all counsel, regardless of when they're asking their questions.

By prior agreement, we have the exhibits that are to be submitted already assigned identification numbers. They still have to be admitted as evidence. But I thank counsel for all their work in that regard as well. I did solicit a statement of agreed facts in this matter and have been provided what counsel's best efforts would yield, given the time allowed.

With that, because there is an audio recording also being made of these proceedings, I'm going to ask counsel who expect to speak today to introduce themselves for the record. And I'll begin with the moving party.

MR. VOLINSKY: Good morning, Mr. Mitchell. My name is Andru Volinsky and I represent the Bureau of Securities Regulation.

MR. TILSLEY: Good morning. Roy Tilsley on behalf of the Bureau as well.

THE PRESIDING OFFICER: Thank you.

MR. WINGATE: Good morning. Earle Wingate, staff attorney, Bureau of Securities Regulation.

THE PRESIDING OFFICER: And with the respondents.

MR. SATURLEY: Good morning, Mr. Mitchell. For the record, my name is William Saturley. I practice with the firm of Preti Flaherty here in Concord, and I represent the Local Government Center business entities.

THE PRESIDING OFFICER: Thank you.

MR. QUIRK: Good morning. Brian Quirk, also from the law firm of Preti Flaherty. I also represent LGC and its affiliated entities.

THE PRESIDING OFFICER: Thank you.

MR. GORDON: Steve Gordon from the law firm of Shaheen & Gordon, and I represent Maura Carroll.

THE PRESIDING OFFICER: Thank you.

MR. HOWARD: Good morning. Mark Howard from the firm of Howard & Ruoff in Manchester. With me is Attorney Kimberly Myers. And I represent Peter Curro.

THE PRESIDING OFFICER: Thank you.

MR. RAMSDELL: Good morning, Mr. Mitchell. Michael Ramsdell from Ramsdell Law Firm on behalf of John Andrews. And with me today is Joshua Pantesco from the law firm of Orr & Reno.

THE PRESIDING OFFICER: Thank you.

Mr. Ramsdell -- I'm sorry -- Mr. Volinsky.

MR. VOLINSKY: Sir.

THE PRESIDING OFFICER: You have a motion this morning regarding Mr. Andrews?

MR. VOLINSKY: Yes. We move the hearing officer to allow us to enter a voluntary non-suit to dismiss all claims against Mr. Andrews pursuant to a settlement reached on Saturday.

THE PRESIDING OFFICER: Thank you very

10:00:20 much.

10:00:20 Is there any objection to that?

10:00:23 All right. Then the charges are
10:00:25 withdrawn. Mr. Andrews is dismissed from these
10:00:28 proceedings.

10:00:31 Mr. Ramsdell, I understand that that
10:00:33 terminates your representation of Mr. Andrews, is
10:00:36 that correct, for these proceedings?

10:00:38 MR. RAMSDELL: It terminates Mr. Andrews'
10:00:42 status as a party in these proceedings. What I have
10:00:45 for you at this point is -- I have for you an
10:00:49 appearance for myself on behalf of the Local
10:00:58 Government Center business entities. And there's an
10:01:01 original and one copy. Do you want two copies or
10:01:04 what is it you'd like?

10:01:08 THE PRESIDING OFFICER: Two copies.

10:01:09 MR. RAMSDELL: You've got it.

10:01:35 THE PRESIDING OFFICER: Mr. Ramsdell, while
10:01:36 I have you, please, is it further my understanding
10:01:39 that both the LGC business entities obviously and
10:01:45 Mr. Andrews have consented to your representation of
10:01:49 the LGC business entities now?

10:01:52 MR. RAMSDELL: That is correct, Mr. Mitchell.

THE PRESIDING OFFICER: Thank you very much.

To the Bureau of Securities Regulation, Mr. Volinsky or Mr. Tilsley, we have a motion -- we have a motion with respect to video streaming.

Could you step to the microphone, please, Mr. --

MR. TILSLEY: Oh. That makes more sense. Based on our discussions on Friday at the orientation, I believe that all parties have assented to our motion to allow live streaming.

We have agreed on one camera at a fixed position, which shows a panoramic view from the bench to the screen. We have agreed that the feed goes dark when the hearing is not in session.

The hearing officer has control over the microphone so that you can turn the sound off at appropriate times for bench conferences and things like that.

And finally, that there will be no copies of the video record provided to any party or anybody else without the hearing officer's permission.

THE PRESIDING OFFICER: Thank you very much.

Mr. Quirk, please.

MR. QUIRK: Thank you, Mr. Mitchell. On behalf of Local Government Center, we assent and join in that motion.

THE PRESIDING OFFICER: Thank you. Is there any objection to this motion?

None being seen, the motion is granted. I also have received a folder of joint exhibits. Have you received this?

Would you please mark that as Joint 1 and 2. There are two joint exhibits.

(Joint Exhibits 1 and 2 marked and admitted into evidence.)

THE PRESIDING OFFICER: Thank you very much. Is there any party here today who is aware of any pending motion on which I have not ruled?

Seeing that there are no outstanding motions, I then ask, are there any motions that should be brought to my attention at this time?

Very good. Then we will proceed with openings. And it's my understanding that the Bureau of Securities Regulation does have an opening. With respect to respondents, you may contemplate giving your opening at this time or reserving until your direct case.

Mr. Volinsky.

MR. VOLINSKY: Thank you, Mr. Mitchell.

The evidence in this case will show that the Local Government Center violated the spirit, intent, and letter of the law that governs risk pool management, RSA 5-B. Although the Bureau need not prove intent in this matter -- the standards of the statute are the standards -- the evidence will show that the Local Government Center acted intentionally; they acted unethically and they acted unscrupulously.

And I use those words intentionally because those are the very words that the Local Government Center boards used to describe the same conduct when they thought their competitor Primex was doing the same thing to them. Unethical. Unscrupulous.

The Local Government Center HealthTrust is the cash cow in this organization. The evidence will show that the HealthTrust intentionally charged more in premiums than they needed to operate the HealthTrust. The money was spent on investments that were unnecessary for the operation of the HealthTrust. The money was spent to subsidize a failing workers' comp program. The money was spent to adopt a defined benefit pension plan which included the former executive director just less than two years before he retired, with knowledge that he was going to retire.

And perhaps in a small way, but emblematic, the money was spent to give the outgoing executive director a $100,000 no-work contract for after he retired.

Oh. And the money was spent to engage in multiple-year, multiple trips to the New Hampshire Supreme Court litigation with the firefighters in which Local Government Center claimed they were exempt from the Right To Know Law because they're not a governmental agency, at a time after the director of the Local Government Center used the Right To Know Law to get documents from Primex and demand that Primex comply with the Right To Know law.

None of these expenditures could have happened if the Local Government Center followed the standards of the statute, which are to return earnings and surplus excess of operations. Return earnings and surplus excess of operations.

You will hear -- and it's in the Local Government Center documents -- risk pool surplus is taxpayer money. And in recessionary times when taxes can't be raised, hoarding surplus at the risk pool means teachers get laid off, police officers have their hours reduced, and firefighters don't get new equipment. This case is fundamentally about a disrespect for taxpayers' dollars.

Let me provide you with some context. The HealthTrust -- $360 million a year passes through the HealthTrust, taxpayer dollars, as premiums. 85 percent of the cities, towns, and school districts in the state are insured by HealthTrust. HealthTrust is the largest health risk pool in the nation. The largest in the nation.

In 2003, a number of affiliated programs went through a reorganization that we'll hear a lot about. The reorganization placed the three risk pools -- health, workers' comp, property-liability -- in a subsidiary position to a parent. It was done by forming Delaware corporations.

You will hear testimony that Mr. Andrews claimed he was completely unaware that Delaware was used and that prior to going to Delaware, the lawyers for the Local Government Center had been advised that it was illegal to combine in this way under New Hampshire law. Didn't know. He also didn't know that New Hampshire standards require New Hampshire risk pools to be in New Hampshire entities. And so going to Delaware was a violation of that standard.

In 2003, when this happened, the building, which is now worth $10 million up on The Heights, was owned 75 percent by HealthTrust, 25 percent by Property-Liability Trust. As part of the reorganization, these were contributed to a wholly-owned subsidiary of the parent for no compensation. And that can be done because the parent owes no fiduciary duty to the subsidiaries.

Mr. Andrews will testify that at the time of that transfer, there was a promise made that if the Local Government Center was ever dissolved, the property would go back to the trusts, creating a constructive trust. Of course, that's not written down anywhere. It's not in a deed. It's not in any of the transfer documents. But that will be his testimony.

In 2007, because workers' comp was being looked at carefully by the Labor Department because it was a financially troubled program, the Local Government Center put it together in one entity with the Property-Liability Trust.

You will hear that since 2003, HealthTrust has contributed $34 million to the parent in what's called strategic planning contributions. It shows up on the financial statements: $34 million. What it actually is is $18 million was a straight-up subsidiary of the failing workers' comp program and about $11 million, which includes real estate, is for support of the parent.

Now, NHMA, after the reorganization, became essentially a lobbying group and a legal education group. In order to belong to a trust to get your insurance, member towns and cities and school districts have to pay dues to NHMA. Those dues recently are $900,000 a year across all the members, 300 of which is kicked over to the parent.

10:14:45 This $34 million, in June of '11, 10:14:49 under the current director, Ms. Carroll, and under 10:14:53 pressure from member organizations, the board adopted 10:14:58 a note for $17 million for Workers' Comp to repay 10:15:06 HealthTrust most of the subsidy. It's not a note 10:15:12 from the new combined entity. It's a note only from 10:15:15 Workers' Comp. It has no interest. It has no 10:15:20 payment schedule. The note provides that it's paid 10:15:23 from surplus only. And of course, parent determines 10:15:28 when, if ever, there will be a surplus in the 10:15:33 workers' comp program.

10:15:36 The only board that exists in this 10:15:38 whole enterprise now is up here at the parent where 10:15:43 the parent does not owe a fiduciary duty to the 10:15:49 subsidiary.

10:15:52 I mentioned unethical and 10:15:53 unscrupulous. In 1975, John Andrews came to the New 10:16:02 Hampshire Municipal Association from the Maine -- 10:16:04 State of Maine counterpart. He had all of three 10:16:08 months' experience running a risk pool when the Maine 10:16:12 director was on sabbatical. Other than that, he was 10:16:16 a lobbyist for the Maine program.

10:16:21 A few years after he joined, in 1979, he hired Paul Genovese. According to Andrews, Genovese, who was operationally in charge of the workers' comp program -- according to Andrews, Genovese convinced the board of the workers' comp program to break away from the New Hampshire Municipal Association and form a separate organization called Compensation Funds.

Compensation Funds, you will hear, later became Primex. Mr. Andrews described Genovese as a traitor, saying he was personally betrayed. He felt hurt personally by the conduct of Mr. Genovese. And you'll see how this animates a lot of the Local Government Center's decision-making as we move forward.

The Local Government Center, as the evidence will show, took an extremely harsh attitude towards its competitors, mostly Primex, but also SchoolCare, which is the third risk pool. Indeed, one of the board minutes reflects board member Julia Griffin asking, How can we infiltrate the SchoolCare board?

How does this play out? Let me give you some examples. In 2001, a representative named

Bob Wheeler submitted a bill in the House designed solely exclusively to strip capital from Primex. He was a board member for one of the trusts at the time. The outside auditor for the trust prepared the financial documents. Julia Griffin testified and provided written testimony on the part of Hanover, where she was town manager, and on the part of the Property-Liability board where she then sat.

She said in her written testimony on behalf of that board, Primex is illegally hoarding surplus. Surplus is taxpayer money. Primex will illegally subsidize the property and liability rates with workers' comp money.

That bill failed because the committee to which it was assigned considered it to be a shot at one business by another business.

Give you another example. The individual boards had a couple of members each that came together and formed what's called a Joint Competition Committee. This happens to be one of their PowerPoints. It's telling that they used, kind of, war symbols and battle medals in their documents.

Julia Griffin at an October meeting

in '02, Is there any way to expose Primex for hoarding surplus? John Andrews, he wants the municipal association to take back workers' comp, so there will be no competition.

Third example. In November of '03, after the combination, the reorganization, Julia Griffin -- now she's on the parent board -- Primex has $75 million in member balance. She complains they use it to subsidize other programs. She calls at this meeting, reflected in the board minutes, Primex's conduct is unethical.

She later votes for the $18 million subsidy. John Andrews: Primex uses its member balance to subsidize Property-Liability and they will use it for Health. John Eich, a board member from Stark: Primex has a war chest they will use to buy us. And then he proposes that the Local Government Center embrace the same concept and build its own war chest.

Bob Wheeler, the representative: Every dollar in the Primex war chest is a taxpayer dollar. He, too, votes to start building a war chest.

Mr. Beecher, who was the chair:

Primex has no scruples. Andrews argues Primex uses money from one program to the next and suggests that the LGC board must overcome its reluctance to engage in this practice.

Unethical. Unscrupulous. Surplus is taxpayer dollars. These minutes were sealed.

Also in these minutes, Wheeler explains that towns can't build up and hold surpluses year to year. It's the very same concept expressed in the amended petition.

So after the board makes decisions and has discussions and decides to build a war chest, they go to their actuary, Peter Riemer, who's been in place for some 25 years -- he's still their actuary -- and asks him how to do it. He recommends the adoption of a concept called risk-based capital, which relates to insurance companies. At the time -- Risk-based capital is expressed in factors or percent. At the time the risk-based capital number for the Local Government Center HealthTrust was between 2.1 and 2.5. 210 percent, 250 percent. He recommends doubling to 4.2.

And then the way they reach the 4.2

is they don't issue a specific open transparent surcharge to members: We're going to increase capital. They bake it into the rates by increasing a factor called risk. And by increasing risk, premiums come in at a higher level than necessary to support the program and allow them to build their capital from 2.1 to 4.2.

But they're not completely honest about the 4.2 either. Because what they do is in addition to the 4.2, is they adopt a 5 percent -- or half a percent -- sorry -- for what are called admin expenses. So the 4.2 is really 4.7. That admin expense in '07 meant premiums came in $7 million higher than necessary. In '08, they came in $7.2 million higher. In '09, they were $8.7 million higher. In 2010, when the investigation is here, they dropped the 5 -- the .5, and now they use $500,000 as their administrative expense.

They set targets of 4.2. The RBC in '07 was 6.7. In '08 it was 6.4. In '09 it was 4.8. '10, under scrutiny, 4.2. This translates to surplus. $90 million here. Just about $90 million here. $77 million, $84 million. If they'd stayed at the pre-war-chest number, this $84 million would be half. That's what this case is about.

You will hear about two defenses. Let me just touch on them briefly. The first defense: everybody does it. Of the 500 exhibits that LGC has in this case, about 100 of them are about practices at Primex, SchoolCare, and risk pools that no longer exist.

Even if the Bureau agreed that everyone does it, as exhibits in this case are the agreement the Bureau reached with Primex in March and the agreement the Bureau reached with SchoolCare last week to return between $25 and $30 million to members of excess capital surplus and to -- to adopt processes to prevent those levels of capital from being built up again. There is no selective prosecution in this case, and the Local Government Center can't hide behind others.

The second defense is the business judgment rule. First, it doesn't apply. We have a statutory standard. As a matter of business judgment, the board cannot decide to avoid/ignore the standard, violate the standard. Second, even if it did apply, they can't justify that they acted in the -- under the business judgment rule in good faith because by their own terms, the conduct at issue is unethical and unscrupulous.

The third point is it's not true. Their business judgment -- I'll use this. This is a chart that compares what are called member contributions in blue, light blue.

THE PRESIDING OFFICER: Mr. Volinsky, can we attempt to focus that any better. Well, I mean for others as well.

MR. VOLINSKY: Right there. A little better?

THE PRESIDING OFFICER: Fine.

MR. VOLINSKY: What this chart shows, member contributions in light blue, paid claims in the health program in dark blue. Year after year from '02 to 2010, member contributions exceed claims. Always exceed claims. Then on top of premiums, member contributions, is this green band that's pretty constant throughout. That's an extra reserve that the Local Government Center HealthTrust maintains to pay claims as they come in. It deals with incurred but not reported -- not-recorded-yet claims.

So you have contributions and then this claims reserve, which is about $20 million each year. It's pretty constant because they've predicted pretty well.

So they have to blow through contributions, claims, before they get to the red. And the red is the surplus we're talking about. And you can see that the red section doubles, a little more than doubles over the course of this period.

The claims, which is what this program is about -- and you'll hear the term "short tail" because these are health claims and they turn rather quickly -- are predictable so that we can set up contributions that always exceed claims. We have a pretty steady claims reserve. And then the net assets are above it. This business is healthy without that red section, without the red assets -- the net assets.

Let me tell you how I've come to that conclusion. This is a document distributed in '97 -- I'll let Adrian try to get a little more focused for me -- by the then-chief financial officer, Sandal Keeffe. She's still the chief financial officer. She's also now the deputy director.

This is in response to a Union Leader article from a case that I was involved in where the LGC is responding to a claim that their capital is too low, that their net assets are insufficient.

And let me just read two quick paragraphs. It should be first stated that a focus on the members' balance, or -- as she calls it, free surplus of the trust -- is not the sole, and certainly not the best, measure of the trust's financial strength. The members' balance represents funds the trust has remaining after it has set aside reserves sufficient to pay claims and related costs of operations. The trust has fully-funded reserves to pay those claims and costs. In addition, the trust believes it has priced its products to remain fully funded and financially sound. Now to the details.

That chart confirms what Ms. Keeffe represents the trust believes it has priced its products to remain fully funded. Member contributions always exceed claims.

In the next paragraph she explains that there was an anticipated reduction of member balance. It came about, quote, because the trustees wanted to reduce the members' balance, as required by RSA 5-B, the trust enabling legislation, and the Internal Revenue Code. When the trustees established rates for '96, the decision was made that a reduction in members' balance would be accomplished through lower rates.

So they lower the member balance; they returned it there in rates.

Second page, same memo. Again, the trust has fully-funded reserves to pay claims. These figures are established based on reviews by Watson Wyatt Worldwide -- that's Peter Riemer -- and is fully funded by the trust. The trust's members' balance is its free surplus -- that's the concept in this case -- which is not associated with its reserve for claims. The trust's financial position clearly shows it is sound and is now meeting, and should in the future meet, its claims reserves and other financial requirements.

What we take from this is free surplus isn't financially required. What we'd ask you to do at the end of this case is to set a legal means for establishing earnings and capital and returning surplus so that surplus isn't built up year over year over year.

We're going to ask you to require the Local Government Center to disgorge its current surplus back to its member communities. We're going to ask you to set up and enforce essentially constructive trusts to repatriate the real estate and to repatriate the workers' comp subsidy, not with a fake note, but with a real payment back to HealthTrust.

And we're going to find -- ask you to find to the extent you hold -- Local Government Center holds illegal surplus, that it acts as a security, requiring registration and meeting those standards.

And finally, we're going to ask that you order that the parent model, formed illegally through Delaware, which does not provide for a fiduciary duty for HealthTrust, that that be disbanded. And that that risk pool be supported by premiums and operations designed to support that risk pool and that earnings and surplus be returned to members.

THE PRESIDING OFFICER: Thank you, Mr. Volinsky.

Mr. Saturley, do you wish to make your opening at this time?

MR. SATURLEY: I do, sir.

THE PRESIDING OFFICER: Please do.

MR. SATURLEY: I understand that I have 10 minutes, Mr. Mitchell; is that right?

THE PRESIDING OFFICER: Take what you need.

MR. SATURLEY: Thank you very much. For the record again, my name is William Saturley, and in this matter I'm honored and it is a privilege to speak on behalf of the Local Government Center and its various business entities.

I will take time now to respond to what I consider to be misleading and misguided characterizations of my client's actions, so distorted and so taken out of context as to create a fiction for what has occurred over the past decade.

As I said, I'm privileged to

represent the Local Government Center, and I want to talk for a minute about what the evidence will show in the next few weeks as you hear from its witnesses and you hear its evidence.

The Local Government Center is 115 employees who have one mission: Provide the highest benefits and the highest level of service of which they're capable to public employees, consistent with doing that at the lowest possible cost to the public employers.

In doing that, they try to do that in a way that makes sure they are always able to pay the claims that are presented to them. And you will hear from many of the staff at the LGC who will come in and describe how they manage that balance, the balance between providing the highest level of benefits at the lowest possible cost.

One of the pools they administer is the HealthTrust pool. There are 75,000 separate individuals whose health depends on that trust. They are public employees, their dependents, and retirees. There are 38 separate medical plans within the HealthTrust. There are seven prescription drug

10:37:05 plans.

10:37:06 Each year in the recent past there 10:37:08 have been in the nature of $360 million worth of 10:37:14 claims presented on behalf of those 75,000 10:37:17 individuals to be paid. And in each and every 10:37:21 instance, the Local Government Center has been there 10:37:23 to pay those claims without question. And LGC plans 10:37:32 to continue to be there for those employees of the 10:37:35 cities, towns, and school districts that it insures.

10:37:43 A second pool that's part of the 10:37:45 Local Government Center group is the Property- 10:37:50 Liability Trust. That pool insures approximately 10:37:53 4,100 locations: buildings and contents within the 10:37:59 State of New Hampshire with a value of nearly 10:38:02 $4 billion. You may recall last August when 10:38:09 Hurricane Irene swept through the New England area. 10:38:14 Thankfully it didn't hit New Hampshire very hard. 10:38:18 Nevertheless, there were hundreds of thousands of 10:38:21 dollars of claims made by the cities and towns and 10:38:25 school districts that insure with the Property- 10:38:30 Liability Trust, and LGC was there to pay them and 10:38:33 plans to be there to pay similar claims in the future.

10:38:39 Speaking of real estate for a moment, the LGC offices hosted last year over 1,700 meetings -- classes, workshops, skill sets -- attended by 22,000 attendees. That's how they use that office building.

The third risk pool, the workers' compensation risk pool. 22,000 -- 26,000, excuse me -- covered public employees in that pool. LGC has taken an approach with that particular pool, and with all of its coverages, of trying to integrate the coverages. It's been a pioneer in approaching coverages by looking at a totally integrated approach so that there are no gaps in the coverages that might cover a public employee, whether his injury or his health problem arises from work or from private.

Consistent with that, LGC's approach has been to offer workshop upon workshop to provide the resources and the education to individuals so that they can help manage their own health and their own healthcare costs, so that they can learn how to be safe at work and at home. Such things as offering personal health assessments to people. 25,000 individuals took them up on that offer last year.

The types of workshops that they offer to -- in the area of safety include everything from chainsaw running to school bus driving to managing crises in school buildings. That's an approach to provide the individuals the tools and the education and the resources they need to minimize health costs, to manage their lives so that they're happier and healthier.

In doing so, the Local Government Center employees make themselves available to people. Last year they fielded over 37,000 telephone calls with inquiries on coverage and how to manage their benefits.

All of those things I've described take talented, creative people. LGC calls that making a difference through caring and innovation. The Bureau calls it wasteful spending. And that's one of the differences between us.

Let me talk for a minute about who runs this enterprise. LGC has a 31-member board of directors. They're town administrators, school business managers, city councilors, mayors, clerks, teachers. People from Hollis to Hanover, from North Hampton to New Hampton have all served on that board, all without compensation, all committed to how to manage that balance between the services that public employers need and the protections they desire, on the one hand, and minimizing the cost and the impact of high rates.

Who better than the members of those boards that I have just described, who better knows the impact that high costs of insurance cause to towns, cities, and school districts? The members who run -- the members of the board who run that organization, all when they leave their LGC board meeting go back to their various cities, towns, and school districts and must justify what they did. They are the ones who are the most sensitive to the costs.

And so therefore, I will suggest to you that they're the ones who understand the balance the best. And you'll meet several of those board members in the next two weeks, past and present, to talk about how seriously they took that charge and how they managed it.

You'll also meet during the next two weeks many of the advisors that they consulted over this decade-plus that the Bureau wants to focus on.

You'll meet the actuary who helps them assess the risk looking forward in the future. You'll perhaps meet the accountant, if it's necessary, and the auditor who prepares their financial records. You'll meet the attorneys. You'll meet the other consultants.

They'll be available to you to explain what it is that the board of directors did and the approach that LGC took to this balance that I've described of maximizing services and minimizing the cost.

This hearing is a criticism of the decisions made over a decade. What guidelines did the board have to operate within? What were the legal constraints on them? RSA 5-B, we know it exists, we know it's the controlling statute. It's a relatively simple statute. It says, Meet certain tests and then, board, it's up to you. Figure out how to strike the balance between service and cost. Figure out what you need for reserves to manage your business. And when there is surplus, return it.

This board, as you've heard, chose a method called risk-based capital: RBC. And you will hear that that's an appropriate choice that they made. And you will hear how they made it, when they made it, how they applied it, and why.

There is no other detail in the statute as to what reserves should have been set other than set them as appropriate. There is no other detail in the statute as to how to return surplus. There is no other detail in the statute as to how you should run your business. And the Bureau and the Secretary of State's office has refused to issue any rules to specify the things that they now say were inappropriate.

So in the absence of detail, in the absence of specificity in the statute, in the absence of rules, how do you measure what this board did and how it acted for the past decade-plus?

And yes, you will hear about the business judgment rule, because in the absence of that specificity and in compliance with New Hampshire law, a board of directors has a prerogative to run its business the way it sees most fit consistent with its duty to run it in good faith, exercising prudence, and in the best interests of the organization.

And again, we're talking about a balance. We're talking about a balance between a board having discretion and a board having responsibility. The business judgment rule is the expression of the respect that's given to that balance. Courts have all long said, As long as there's a rational business purpose for a board's decision, as long as they have acted in good faith with ordinary prudence in the best interests of the organization, then we will not second-guess what a board of directors has done. Because that's their area of control.

And so with regards to the charges that the Bureau has brought in the amended petition and in this hearing, for each of the topics that the Bureau considers and wants you to consider, you will see as part of our evidence the process that the board of directors went through.

For each one of these issues, you will see a lengthy planning process. You will see experts and consultants considered. You will see counsel engaged. You will see robust extensive discussion with multiple viewpoints solicited. And you will see a board that adhered faithfully and fully to its fiduciary duties. All this material will be available through the meeting minutes, the lengthy, extensive meeting minutes that are part of the evidence that we will tender in this case.

For each one of the issues that the Bureau considers, it must establish that this board acted in bad faith. Lack of due care. No rational business purpose. That's their burden. And the decision you will need to render is whether or not -- how did the Bureau -- how do you determine that this board acted with these decisions?

In contrast to the balance and the reasonable balance and the reasonable approach that this board has taken in the decade-plus that we're talking about, the Bureau, through its witnesses, will urge you to take and find that the board should have taken an extreme position, a radical position. The numbers that the Bureau is pushing now in hindsight that the board should have established for RBC is radical. It would leave LGC in a weakened position. It would leave it out of balance in terms of its size, in terms of its obligations, in terms of its ability to move forward.

We believe that at the end of this period of this hearing, you will be unable to conclude that the board violated its duties. We believe you will conclude instead that this is a board that should be applauded for acting in its good faith, for acting selflessly, for acting with great care, and for acting always with a legitimate, sound business purpose. This is a board whose mission was dedicated to providing the best service available to public employees at the least cost that it could do for the public employers, consistent with always being there to pay claims.

We ask you to contrast that balance with the position, the extreme positions taken by the Bureau. We know that you will hold your judgment until all the evidence is in and all the witnesses have testified.

We thank you for that and I thank you for your time.

THE PRESIDING OFFICER: Is there any other respondent that would like to make their opening at this time?

MR. GORDON: I would.

THE PRESIDING OFFICER: Mr. Gordon, please come forward.

MR. GORDON: Thank you, Mr. Mitchell.

As you know, I represent Maura Carroll. And the directors of LGC faithfully exercising their fiduciary duties, knowingly and prudently chose Maura Carroll as their executive director. Their choice was a prudent one.

After the long and dedicated service of John Andrews that brought LGC to the national forefront of pooled risk management programs, the board sought a new and different kind of leadership, a leader who would serve the organization with integrity and intelligence. A leader possessing the intangible qualities of grace, humility, and strength. And a national search was undertaken.

A profile of the qualities necessary to assume the mantle of leadership of an organization that was dedicated to its members to provide the best quality service at the lowest possible cost was begun. Interviews were conducted of board trustees and staff.

And then exercising their fiduciary duties, the board described the ideal candidate as follows: A leader of professional management with the very background to include municipal and statewide public experience, public policy experience, familiarity with legislative and strategic planning, familiarity with insurance pools, unquestionable ethics and integrity.

And then the skills section. And this will be Exhibit 450 when it gets introduced. Ability to implement and execute the strategic plan as developed by the board of trustees. The responsibility was to execute the plan.

An ability to build a vision for the future, work hard and build a consensus amongst different groups of different constituencies and interests with different roles and different responsibilities.

A negotiator, a delegator, a problem solver. And that person had to have the unique capacity to balance these divergent interests. Divergent interests to make the organization stronger and better for a singular and dramatic purpose. That purpose was to serve its members.

And in the end, as it goes through the other personal characteristics, unquestioned morals, integrity, ethics, they sought a high energy individual with contagious enthusiasm, and thank goodness, a sense of humor.

And I'd like you to meet Maura Carroll. For she was the choice. Born in Concord. She now lives in the house she grew up in, and she lives there with her husband, who's seated right beside her. She went to Bishop Brady and Holy Cross. And the summer before attending Tulane Law School, she worked at Health and Human Services.

Public service was in her bloodline. Her dad was a public employee, a public servant for 58 years. Serving also as County Treasurer and a Supervisor of the Checklist for as long as Maura can remember. She served in the Legislature for three terms, representing Ward 6 in the City of Concord. She then served as a city councilor for 8-1/2 years. And added to this broad array, she has served on numerous nonprofit boards: United Way, Capital Regional Development Council, and here in Concord, our own Capitol Center.

She had a short stint as a private attorney, nine months, and then she realized that her passion, her devotion, and her commitment was to serving people, to helping people. And she became a staff attorney at the NHMA in 1988, government affairs director in 1999, and in 2000 she became head of both of those organizations.

For nearly a quarter of a century -- a quarter of a century -- she has devoted her professional life to doing good and doing well. And it bears note that certain of the issues in this case -- RBC, corporate structure, surplus, return of capital -- these were all decisions that were made by the board and not by Maura. She had no principal involvement in those decisions. And the bylaws that you will read make it clear that it's the duty of the directors to set the policy. It is the duty of the executive director to carry out the policies of the board.

In 2009, she was chosen as interim director and then quickly after that, she became appointed executive director, a position she now holds.

Once appointed, and consistent with the charge that she was given by the board, she began an immediate management review of the organization and implemented internal structural changes designed to make the LGC more efficient and effective, again, when serving its members.

These changes were significant, eliminating 20 percent -- 20 percent of staff positions. There was also increased transparency. With everything you want to know, you can find on the LGC website. High-level changes have occurred. There is now in-house counsel. Of the seven-member leadership team -- of the seven-member leadership team, four are new. But those who have the institutional knowledge and expertise regarding the management in the operation of the pools have remained the same.

And as I heard some of the comments today, the LGC is being attacked in part because of its success, not for its failures. And woe be it for anybody who's gone through the FRM debacle, woe be it that this hearing was one about insolvency and not having too much money.

This is not about embezzlement, this is not about stealing, this is not about misapplication of funds. This is an issue about return of surplus and what that means under the statute.

I think, in part, success is determined just simply not by money, but member satisfaction, and member satisfaction can best be memorialized, can best be quantified by the retention of our members. Are our members unhappy with what we are doing? If they are unhappy, they should be leaving. If they think their costs are too high, they should leave. They are free to do so. But they have chosen not to leave. They have chosen to remain with us for a dramatic and simple reason: what we do, we do well. And we do better than others.

Our membership has increased, in fact, by 1.6 percent. About 90 percent of the local government entities able to participate in risk pools have some sort of coverage with us. 90 percent: medical, dental, FSA, property, vehicle, workers' comp, unemployment comp. They are with us for a reason. And the reason is we are fulfilling our mission.

The actual number -- the actuarial numbers in this case can be mind-numbingly complex. And before this case I thought RBC was the Royal Ballet Company. And I don't profess to have a deep understanding of the issues, but having reached a certain stage of my life, there is some issues that I do believe in and that nothing or very few things can ever be certain. The future is simply not predictable.

And this case involves, as Mr. Saturley so eloquently stated, the decision-making of the board and the exercise of their fiduciary duties. And I heard some snippets in the opening by the BSR about what minutes would show and say.

And I was thinking that there may be one snippet that they were going to use -- it's going to be Exhibit 32 -- and it was a quote of Julia Griffin, a very simple one, short one in those minutes where she talked about infiltrating the school board. When you get these minutes and you read them, you'll see that there was not even a response to that statement. And when you want to talk about robust, complete, dramatic, full dialogue, these minutes are going to give you everything you wanted to know about robust dialogue and were afraid to ask because everything that was said -- it's almost like a transcript.

But what the BSR did not include after giving its dramatic statement about unethical, unscrupulous conduct, you'll find in the minutes, these are also some of the other things that were said in that very meeting minutes spoken to by the BSR. And I'm not going to read the whole thing. I'm just going to give you little brief snapshots so you can get a taste.

Keith Burke insisted, How can we change our operation to make it better for our members? I think that is what we have to focus on.

Paul Beecher concurred by stating, That's a good point.

John Andrews stated, We are not drawing the line with municipalities. One-stop shopping. That is the integration plan -- one-stop shopping, that's important. It enhances services. I think better governance makes a better workplace.

Wendy Parker stressed that, This exercise can make us stronger and give us more

11:04:38 resources for our members.

11:04:41 Julia Griffin pointed out that, The cumbersome nature of having three entities with three mission statements, as an organization, you can't succeed.

Bob Lloyd, the counsel, who is sitting at this meeting, he concurred and he said, A facilitator would be beneficial. Combine the products. And we should set a series of meetings to see if this can be accomplished. I think you have to keep on focusing on these goals.

In that meeting where one maybe silly comment was made, these were the other comments uttered by the board. And for each of those minutes where you get a headline statement, when you look at the context of the communication, you look at the nature of the dialogue, the issues being addressed, the complexity of the discussion, and the dramatic attention and laser-like focus to serve the mission, keep the organization competitive, and treat its members well, you will see the living embodiment of the business judgment rule being exercised faithfully, prudently, and forcefully.

And I suggest with the application of that rule, of the things I am somewhat certain of, the law is such that when that rule is properly exercised, it is not for the court to impose a different judgment.

Thank you.

THE PRESIDING OFFICER: Mr. Howard, do you wish to make your opening at this time or reserve?

MR. HOWARD: I do wish to make a statement, Mr. Mitchell. Thank you.

THE PRESIDING OFFICER: Very good. Please come forward.

MR. HOWARD: As the hearing officer is aware, I represent Peter Curro, who is a current member of the LGC Board of Directors. I will confess to you right upfront, Mr. Mitchell, that I share with Mr. Volinsky a skill that probably all trial lawyers share. And that is a skill of hyperbole and histrionics. Mr. Volinsky has shown his skill. I do not intend to show mine this morning.

What I do not share with Mr. Volinsky is a skill for revisionist history. And I do not share with the Bureau the desire to disparage the good work of an incredibly dedicated member of the LGC Board of Directors with absolutely no evidence to support it whatsoever.

Peter Curro is a current member of the board and is chair of the Finance Committee. He's served on LGC-related boards for about 17 years now. Like all members of the board, his service is on completely a volunteer basis. He is not compensated save for being reimbursed his mileage. He commits countless -- and as it turns out in the eyes of the Secretary of State -- thankless hours every year to understanding the complex issues involved in the operation of the risk pools, especially in the setting of rates in the health coverage line of pooled risk management.

Peter brings nearly 30 years of invaluable financial expertise and experience to the LGC board, all that it gets for free. He's the business administrator of the Londonderry School District, a position he has held since the year 2000. He previously was the finance director of the Town of Londonderry from 1992 to 2000. And prior to that position, he held various positions in finance at

Boston University, including the position of director of finance and personnel for the Boston University School of Management. He holds his bachelor's degree from the University of Lowell and a master's in business administration from Boston University.

The evidence, Mr. Mitchell, will demonstrate conclusively that Peter has engaged in countless robust discussions with his fellow board members, debated numerous issues affecting the organization, and voted on proposals, both in favor of and in opposition to, alongside scores of other individuals who have served on the various boards, LGC-related boards over the years, this all being done in the exercise of the board's best business judgment in compliance with the law and his fiduciary obligations as a director.

What are the bases for the claims against Mr. Curro as the sole individual in this room who's a member of the board? And Mr. Saturley and Mr. Gordon reminded you, there are 31 members of the board. Mr. Curro is the only one here.

As his counsel, I have complained to you, Mr. Mitchell -- you're probably tired of hearing of it -- that since the outset of this matter, the BSR, despite naming Mr. Curro as an individual respondent, and despite having several opportunities to do so over the last eight months, and in blatant disregard of Mr. Curro's due process rights to notice and the opportunity to be heard on allegations against him, the BSR still has not made any allegation of wrongdoing against Mr. Curro.

The BSR -- and even Mr. Volinsky here this morning -- has not identified one single action that he took or one single proposal upon which his vote made any difference whatsoever, nor has it identified anything that Mr. Curro said or did differently than any other board member to substantiate the claims they've made in this case.

As a matter of constitutional law, fairness and logic, and in the absence of any specific allegation concerning any conduct by my client, his mere membership on a board and his participation and votes as a board member is wholly inadequate to impose any liability on him.

Why the Bureau, as a representative of the state -- of our state government doesn't recognize that, is a complete mystery to me. They are, after all, supposed to be the guardians of the due process rights of our citizens. Yet they feel no compunction whatsoever, no reservation whatsoever to call him unethical, unscrupulous, and any other name they can, just to disparage his good name, all in the mission of what, I ask you.

In the March 26 hearing on the dispositive motions, Mr. Mitchell, I, again, playing the same tune, asked -- indeed challenged the Bureau attorneys -- to just tell me one thing he did. That's all I asked, was one thing. And the best they could say was, Well, he's here as a representative defendant of the Board of Directors.

There is no basis in law to impose any liability upon any individual as a representative defendant of an organization. And the Bureau knows that. But they insist on dragging him through this process. They want wasteful spending? They're forcing wasteful spending.

As best as I can guess, the BSR accuses Mr. Curro -- this is a little messy at this point -- of causing the corporate reorganization in

2003. Mr. Curro sat on the HealthTrust board as one of 10 members who voted for the reorganization. The vote was 7 to 3, with 1 abstention. Therefore, Mr. Curro's vote in support of the reorganization was completely inconsequential. Without his vote, it would have been 6 to 3. So what? It would have been happened anyway.

What the Bureau consistently refuses to acknowledge with respect to Mr. Curro, there were two other boards existing at the time: the NHMA board and the PLT board, the Property-Liability Trust. Those were independent boards who also voted for the reorganization, and not one member of those boards was sued in this case, nor should they have been. But more importantly, Mr. Curro had absolutely no voting privilege or authority with respect to those two boards. Yet he sits here in the eyes of the Bureau as the one man who is to accept all responsibility for that vote.

Mr. Volinsky said that there are two defenses in this case. And he outlined them for you. He forgot one. And it's a very important one. In addition to the business judgment rule, Mr. Curro also acted, as did all of these boards over the entire relevant period of time -- in fact, the entire history of these organizations -- with the advice of legal counsel. The merger was voted on when the lawyers told them that the reorganization was lawful.

When they -- when the board in 2007 was looking to decide what to do in terms of return of surplus and how to make it happen, does it have to be in cash back to the towns? Can it be in the form of rate credit and rate stabilization? They sought and obtained a letter from their counsel which explained to them that the statute does not prohibit them from doing return of surplus in the form of rate credits.

When you have the advice of your lawyer telling you that what you can do is lawful, then your decision to follow that advice cannot under any circumstances be unreasonable or a negligent violation of a statute.

In terms of -- and this falls under the category of robust discussion -- the RBC method that was chosen, Mr. Curro was part of that discussion and only part of that discussion. It was made, a decision was made after fully vetting the issue with outside consultants, just what you would expect this board to do: The adoption of a strategic plan done with the presence of legal counsel and with a full vetting of the issue with outside consultants.

Mr. Curro has at all times acted in compliance with his fiduciary duties. And in Mr. Volinsky's opening remarks, he made no indication to you whatsoever that Mr. Curro has violated any of them.

He has at all times acted with the advice of counsel. As such, his actions are reasonable, always performed in good faith, and, therefore, under the two relevant statutes, neither a knowing or negligent violation.

Finally, Mr. Mitchell -- and I will sit down and let the proceedings commence -- with respect to Mr. Curro, we have to ask the question, What are the possible remedies that could be imposed against him that are pled by the Bureau. In this case, there are none. The Bureau asks for injunctive relief. And Mr. Volinsky laid out all the things it wants the hearing officer to do. Not one of those remedies that the Bureau is seeking can be imposed against Mr. Curro as an individual member of the Board of Directors.

If you were to say cease and desist your violations of RSA 5-B, saying that to Mr. Curro accomplishes absolutely nothing. He's one member of the board. The statutes do allow for penalties of $2,500 per violation. The Bureau has rightly withdrawn any request for that and is not seeking imposition of those penalties, so that cannot be done against Mr. Curro.

There is no other remedy sought. And with all due respect to you, Mr. Mitchell, under the relevant statutes, there is no remedy you can impose against him. He doesn't belong here. He's going to sit here for two to three weeks. And in the end you're going to conclude, Why was he here, and you're going to dismiss him.

Thank you.

THE PRESIDING OFFICER: Thank you, Mr. Howard.

Mr. Volinsky, are you prepared to call your first witness?

MR. VOLINSKY: I am.

THE PRESIDING OFFICER: All right. Why don't we take maybe a 10-minute recess, and we'll return. In the meantime, you can set up for him, or her.

MR. VOLINSKY: Thank you.

(Recess at 11:19 a.m., resumed at 11:37 a.m.)

THE PRESIDING OFFICER: We've returned from brief recess. Mr. Volinsky, are you ready to proceed?

MR. VOLINSKY: Yes.

THE PRESIDING OFFICER: Mr. Witness, would you stand and raise your right hand.

(The witness was sworn by the Presiding Officer.)

THE PRESIDING OFFICER: Please be seated.

Would you state your name -- and if you allow me, gentlemen -- your business address -- please approach me if anyone has a need for any other personal identifiers -- and your business address. And then you may have your witness, Mr. Volinsky.

THE WITNESS: My name is Michael A. Coutu, C-o-u-t-u. I'm retired so I don't have a business address, but my residence is 805 Central Road. And that's in Rye Beach, New Hampshire 03871.

THE PRESIDING OFFICER: Your witness, Mr. Volinsky.

MR. VOLINSKY: Thank you, Mr. Mitchell.

MICHAEL A. COUTU,

having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. VOLINSKY:

Q. Mr. Coutu, you're here as an expert witness so I want to ask you first about your background. Tell us your educational background, please.

A. I graduated from the University of Rhode Island. I would have been the class of 1993 [sic], but I completed my program a year earlier with a business degree in business administration with a concentration in finance.

Q. Business with finance concentration?

A. Correct.

Q. Before or after, did you serve in the military?

A. Before college, I served three years in the

United States Marine Corps.

Q. Honorably discharged?

A. Yes.

Q. As it's relevant to the expert testimony you're going to be offering in this case, would you outline your professional employment experience.

A. I think it's probably best to divide my career into two -- into two pieces. From 1969 through 1984, I was primarily a banker, initially with Industrial National Bank, which became known later as Fleet National Bank. There I served initially in the credit department, which was the training ground for future lending officers.

Once I completed that training, again, a couple years, I was asked to set up an international credit department as the bank began its lending to nonsovereign entities, borrowers. And also part of that time in the credit function, I also managed two workouts, workouts as in failing operations. One of them was a subsidiary, the bank, a commercial finance company located in Montreal, Canada, and the second was a golf cart manufacturer, which ultimately went bankrupt, managing that business, having separated certain of the operations prior to bankruptcy.

As far as my lending career, I was made head of the trade finance group, which finances the importation and exportation of goods from the U.S. to foreign nations or the importation from foreign nations to the U.S.

Those financing vehicles were largely done in connection with government programs: the Export-Import Bank of the United States, which guaranties the payment obligation, and quasi-governmental as in Foreign Credit Insurance Association, which reinsures the political risk to Ex-Im Bank, but otherwise provides coverage for nonpayment by the foreign borrowers.

I then was asked -- I think it was in 1979 -- to run an international bank which was located in New York City. That international bank was, again, engaged in trade finance as well as commodity finance and foreign correspondent banking.

And in 1982, I was recruited by American Express to run American Express's commodity trade and project financing lending group, which I did till 1985.

While at American Express, in mid 1984, an insurance company owned by American Express at that time, Fireman's Fund Insurance Company, had a rather large credit-sensitive exposure to a company by the name of Allis-Chalmers. I was asked by American Express to provide financial guidance to Fireman's Fund and how best to manage that exposure. Allis-Chalmers at that time was teetering on bankruptcy.

In 1985, I began changing my career from banking into insurance. Fireman's Fund suffered a $300 million capital loss in 1993 -- excuse me -- 1983. And American Express sent myself, along with a couple of other fellows, to Fireman's Fund, the thought being that perhaps banking-type people might be able to better manage the insurance company.

My specific assignment at that time was to run the financial guaranty division of Fireman's Fund, which based on guaranties issued primarily in respect of municipal borrowers, general obligation bonds, and revenue bonds, and before giving effect to reinsurance, was a book of $26 billion in liabilities.

While working at Fireman's Fund, a decision was made by American Express to sell Fireman's Fund, and I was working -- or I did work primarily with Lehman Brothers on the due diligence with respect to that sale. It did get sold in September of 1985 in an IPO. And with that sale, I then left Fireman's Fund and joined an investment banking boutique by the name of Glucksman & Company. Glucksman & Company was formed by Lew Glucksman, the former chairman and CEO of Lehman Brothers. He and I and several other ex-Lehman partners formed a -- I'll call it an investment banking boutique. My specialty at that time was primarily bankruptcy.

And I also was the advisor to Fireman's Fund in the creation of a company which exists today in New York City called Municipal Bond Insurance Association in its corporate form as it's constituted today.

Q. What kind of company is that? What does that company do?

A. MBIA is -- issues credit enhancements. Its initial charter was to do so in connection with, again, municipal risk. These would be general obligations and revenue bonds. Well after my association with MBIA, they then unfortunately got involved in providing credit enhancements with respect to pools of mortgages, known as structured financings, and that became a -- as part of the 2008 credit failings, major issues of that.

Q. So after Glucksman, what -- other than MBIA, did Glucksman have other involvement with insurance companies?

A. Well, Allis-Chalmers was a company that -- to whom Fireman's Fund had a substantial amount of exposure. And after separating from Fireman's Fund, I continued to advise Fireman's in connection with Allis-Chalmers, which ultimately did file an order for relief, a petition for relief in bankruptcy under the Bankruptcy Code.

Q. Move me forward from there. I think international --

A. Yes. Sandy Weil, who acquired Prime America. Prime America included Smith Barney, the investment banking firm. And Sandy asked Lew to come over and run Smith Barney. And in concert with that decision, then we wound up the Glucksman Company. I went forward with my own business. It was called Oak Hill Financial Group, continuing primarily in the bankruptcy sector.

Q. And then after Oak Hill?

A. After Oak Hill, I was recruited by Xerox Corporation, along with some other senior executives. Xerox owned a large property and casualty company called Crum & Forster, based out of Morristown, New Jersey. Xerox had made substantial capital contributions to Crum & Forster, made a decision that it did not want to continue in the insurance space. And I was hired for the purposes of finding an exit strategy for Xerox to get out of the property and casualty insurance business.

Q. Were you able to do that?

A. We -- we did accomplish that goal. We tried not to get into a lot of technical insurance matters, but we -- there was an intercompany pooling arrangement, which is common in the property and casualty sector -- we unbundled that arrangement and created six standalone underwriting companies and then created a separate company which became the repository for lots of latent liabilities. That entity, sometimes known as the bad bank, was known as The Resolution Group. And in due course, it was my responsibility to run the bad bank.

Q. And what business purpose did the bad bank serve while you were running it?

A. Certain of the liabilities for the continuing underwriting businesses that caused or created the balance sheet stress, those liabilities were transferred over to The Resolution Group.

In addition, the captive insurance company, which was the hub of The Resolution Group, International Insurance Company, had already a substantial amount of latent liabilities, coupled with approximately $1.7 billion of uncollectible reinsurance.

In addition to that, as part of The Resolution Group, we formed a separate claims entity to manage latent claims, which included many various forms of toxic tort claims: asbestos probably being the largest particular claims; breast implants, pollution claims, and such other claims. And that entity, which was known as The Division, provided that service for all of the underwriting companies, the 600 underwriting companies plus The Resolution Group.

Q. And were you the president of this company then?

A. I was.

Q. CEO?

A. I was the president and CEO of the International Insurance Company, its sister company, which is the International Surplus Lines Company, the holding company which is The Resolution Group, and then the sister or affiliate company called Envision Claims Services.

Q. And when you say that they were underwriting claims, that's a form of insurance, right?

A. That's correct.

Q. Take us forward in your experience in The Resolution Group and how you moved forward from there.

A. The International Insurance Company, that -- the usual remedy for insurance companies which were either failing or in financial difficulty was to place the company into a formal proceeding.

And that would be done by the domiciliary regulator. And the proceeding would either be a rehabilitation or an insolvency.

What I had proposed to the regulators for International, which is the State of Illinois, was to manage International as a noncontinuing business in runoff but to do so as a voluntary runoff, thus to not place it into a formal proceeding.

At that time voluntary runoffs were something that had not -- as far as I know, that had not been done as an alternative to, again, a formal proceeding. And so with the blessings of the Illinois Insurance Department, International went into this voluntary runoff.

Q. May I ask you a question about that. When you're managing a company that's voluntarily running off its business, how closely do you work with the regulator?

A. It's a glove-in-hand relationship. At least in the initial goings of the runoff, it would not be uncommon for me to have conferences calls to the regulators every week. As time goes on and if the, quote, runoff plan is successful, it is that our operations is the plan that we cast, then the level of supervision becomes less intense.

But if I contrast runoffs versus underwriting companies, the level of interaction with regulators is a hundredfold increase.

Q. Let me also ask you, as the chief executive of an underwriter versus being the chief executive of a runoff company, how familiar do you have to be with the finances of the company at issue and your understanding of the details of those finances?

A. You really can't successfully manage a runoff company if you don't have intimate knowledge of the financial side. There are two key elements -- There are a lot of elements in a runoff. But the two most critical elements are you have to have sufficient liquidity, i.e., cash to pay claims when due. And then second is you have to have enough continuing surplus to avoid the presumption of being insolvent, requiring the regulatory domicile regulator from intervening into the business.

Q. And did you have to deal with both of these issues as the person leading this company through voluntary runoff?

A. Yes.

Q. How did you do the voluntary runoff?

A. International Insurance Company was at that time the largest runoff measured by reserves, which was $3-1/2 billion, when it went into runoff. And this would be '93-ish.

To give some scale to that in comparison to a global statement, International was the largest runoff in the world with the exception of Equitas. Equitas was the runoff mechanism for Lloyd's of London. That was significantly bigger.

That runoff was ultimately successful in part because another company based in Toronto, Canada by the name of Fairfax Financial Services, Limited had its own stressed businesses -- stressed as in financially stressed -- and the chairman of that company approached me with respect to potentially acquiring The Resolution Group in order to get the benefit of the skills and services of that group. That transaction was consummated in August of 1999. And The Resolution Group then became part of the Fairfax Financial family of companies.

Because Fairfax had its own troubled

companies, I then created a separate entity called the RiverStone Resources Group, LLC. And the RiverStone Group was for the purposes of managing Fairfax Financial's troubled, distressed businesses, both in the U.S., Canada, and in London and in Paris.

International's journey continues a bit. It was -- ultimately got to the point that the success in managing that runoff created such a large surplus balance -- when I say "large," it was in excess of $500 million. And because it was a runoff, the regulators would not allow me to extract some of that excess surplus, excess of the size that the balance sheet would find, and as a result of another runoff in the Fairfax family called TIG Insurance Company. TIG --

Q. T-I-G?

A. -- T-I-G -- company, in working with the California regulators for TIG where TIG was domiciled, I ultimately merged International into TIG, which had no capital, thus creating a mechanism for TIG to have a successful runoff under the auspices of the California Insurance Department.

Q. So you worked closely with regulators in

California as well as in Illinois for these runoffs?

A. I have, as well as other states. The way to think of the regulatory community in the U.S. is the domiciliary regulator is sort of the lead. But because insurance companies will write large books of businesses in a multitude of states, the regulator for a given state also will wade in the waters of a runoff.

California is a good example. Many of the companies that I managed had large California exposures. And in that case, it would not be uncommon to have another regulator, California in the case of International, or Illinois in the case of TIG, to wade in on how the runoff plan is constituted and managed.

Q. Based on all of this experience, do you consider yourself a runoff specialist?

A. I do.

Q. How does that compare to being a chief of a non-runoff insurance company?

A. Let me just say that while the mission of a runoff is to curtail underwriting altogether, that doesn't always occur. And it doesn't occur because there are outstanding contractual matters that need to be addressed and honored. So there are elements of continued underwriting which is usually part and parcel of the runoff. But again, the goal is to curtail all underwriting.

The key difference between someone who's running a company in runoff and someone who's running an ongoing continuing underwriting company, the key and critical mission of runoff is to fully discharge all of the contractual obligations to policyholders. And in the case of the companies which I've managed, most of those policyholders were corporate entities.

In order to -- again, to be able to fully discharge 100 percent of those obligations, you have to have sufficient cash to pay claims in capital or surplus in order to avoid being placed in an insolvency proceeding.

With respect to an ongoing underwriting company, the challenge -- the fundamental challenge is to generate new business. And new business is in the form of premiums. It may be in concert with long-established programs. It may be new programs of insurance. And the skill there is to price the business at a level that would suggest that the level of claims and expenses would be less than the amount of premium that is charged in concert with those programs.

The goal, I might add -- that is not always accomplished.

Q. As a person who ran all of these companies, did you ever sue a regulator?

A. No.

Q. Were you ever forced into involuntary when you started the voluntary runoff process?

A. None of the companies that I've managed were entities that ultimately failed, meaning were placed into an insolvency proceeding.

Q. After TIG, do you have further relevant experience in the insurance field?

A. I do. I might -- First, I retired after TIG, so that would have been in 2002. I probably would have stayed retired. I, however, was approached by some individuals which had made a large equity investment in a Canadian company by the name of Kingsway Financial Services.

Q. Case- --

A. Caseway. Kingsway. K-i-n-g-s-w-a-y. Kingsway.

Q. What happened with Kingsway?

A. Initially the board had me come in to determine what to do with respect to its largest subsidiary. The largest subsidiary of Kingsway was a company by the name of Lincoln General Insurance Company, based in York, Pennsylvania. It underwrote a substantial amount of long-haul trucking and nonstandard auto. It's a company which -- which wrote, on a fairly regional basis, perhaps $40-45-50 million worth of premium a year.

When it was acquired by Kingsway -- and I believe it was 1997 -- Kingsway grew that company from roughly $45 million in premiums a year to over $1 billion in premiums by 2007. It was an unprecedented growth in business. Long-haul trucking is known to be a very difficult business to underwrite. It has -- almost all writers of that business experience losses in excess of premiums. That turned out to be the case with respect to Lincoln General.

And as losses mounted, the need for severe, if not dramatic, reserve actions suggested that Lincoln may not make it. I was brought in by Kingsway to determine what was potentially a salvageable business. If not, then what would be the best result with respect to preserving the economic value of that entity.

Q. And in part, was this based on a detailed financial analysis by you?

A. Yes. One would prepare a substantial analysis to examine the business. But what happened in the case of Lincoln is from the time that I was engaged as a consultant and began to write the report that you're questioning about, a regulatory action level event occurred.

Q. What does that mean?

A. There was some discussion this morning about risk-based capital. Risk-based capital, which was promulgated by the National Association of Insurance Commissioners pursuant to the Model Act of 1983 -- excuse me, 1993 -- is a model which determines, based on the type of business, meaning insurance business, and the various elements of the balance sheet, what the appropriate level of capital should be.

Insurance companies have been grappling with the issue of capital adequacy for many years. But incidents of insurance insolvencies is quite substantial. And the intent of developing this risk-based capital was to provide a guidepost to regulators in both determining capital adequacy, as well as intervention potentials if levels of capital declined.

Q. You used the term "capital adequacy." What does that mean?

A. "Capital," first of all, is a generic term. But in insurance-speak, it's surplus. And "surplus," I might note, is shorthand for the technical term of policyholder surplus. So when insurance business is referred to in terms of capital, the word "capital" and the word "surplus" are interchangeable words.

And I might note for the record, because we'll be discussing it a bit later, that the word "net assets" or "member balances" all mean capital. It does not mean reserves.

Q. Okay.

A. So going back to the risk-based capital, when that act was promulgated by NAIC, they have certain triggers. First of all, under the risk-based capital, I might note that there are different formulations that are required, depending on the business.

So property and casualty has a different mathematical configuration for determining its capital adequacy than does healthcare. And both of those have a different mathematical calculation for capital adequacy than does a life insurance company.

Notwithstanding the different calculation methodologies, a company is deemed to be capitally -- sufficiently capitalized if its RBC ratio is 200 percent or higher.

Now, so that I don't confuse the numbers, sometimes RBC is referred to as a percentage and sometimes it's referred to in decimal notation. So if I were to convert 200 percent to a decimal, it would be 2.0.

The second aspect of risk-based capital is something called the authorized control level.

Q. What does that mean?

A. The authorized control level -- again, going back to this methodology, this mathematical formula that's used -- is a calculation used to determine the hypothetical amount of capital a given insurance company needs.

So again, hypothetical. And it was the decision of the NAIC and its advisors that to create a margin of comfort, that two times the authorized control level would provide a sufficient capital structure to support a given insurance business.

So ACL, or authorized control level, equals 100. And then when we say an RBC of 200 percent, we're simply saying twice the authorized control level.

Q. Twice the hypothetical need?

A. The hypothetical level of capital needed. A regulatory action level event is -- first, is if you fall below 200 percent, the regulators will require you to file a plan how you will restore the capital so that the capital RBC calculation is

200 percent again or more. Then --

Q. Let me just ask, have you filed those kinds of plans?

A. Yes.

Q. And sometimes are they as simple as, Next year's premiums will be higher?

A. Unfortunately, when I usually get involved in insurance companies, it's sort of the story of being in the -- a big city emergency room. And that is to say that the damage has been done before I pop up on the scene. It's been so substantial that I'm already into the regulators, not as a, Let's make it a better story, which would portend that this would be a continuing underwriting situation, but rather that the company is not going to make it as an underwriting company, and therefore, it's going to go into a runoff or a formal proceeding.

Q. Okay.

A. So what happens, going back to the earlier question of writing a report for the board of Kingsway, because of the regulatory event that occurred, it went from maybe writing an analysis to now filing a formal runoff plan.

Now, the statute doesn't call it a runoff plan. But effectively that's what it is. It's demonstrating to the regulators how a particular company can be run off successfully so that all of the contractual obligations, as defined by policies of insurance, can be fully discharged.

So that runoff plan was filed in the case of Lincoln General.

Q. I interrupted you when you were describing what happens when you reach the RBC of 200 percent. There are other standards in that RBC category that result in different kinds of regulatory actions.

Would you just quickly describe them.

A. Yes. If the RBC falls below 100 percent, theoretically -- and the statute provides -- the regulator could intervene in the business of that insurance company and put it into proceeding. I've never seen that happen. I won't say that it's never happened. But at the minimum it would be quite unusual.

As the RBC continues to decline and falls below 70 percent, then the RBC statute in most states requires the regulator to intervene in that business. The level of intervention is at the discretion of the regulator. It may need to place the company into a formal rehabilitation. It may be to place the company into insolvency. Or it may involve placing the company into a conservatorship, which is the least severe of those three options.

Q. We're talking about RBC because it's part of insurance regulation statutes, correct?

A. When the Model Act was promulgated in 1993, RBC, substantially in the form as promulgated by the National Association of Insurance Commissioners, was adopted by all 50 states. New York and the Superintendent of Insurance for the State of New York took a slightly different variation. But in conceptual construct, it's the same thing.

Q. And in all of those states where there are insurance carriers domiciled, those insurance carriers have to use this RBC methodology for their --

A. It's not discretionary.

Q. You understand in this case, the Local Government Center has been given an exemption from all insurance regulation if they comply with the standards of RSA 5-B, correct?

A. There was no obligation of the health trusts to adopt RBC as a basis for calculating capital adequacy. It did so for its own choosing. There are other capital methodologies that could have been used to determine the appropriate level of capital. But in the case of HealthTrust, they did adopt RBC and did apply it in a manner consistent with the NAIC Model Act.

Q. And so let me just ask you on this point. If I represent to you that the minutes of HealthTrust and the Local Government Center reflect that they had an RBC of between 2.1 and 2.5 before they voted to enhance the member balance amounts, if they had been required to use RBC, that would have been an acceptable level of capital?

A. Again, the presumption is that in an RBC of 200 percent or better, the regulatory community, all right, would determine or conclude that the level of capital is sufficient. Again, absent some unique aspect that might warrant a different answer.

Q. It sounds as though you have extensive experience as a practitioner working with RBCs?

A. I do.

Q. Pick up with what happened with Fairfax. Kingsway, I'm sorry.

A. When Kingsway's regulatory action level occurred, the gears shifted and instead of, again, writing a report about options, I had to file a report which became the runoff plan. And that had to be submitted -- first it was approved by the company, and then -- the holding company, Kingsway -- and by the respective board of directors. And then that plan was submitted to the Department of Insurance for the State of Pennsylvania.

At this particular point, I'm still a consultant. There was some discussion with the Department about my coming in to run the company. That was still in the works. But as a consultant, I appeared before the Pennsylvania Insurance Department to explain all of the elements of the runoff plan and to invite any potential changes that the Department may require or desire.

Q. And what happened after that?

A. The Board of Directors of Kingsway asked me to run the runoff, to manage the runoff of the Lincoln General Insurance Company. There were a lot of discussions. I had put the chances of that runoff being successful at about 50/50. So I wasn't particularly keen on taking on the assignment. I'll spare the details.

Ultimately, an arrangement was worked out. I brought in one of the fellows who works for me under the banner of a company by the name of Rockwall Financial Advisors, LLC, which was the contracted party to manage the runoff of Lincoln. And I served as the chairman of the board of that insurance company. And in a somewhat unique situation, in addition to serving as the chairman of the board, the claims function for that company reported to me, not to the CEO.

Q. And those claims were of what nature?

A. Mostly long-haul trucking, nonstandard auto, and fleet -- you know, vans, buses, taxies.

Q. Property-casualty-type coverage?

A. It's all considered P&C. It's mostly dedicated in a fairly finite area of the business.

Q. How did things end with Lincoln?

A. The incumbent board -- unfortunately, because of the company going to runoff, most of the directors -- or in fact, all of the directors resigned except for four of us. Two incumbent directors that represented the then-president and CFO of the company, myself, and another Rockwall fellow who was the CEO of the company. And almost immediately we got into issues associated with the directors -- both adding more directors, as well as choice of consult.

And in the midst of that battle, Kingsway did something that was unprecedented in the history of insurance. It donated the stock of Lincoln General's immediate parent to 20 New York City-based charities. That occurred on October the 19th, 2009. It was done as a prophylactic measure. The Pennsylvania Insurance Department was making noises about Kingsway putting capital -- additional capital into Lincoln General. I believe that Kingsway decided to cut off that possibility by donating the stock.

Q. What did the stock donation do to you?

A. It was a breach of the runoff management agreement. The agreement was a tripod agreement between Rockwall, Lincoln General, and Kingsway.

There was a provision in the agreement with respect to change of control. It required Kingsway to own 100 percent of Lincoln stock during the pendency of the runoff agreement, which was five years. And as a result of the donation of the stock, it breached the contract.

Q. Was there ultimately a suit between you and Kingsway?

A. Not a suit. What happened was, is that the breach of the contract resulted in the claim of Rockwall as against Kingsway for $21 million. That claim then created a potential conflict of interest for me with respect to my position on the board.

I brought the claim to the attention of the other board members, other non-Rockwall board members and to the outside lawyers and to the regulators, that in my judgment I had a substantial conflict and took the position that I needed to recuse myself from any decisions that touched upon Kingsway.

Q. And were you allowed to remain on the board?

A. The incumbent directors took the position that because of my conflict, I could not serve as a director. It changed legal counsel and brought in new lawyers. Those new lawyers took the position that I could not serve in light of my conflict. That ultimately led to my termination as the chairman. The CEO was also terminated. And the contract was unilaterally terminated.

They then ordered a declaratory judgment action to have the court make a finding that determinations both individually and corporately were appropriate. We countersued for exactly the opposite reasons. That is, the conflict did not require me to step down, et cetera.

Q. Ultimately was there a confidential settlement reached in that lawsuit?

A. There was.

Q. After that was resolved -- and by the way, International and Resolution were physically located in Manchester, and RiverStone --

A. Well, for the preponderance of the early years, it was located in Chicago. I was getting ready to retire in 2000. And so I moved the company from Chicago to Manchester, New Hampshire.

Q. And RiverStone is still in --
A. It's still here in New Hampshire, in Manchester.
Q. After the experience you had with Lincoln and Kingsway, did you go on to manage other companies?
A. No. With that -- Well, after concluding the litigation between Rockwall and Lincoln, I then focused on the arbitration between Rockwall and Kingsway where the $21 million claim rested. That was an arbitration proceeding, and that matter settled in due course. Once that was completed, I retired in December of 2010.
Q. And have you stayed retired at this time?
A. Other than this engagement.
Q. It's probably evident from the positions you've held, but let me ask you if you could, in short summary form, describe for us the particular training and experience that you've had relevant to financial analysis, to understanding balance sheets and income statements, particularly how it relates to the work you did in this case.
A. I mentioned that I had spent a couple years in the commercial credit function. The commercial

credit department, as I also mentioned, is sort of the training ground for future lending officers. You start off at a very fundamental level, spreading financial statements to a common sheet, sort of a spreadsheet. You learn the basic concepts of a balance sheet and an income statement. You learn various accounting practices that may have relevance with respect to financial reporting. You understand and learn cash flow analysis.

That whole process may take well over a year. And then after the year's time, you tend to specialize. So in my case I specialized in lending to REITs, real estate investment trusts. I also specialized in finance companies. And I also became proficient in analyzing Fortune 100-type companies, large conglomerates.

That kind of training then becomes the hub or the cornerstone of everything you do as a lending officer. That is to say, the fundamental task of a lending officer, besides generating business, is to make sure that the obligations and the loans are going to be repaid. That's all about financial analysis and credit.

I might also say that in my bankruptcy practice, again, financial skills are very substantial. You're evaluating the plan of reorganization. And before that you're trying to decide perhaps how the plan of reorganization might be shaped with respect to distributions to various creditor classes. All of that requires financial analysis.

And I would say virtually my whole career, even though I switched from banking over to insurance, because of the acuity of a runoff company that may ultimately fail and go into an insolvency proceeding, understanding precisely where you are from a financial point of view is absolutely critical.

Q. Same kind of question. With respect to bankruptcy, which you mentioned you worked in and around in a number of capacities, did you also have to deal with your own fiduciary duties as a potentially bankrupt organization and the fiduciary responsibilities of other board members?

A. The answer is yes. I would say that the issue of fiduciary duties is far more acute in the context of a runoff company which may ultimately fail. Consequently, I made sure that I had a very firm grasp on all of the fiduciary duties and obligations that a board needed to fulfill.

Early on in my career, I brought in two large law firms to help guide in the form of a memorandum all of the fiduciary duties that I ought to be concerned with. That was LeBoeuf, Lamb & Walters, then LeBoeuf Lamb, and then I think it became Dewey LeBoeuf, and I think it's something else today; probably the number one regulatory firm with respect to insurance matters.

The other firm that I brought in was Locke, Lord & Bissell. Their construct and their guidance was different. Theirs was to look at issues associated with insolvency; and that is, if an insurance company became insolvency [sic], what are some of the things that could be asserted as potential claims against directors.

Q. So although you are not a lawyer, you are experienced with fiduciary duties as a practitioner in the business area?

A. I would consider myself to be someone who is a student of fiduciary duties, who spent a lot of time understanding it. I will say that as a practical matter, whenever I take on the running of a company, usually one of the first things I do is go through with precision, what are the fiduciary duties that a board of directors needs to discharge to meet the higher standards associated with runoffs.

Q. Associated with --

A. Runoffs.

Q. Okay. In your spare time, Mr. Coutu, have you managed to find time for elected or appointed office?

A. I did. Prior to the Kingsway/Lincoln engagement, after I retired with respect to the TIG runoff, which was 2002, I ran -- I, first of all, became a member of the Municipal Budget Committee for the Town of North Hampton. And then that led to my heading up the Labor Negotiating Committee with respect to the Town as their negotiator for the Police, Fire, and Highway Department contracts.

And then in due course, I ran for office, Select Board, and was elected in 2008.

Q. As a person involved in collective bargaining, did you have to deal with issues related to insurance coverages, particularly health?

A. I did.

Q. And what was your involvement with respect to healthcare coverage for public employees in North Hampton?

A. I led the negotiating team for the Town for five years. In healthcare over that course of time, which would be 2008 to -- up until last year, I'd say on an increasing note, healthcare became an ever-higher issue with respect to negotiating an equitable contract as between the Town as the employer and the various unions as employees.

Q. Was there a single insurer for healthcare during that time you were involved with collective bargaining?

A. The only insurer for healthcare at that time that I was involved -- and I think it's still today -- was the HealthTrust of the LGC.

Q. And are you aware of North Hampton's experience during that five-year period with respect to health insurance rates?

A. There were two back-to-back increases which occurred. And if my memory serves me right, I think it was 27.3 percent and followed by an 18.6 percent increase. I believe that those were 2009 and 2010 increases.

Second, it was the practice of the HealthTrust to provide a so-called GMR, guaranteed rate structure. And the applicable rate which developed some months later historically would come in less. In the case of 27.3 percent GMR, the actual rate and the GMR were the same rate. There was no economic benefit or lift.

Q. So in the course of negotiating with firefighters, police officers, teachers, highway people, you had to deal with a 27 percent health insurance premium increase?

A. Again, the way the negotiations went was to either change the program -- there are other programs offered by LGC HealthTrust that have different economics associated with it -- or alternatively go with a different allocation of the premium course, which for the collective bargaining agreement purposes was 90 percent town and 10 percent employee.

So changing that dynamic, maybe making it a 20, changing the plan, were part and parcel of the negotiations with the labor unions.

Q. I take it that as a Budget Committee member, the town wasn't particularly happy with seeing 27 and 18 percent rises?

A. It was not. I might note that I resigned from the board -- excuse me -- yes, the Select Board in, oh, 2010. So I served about two years. And the reason I stepped down, again, was because of the litigation involving Lincoln General and the arbitration involving Kingsway.

As those two issues got under control, the Municipal Budget Committee came to me and asked me if I would be willing to serve on a subcommittee of the Budget Committee to analyze why the rates were where they were, whether there was something unique about North Hampton from a risk point of view. And also to consider whether or not providing or obtaining coverage away from HealthTrust was an option.

Q. And did you agree to serve on that subcommittee?

A. I did.

Q. And tell us what you found.

A. What I found is I didn't know a whole lot about HealthTrust's working operations. So I initially compiled quite a long list of documents that I thought needed to be reviewed to answer such questions as what were the driving forces behind the rate increases and some other related issues.

That list of documents was sent to Mr. Fournier, who is the town administrator, then and now, for the Town of North Hampton. And my understanding is that that list was ultimately sent to LGC to respond to.

Q. Was Mr. Fournier also on the Local Government Center board?

A. At the time of the formation of the subcommittee, he was. Was and still is. I believe still is.

Q. So he was both a town administrator for your town and an LGC board member?

A. Correct.

Q. So the request for documentation so you could get an understanding goes to Mr. Fournier. What happens from there?

A. Some documents come in. For the most part the documents that I thought were more salient were not produced. Based on some of the documents that were produced, it triggered additional questions, and a secondary list was generated by me, which went to Mr. Fournier, which was sent to LGC.

Q. Let me ask you, were you doing any of this in connection with the Bureau of Securities Regulation at this point?

A. No, I was not.

Q. It was all on behalf of your town?

A. Right.

Q. What happens with the second request?

A. Again, some documents were provided, but not what I would call the key and critical documents that answered a number of questions -- oh, which potentially could have answered a number of questions that I had about the workings of HealthTrust.

Q. Can you give me some idea what those missing documents might have revealed.

A. Oh, I wanted some information with respect to incurred but not reported claims, IBNR. I wanted information with respect to what I called at that time dividends being made by HealthTrust up to LGC, which has been re-characterized as distributions.

I had --

Q. Let me stop you. Are those now in the context of this case strategic plan distributions?

A. Yes. They were explained to me. I might mention that these document requests ultimately led to a meeting between the Budget Committee -- the budget subcommittee and two representatives from LGC, which occurred on, I think, February the 11th of 2011.

Q. And who was there for the LGC?

A. Representing the LGC was Sandal Keeffe who was then and who still is, I believe, the chief financial officer, and I think, deputy director. And I believe it's pronounced Merelise O'Connor, who is the program director for LGC.

Q. And were you able to satisfy your request for information at this meeting?

A. I was not.

Q. Why not?

A. I can't say for sure. And please understand that I was not interacting directly with LGC, but through Mr. Fournier. So I'm not sure, and I can't say just what of everything that transpired on the budget subcommittee actually migrated over to LGC.

I just -- I don't have that factual knowledge.

I think there was -- fair to say there was some disagreement between myself and my characterization and how Ms. Keeffe characterized this so-called strategic plan.

Q. What was that distinction?

A. I said that -- in my judgment that while this was not a business model that involved the ownership of stock -- again, the way this is constructed is that the risk pools are owned by the participating political subdivisions. Unlike a typical parent/subsidiary model, the parent would own 100 percent typically of the stock of the underlying subsidiaries.

And so it's not uncommon in the corporate sense that dividends would be declared by the subsidiaries and then sent upstairs to the holding company.

So when I looked at the distributions that were being made by healthcare -- again, I wasn't focusing on the other risk pools at that time -- I used the word and I characterized those distributions as dividends.

Ms. Keeffe objected to the term and said it's not a dividend. She said, These are payments for the strategic plan. I said at the meeting, What is the strategic plan? And while she responded, it seemed to me that the strategic plan was along the lines of the various businesses that were being offered by the consolidated LGC entities. And it seemed like that might have involved marketing and other kinds of activities, most likely at the holding company.

I did not realize at that time that these dividends -- these distributions were going over to the Workers' Comp Trust because, again, at that time, I did not examine that particular risk pool.

Q. So you, at that time, simply saw the distributions going from HealthTrust to the parent?

A. Correct. And in large amounts, which questioned just what services were being provided as consideration for these large distributions.

Q. Just -- I know we'll go through this in more detail in a moment, but give us an idea of the scale of those distributions you were seeing going from HealthTrust to parent?

12:41:06 A. Three to five million. Of particular note is that in 2009, the HealthTrust sustained a loss, if my memory serves me right. We have the documents here. But I think it's roughly $8.4 million. And the loss notwithstanding, there was a distribution made that year -- and again, I think around $4 million. We have a chart on this, if we want to . . .

12:41:52 MR. VOLINSKY: Excuse me just one second.

12:41:54 THE PRESIDING OFFICER: Mr. Volinsky, you are excused, but would you also tell me how much longer you are considering going in this phase of your inquiry of the witness?

12:42:04 MR. VOLINSKY: I would say 10 minutes and that would be a very appropriate time to break, if that's all right.

12:42:11 THE PRESIDING OFFICER: That's my thought.

12:42:14 MR. VOLINSKY: Okay.

12:42:20 THE WITNESS: In two thousand --

12:42:22 Q. BY MR. VOLINSKY: Go ahead.

12:42:23 A. In 2009 healthcare sustained a loss of $8.8 million, okay.

12:42:33 THE PRESIDING OFFICER: Do you have this in a hard form that I might see?

MR. VOLINSKY: Yes. This is Exhibit --

THE PRESIDING OFFICER: There you go.

MR. VOLINSKY: -- 7 in your notebook. The lower left --

THE WITNESS: I can show it right here. I'm not sure where to stand. Let me see.

MR. VOLINSKY: Just hang on a second.

THE WITNESS: Oh.

THE PRESIDING OFFICER: Let me jump back in and help you all with some structure.

MR. VOLINSKY: Yes.

THE PRESIDING OFFICER: The chart that you're referring to has been marked for identification as BSR Exhibit No. 7; is that correct, Mr. Volinsky?

MR. VOLINSKY: Yes. And I'd move to strike the ID.

THE PRESIDING OFFICER: All right. And is there any --

You're going to put this in, I assume?

MR. VOLINSKY: Yes.

THE PRESIDING OFFICER: Any objection?

MR. SATURLEY: I have no objection.

THE PRESIDING OFFICER: Seeing no

objection, it's admitted. And do we want to begin the count now, or do we want to leave it as your BSR 7 for admission as an exhibit?

MR. VOLINSKY: I would hope to leave it as No. 7.

THE PRESIDING OFFICER: Thank you very much.

Am I going to see this again in another form from the respondents?

MR. SATURLEY: No. You're not going to see this chart, your Honor. So I think the idea of moving with the -- continuing with the designation as it exists is by far the preference.

THE PRESIDING OFFICER: Very good. I just wondered if I was going to see a sister number. So this will be then BSR No. 7.

(BSR 7 admitted into evidence.)

THE PRESIDING OFFICER: Please proceed.

Q. BY MR. VOLINSKY: You were going to show us the loss it --

A. Besides the size of the chart and the limitation of the overhead, this is HealthTrust No. 1. Number two, the column that I'm pointing to is the year ending 12/31/2009. Down here is the net income/loss. I might note just to be clear this is a not-for profit enterprise so there are no taxes that are being paid, federal or state. So this pretax loss and post tax loss is actually the same number. This is the $8,774,000 loss that was posted in 2009.

And my comment was that notwithstanding that HealthTrust lost money in 2009, it still paid to LGC, the holding company, $4,431,000.

Q. And while you're there, am I right to understand that they paid $6.54 million the year before?

A. In 2008, they -- operations produced a profit of $7.7 million. And in addition to that, there was a distribution made by HealthTrust to LGC in the amount of $6,545,000.

Q. And 2010, since this happens to be up?

A. 2010, operations produced a profit of $11,175,000. And again, there was a distribution made by HealthTrust to LGC Holding Company, $3,875,000.

Q. Thank you. If you'll return to your seat, I'll get this out of your way.

So as you're having this discussion asking about the distributions, were you given sufficient information to understand or explain why the 27 percent and then 18 percent increases suffered by your town in health insurance premiums?

A. There was -- when I received -- and I don't remember exactly when it was received -- there is a rating formulation that is used to establish the rate. And the methodology for doing that, that template, as it were, was given to me. So I was able to discern based on the template what elements were being considered.

But again, it was a template. I don't recall receiving the actual figures that supported the 27.3 and the 18.6 premium increases.

Q. So let me ask you this. It sounds like, if I'm understanding your testimony, you as a representative of your town and your town were not particularly happy with getting hit with these large premium increases? Is that a fair statement?

A. Just to be clear, I was not serving in any official capacity at that time. Again, my time on the Budget Committee came to an end. My time as a

Select Board member had come to an end. So I'm really a private citizen who is serving as an advisor to the Municipal Budget Subcommittee.

Q. Okay.

A. The Budget Committee of North Hampton had been concerned about the cost of healthcare for a fairly considerable period of time, so these large increases were not the first time that the Budget Committee had on its radar screen the cost of healthcare. It became an acute issue with the increases that I've mentioned.

Q. So you heard during the opening statements that the municipalities so like the Local Government Center programs, that they stay year after year and that's evidence of their acceptance, appreciation of the Local Government Center. Did North Hampton leave?

A. It did not, all right? It did leave LGC Workers' Comp and joined Primex.

Q. Okay.

A. It did not leave healthcare.

Q. Why not?

A. The analysis that we're talking about, okay, never really got completed -- and again, in large measure because all the kinds of documents necessary to do the kind of exhaustive analysis was not something that was available through Steve Fournier to me.

Second is there was -- there was at least the concern that the ability to find alternative coverage may not be available as a capacity statement or may be available but at a rate and price structure that may not be preferential to what LGC or HealthTrust was charging. Again, that was a concern. The homework had not yet been completed.

The third issue was there's a lockdown or lockout arrangement that is part of being a member of LGC.

Q. What kind of arrangement?

A. A lockout.

Q. A lockout? Okay.

A. A lockout.

Q. What does that mean?

A. There's a provision that LGC has -- I think it's in its bylaws -- that basically says if you leave the program -- and I'm talking about healthcare in this instance, okay? -- you cannot come back in as a member of that pool for two years unless and until the board of directors of LGC grants an exception for you to come back in that pool. Absent that, absent that, you're locked out for two years.

Additionally, you cannot, sort of, go around LGC to go to Blue Cross Blue Shield directly to obtain a quote for healthcare; part of the lockout arrangement. So if one's going to begin the journey of potentially leaving LGC, one has to understand what the potential consequences were. So consequently, work was beginning on what might be alternative markets for North Hampton to consider, but that work wasn't complete -- was not completed by me at least.

Q. And part of that consideration was the understanding that North Hampton could not go to Blue Cross because of the lockout. And if they left, they were out for two years absent discretion of the board?

A. Right. Absent the board granting on an exception basis the ability of the town to come back in as a member of that risk pool.

MR. VOLINSKY: This would probably be an

appropriate time.

THE PRESIDING OFFICER: All right. Very good. At this time we'll take a lunch recess, returning at 2:00 p.m., where we'll pick up with this same witness.

Counsel, you can leave your materials here. And we'll see you at 2:00.

(Whereupon, at 12:52 p.m., the proceedings were recessed, to reconvene at 2:00 p.m. this same date.)

AFTERNOON SESSION

(2:06 p.m.)

THE PRESIDING OFFICER: Good afternoon, ladies and gentlemen. We will reconvene after a lunch break. Mr. Volinsky has a witness, Mr. Coutu, on direct.

Please continue, sir.

MR. VOLINSKY: Thank you.

MICHAEL A. COUTU,

the witness at the time of recess, having been previously duly sworn, was further examined and testified as follows:

DIRECT EXAMINATION (continued)

BY MR. VOLINSKY:

Q. Mr. Coutu, did you ever attend any of those meetings that were mentioned this morning at Local Government Center?

A. I did.

Q. In what capacity?

A. The LGC has a seminar for newly elected Select Board members. I think it's called the Select Board Institute or words to that effect. And I attended it, I think within four or five months of being elected.

Q. When you attended that seminar, did you try to assist the Local Government Center around the issue of municipal bank accounts?

A. First, I had a discussion with the program director, whose name, I believe, was Jack Calhoun. And the discussion I had with Jack was to share with him some of the findings that I came across as a newly elected official from the Town of North Hampton. And he and I spoke, and that led to my distributing through Jack a handout relating to the professional security interest and collateralized securities.

Q. Without going through much detail on that, you found that North Hampton's bank accounts were not collateralized at a time when banks were failing?

A. This was 2008. You know, the whole financial meltdown was occurring. The failure of banks in 2008 was unprecedented. There were 161 banks that had failed already. I was concerned that the public funds of our town was properly protected, investigated it, met with the banks that provide various municipal services, and discovered that notwithstanding the representation of the banks that the public funds were properly collateralized, they were not.

THE PRESIDING OFFICER: Mr. Volinsky, can you tell me where we're going with collateralized bank accounts of North Hampton?

MR. VOLINSKY: Yes.

Q. BY MR. VOLINSKY: Just real quickly, you offered to help the Local Government Center get out the word on this issue to its member municipalities?

A. I did. I had several conversations with a Barbara Reed. I'm not sure what her position was. I think working with communities and municipalities on financial kinds of matters.

I shared with her the work product that I had written about collateralization and suggested that if North Hampton had that kind of problem, since we're talking about the largest banks, the three largest banks in the state, arguably other towns, villages, and cities have comparable problems.

Q. Local Government Center ever take you up on your offer to help?

A. No, they did not.

Q. You had at North Hampton a nonlapsing account to deal with premiums for health insurance; did you not?

A. We did.

Q. What did that account do?

A. It became clear to us that because the HealthTrust provided a two-tiered rating scheme, that to the extent the actual rate was lower than the guaranteed maximum rate, and to the extent that the budget for the town was based on the guaranteed maximum rate, or GMR, then to the extent the voters have approved the budget, then potentially there's a windfall that arise in the delta between the actual rate and the guaranteed maximum rate if, in fact, that -- there was a positive result.

And I testified earlier that I believe in respect of the 27.3 percent increase, the GMR and the actual rate were the same. So that -- but for the most part, there was a positive variance between actual and GMR.

Q. And so your town actually went through the trouble to have a taxpayer-approved nonlapsing account to hold these funds to use in later years against premiums, correct?

A. It is. The actual final piece of that was approved by the voters, I think I'd already stepped down. My recollection is that the town administrator makes a projection of what should go into that account, and whatever that amount is. But the theory is it's available to subsidize future healthcare costs.

Q. So you were, at your town level, able to create an account to subsidize future premium payments for healthcare?

A. That was the intent of the program. I can't speak to whether it's being done or --

Q. Because you've gone?

A. I stepped down in 2010.

Q. One last point. The issues that you're about to talk about today concerning Local Government Center's finances, have you ever offered to assist the Local Government Center in straightening out the issues that you see and that you'll talk about?

A. I have. As I've testified earlier, the town administrator for the Town of North Hampton is a Mr. Steve Fournier. Mr. Fournier also sits on the

LGC board.

When -- I'll say when Mr. Wingate's report of August 2, 2011 was released, I had a number of discussions with Mr. Fournier in the nature of making suggestions or recommendations to him, such as the board retaining independent counsel to vet the assertions and allegations. And he, in turn, had said to me that it was likely the board would have me come in to work through all the technical issues and help the board understand them.

Q. Did the Local Government Center ever take you up on that offer?

A. It did not other than one meeting which occurred in October of 2011. When I met with Mr. Fournier in -- and -- I think his name is David Caron --

Q. C-a-r-o-n?

A. C-a-r-o-n.

-- who is on the board. There was a third gentleman who was supposed to be at the meeting but couldn't make it at the last minute. I'm drawing a blank on his name. The purpose of the meeting -- and this was all prefaced by my coming in to meet with the board. And my understanding was that Mr. Caron and this other gentleman, whose name, again, I'm not recalling, wanted to get a sense of my view of things. So we had the meeting on October the 5th.

And what I explained to Mr. Caron and Mr. Fournier was issues associated with the level of capitalization or surplus. And I contrasted that as respects the investments and the duration of the investments made by HealthTrust.

Q. Well, we'll get into that in a moment. Did they take you up on your offer to help beyond that?

A. Well, Mr. Caron wrote me an email, I'm going to say a week or so later, and attached a report that was written by Milliman. Milliman is one, if not the largest, actuarial consulting firm in the U.S. And the Milliman report, in effect, was seeking to support, maybe even justify the level of RBC that HealthTrust was utilizing. And Mr. Caron asked me to, in effect, evaluate their evaluation, which I did.

Q. Which you did?

A. In writing, correct.

Q. Were you in communications at all with the

Bureau during the summer/fall of '11?

A. I sent an email to Mr. Earle Wingate, I'm going to say within a week or so of the report that he wrote or his department wrote, which, again, was October 2, 2011.

Q. And did Mr. Wingate have you come in and help the Bureau?

A. No, he did not.

Q. When was the first time that you were contacted substantively by anyone to get involved and work through the finances of this organization?

A. The first -- the first time I was contacted was by yourself. And that occurred, I believe, the third or fourth week of January this year.

Q. Let's switch topics. I want you to -- as a preface to your financial analysis, I want you to explain to us the LGC landscape as you understood it and as it will relate to the specific financial analysis that you're going to describe for us.

A. LGC underwent a substantive reorganization in 2003. Prior to that time, it was cast as separate -- independent with separate boards, meaning trustees in respect of the two risk pools. In 2003 --

I should have said three risk pools. The third being Workers' Comp Trust in about the year 2000.

The change which occurred in '03, the reorganization was to follow a typical corporate business model of a holding company/subsidiary structure. I distinguished in my earlier comments and testimony today that since these were not a stock corporation, the somewhat nonconforming piece is the fact that the holding company did not own, quote, the stock of the risk pools. Indeed, the risk pools are owned by the participating members.

In going through all of the related materials, my observations is that, number one, HealthTrust has been a very successful operation. I think it's been mentioned earlier that they have approximately 85 percent of the state healthcare. If you measure it in dollars and cents, in 2010, the total premiums collected by healthcare were $392 million.

If I contrast that against LGC on a consolidated basis, meaning the other risk pools, on a consolidated basis, LGC is $415 million, again, in 2010. So by dint of the 392, HealthTrust really is the story behind LGC, at least from a numbers point of view, and represents 95 percent of 2010 revenues.

Therefore, most of my analysis and my comments about the financials will be centered on HealthTrust, although there are other points that I'll be making with respect to the other risk pools.

Q. Let me pause you for a second. I drew a real quick schematic in my opening. This is, as you call it, a typical holding company --

A. Structure.

Q. -- structure. But ordinarily in a holding company, all of the stock in the subs is owned by the parent, correct?

A. Correct.

Q. And the distinction here is what?

A. Number one, there is no stock to evidence ownership with respect to the subsidiary companies. Number two, unlike a corporate parent/subsidiary model, the legal owners of the three risk pools are the participating members, not LGC holding.

Q. So the towns, cities, and school districts?

A. And counties.

Q. Counties. But in this holding company model, the fiduciary responsibilities all go up to the parent, correct?

MR. SATURLEY: Mr. Mitchell, at this point --

THE PRESIDING OFFICER: Mr. Saturley.

MR. SATURLEY: -- at this point I'm going to object to the questions that have been asked recently and, I venture to guess that are about to be asked, with regards to Mr. Coutu's qualifications to answer legal questions about legal structure and fiduciary duties with regards to corporate entities.

While he's been -- he's got numerous credentials in a particular field, he's not a lawyer; he's had no legal training; he's made no particular study of 5-B.

To the extent that we've heard anything about fiduciary duty, we've heard that what he did was hire a great big law firm and then another great big law firm to write him a long memo with regard to fiduciary duties.

I do not believe he has been sufficiently qualified to be offering legal opinions with regards to the fiduciary duties and how they run up and down in this particular structure, or indeed, how they would work with regards to anything under RSA 5-B.

THE PRESIDING OFFICER: Mr. Volinsky, do you want to make your response from the microphone, please.

MR. VOLINSKY: Sorry. Yes. I'll represent to the hearing officer that I asked pretty much that same question of Ms. Carroll, the executive director, to get her understanding of how that fiduciary duty runs --

THE PRESIDING OFFICER: Um-hum.

MR. VOLINSKY: -- and she told me that she understands the parent does not own -- owe fiduciary duties to the subs. It's the subs who owe it to the parent.

I don't think this is a point that's seriously contested, because of that deposition. I don't think, given the absence of the Rules of Evidence in this case, that this is a point on which we should spend a whole lot of time.

THE PRESIDING OFFICER: I understand that. But I believe Mr. Saturley's point, among other things, was qualifications in law, qualifications with respect to his experience or study, education in fiduciary relationships. And you telling me that you are asking what is a relevant question is the same as me considering whether or not this gentleman has special expertise in the area. So I need to hear more from you.

MR. VOLINSKY: Yes. I offer this as a practitioner, not as a lawyer. Mr. Coutu has testified that he has acted and managed and been a participant in numerous holding companies exactly in this model. And he's also testified that he's been very careful to understand the fiduciary relationships.

So I think as a practitioner businessman in the field, he can offer his understanding.

THE PRESIDING OFFICER: Okay. I'm going to deny the objection. But I will assign appropriate weight as he goes forward, and we'll see --

MR. VOLINSKY: Fair enough.

THE PRESIDING OFFICER: -- where he goes when he gets to the statute.

MR. VOLINSKY: Fair enough.

THE PRESIDING OFFICER: Mr. Gordon?

MR. GORDON: Can I speak from here? Is that appropriate?

THE PRESIDING OFFICER: I think you should come forward just a little bit. You're far back there in the back row.

MR. GORDON: One of the issues and following up with what Mr. Saturley said is that I thought I heard Mr. Coutu say -- give an opinion or a statement about legal ownership. And I think that is a far different cry than from his, I would say, practitioner's view of what fiduciary duties are.

Precise testimony as to what legal ownership interests are, I think are beyond his expertise. And understanding your ruling, I would suggest that he is not to weigh in on legal opinions for which he's not qualified. If he wants to give his practitioner's point of view as to what he did and why he did it in his practice, but not to offer legal opinions as to such things as ownership of stock or interest in these entities.

THE PRESIDING OFFICER: Mr. Volinsky, any response?

MR. VOLINSKY: That's fine. We won't have him offer legal opinions about ownership.

THE PRESIDING OFFICER: Okay. So we will strike the reference to legal ownership, and you can ask your question in a different way, or you can respond in a different way, Mr. Coutu. We'll proceed.

So Mr. Gordon, your objection is granted as clarified.

MR. GORDON: One for one. Good.

THE PRESIDING OFFICER: Please be seated.

Mr. Volinsky.

MR. VOLINSKY: Okay.

Q. BY MR. VOLINSKY: Just very basic, Mr. Coutu, fiduciary duties as a practitioner, they run down from the parent or up to the parent?

A. The fiduciary duty of the board serves at the local government level. The holding company level is up, not down.

MR. VOLINSKY: I just wrote the word "board" on here.

Q. BY MR. VOLINSKY: Let's go back to the landscape. So you were describing what you understood the size of the pool was driven by

HealthTrust with its 90 percent of premiums. After the reorganization, they're in this model.

Can you, for us, compare in a general way the activities of the Local Government Center versus the activities of a true insurance company.

A. Notwithstanding the caveat that Chapter 5-B makes clear that the LGC risk pools are exempt from the insurance regulation and notwithstanding that from just a technical point of view, they're not insurance companies, if measured and examined from an operating point of view, the kinds of activities that LGC HealthTrust and insurance companies perform -- property and casualty specifically -- are literally mirror imaged.

Number one, HealthTrust collects premiums. Number two, it issues policies of insurance or coverages. Number three, through a third-party administrator -- in the case of HealthTrust, Anthem, Blue Cross and Blue Shield -- settles and pays claims, the settlement being Blue Cross Blue Shield; the payment coming from the coffers of HealthTrust.

It has loss prevention programs that

go to the issue of mitigating loss as a sort of a consulting service to insureds. They have -- to the extent there is reinsurance involved -- and in the past there has been reinsurance for HealthTrust, not currently -- but it would purchase reinsurance and then to the extent of losses meeting the threshold requirements of reinsurance, it would cede those losses, cede meaning to transfer those losses.

Q. So in all those aspects, HealthTrust acts like an insurance company?

A. Just like it.

Q. You have experience managing insurance companies?

A. Quite a few, yes.

Q. Talk to us now a little bit about the nomenclature that we need to understand in order to follow the financial analysis and what the Local Government Center does in the course of its handling of taxpayer money.

A. I testified earlier with respect to surplus and pointed out that surplus is sort of the shorthand term for policyholder surplus. I also made the comment that surplus net assets and members' balances all have the same meaning and in general financial-speak, that would be referred to as capital.

I think the second term that's helpful is an insurance term that's quite common. It's been mentioned here at least once this morning: "short tail" versus "long tail." You can take the property/casualty issue and you can divide it into two buckets: short tail. Short tail generally is coverages in which the claims payout pattern -- that is, the period of time it takes for claims to come in -- is generally within 30 to 36 months.

Long tail is typically where the claims manifestation period can be much longer. If I use asbestos as an example, there were insurance companies which insured companies that manufactured asbestos products back in the 1920s, '30s, and '40s when asbestos found its way as a common material in building supplies: linoleum, siding, roofing shingles, et cetera.

Because asbestos mineral was not known to be hazardous to one's health, the claims that arose from exposure to asbestos in many cases did not manifest for 20-30-40 years after an individual was exposed. So you had situations where companies writing insurance in the '20s and '30s ended up with losses that they paid in the '70s, '80s, '90s, and later, once it could be proven that the event -- that is, what gave rise to the exposure to asbestos -- occurred in the '20s-30s as the case may be.

Within the short tail bucket -- and my comments, that's typically 30 to 36 months -- some examples of short tail insurance coverage would include auto, homeowners, and healthcare.

In the case of healthcare, the claims manifestation period is generally two years or less. And indeed, we have, I think, an exhibit that will show what it is specifically for HealthTrust.

MR. VOLINSKY: Okay. That's a nice run-up for me. So I will refer everybody to Exhibit 69, which is the compilation of the consolidated and nonconsolidated financial statements for the Local Government Center and the subsidiaries.

THE PRESIDING OFFICER: Book 3?

MR. VOLINSKY: It is 69, which is Book 5 by itself.

THE PRESIDING OFFICER: Book 5.

MR. VOLINSKY: 5. That book is all financial statements. And I have added numbers to the bottom of each page consecutively, starting from 1 going through 1,300, I think. And there should be a table of contents at the beginning of it.

THE PRESIDING OFFICER: Give me a moment, please.

MR. VOLINSKY: Yes.

THE PRESIDING OFFICER: There's only 1,300 or so pages in this exhibit. And I just want to correlate that the exhibit number BSR 69 for identification has Exhibit 1 within it?

MR. VOLINSKY: It has a number of exhibits within it because this was used as a deposition exhibit for Ms. Sandal Keeffe's deposition. So I recopied it, left the other sticker on.

THE PRESIDING OFFICER: And everything then that is in Exhibit 1 represents -- or falls within the description you had in the table of contents?

MR. VOLINSKY: Yes.

THE PRESIDING OFFICER: Can I assume that that goes through page 15?

MR. VOLINSKY: Exhibit --

THE WITNESS: Exhibit 69, sub 1?

MR. VOLINSKY: I don't remember if it's broken up exactly that way. But the Keeffe exhibit numbers are no longer relevant to this proceeding other than to allow my colleagues to recognize that that's where this exhibit comes from.

THE PRESIDING OFFICER: Okay.

MR. VOLINSKY: We'll use the numbers on the lower right of each page --

THE PRESIDING OFFICER: Very good.

MR. VOLINSKY: -- so that we can keep track.

And I would move to strike the ID on 69.

THE PRESIDING OFFICER: Okay. And moving for admission at the same time?

MR. VOLINSKY: Yes, sir.

THE PRESIDING OFFICER: Any objection from the respondents as to BSR Exhibit 69? Let me make this --

MR. RAMSDELL: Can we take one second?

THE PRESIDING OFFICER: Sure. Let me make one other observation. Can I assume further that if there were to be objections, there can be objections to the several sub-exhibits of BSR 69?

Has there been any discussion among counsel with respect to that? All right. Then I'll recognize Mr. Saturley who has risen for purposes of being recognized.

MR. SATURLEY: Thank you, Mr. Mitchell. LGC has no objection to the proffered content.

THE PRESIDING OFFICER: Understood.

MR. SATURLEY: However, I do want to make it clear that we've not had an opportunity to check whether or not these are complete. In other words, the first --

THE PRESIDING OFFICER: Understood.

MR. SATURLEY: -- one, for instance, says it's the consolidated financial statement. I have no idea whether it's complete or not.

And secondly, there are other -- certainly other statements which we have tendered as part of our exhibits. For instance, there's only -- a quick scan indicates there are only a couple of -- I'm not sure whether all of them are here.

THE PRESIDING OFFICER: Understood.

MR. SATURLEY: So as long as you're aware that we're not sure they're complete and we do intend to proffer others, so that I don't want this recognized as the only financial statements that can be used in this case, then I have no objection with those caveats.

THE PRESIDING OFFICER: It's admitted then as BSR 69.

(BSR 69 admitted into evidence.)

THE PRESIDING OFFICER: And I understand that if you have an objection, you'll reiterate it further in these proceedings. If you should find in your review that these are not complete, as the fact finder, I do not want to be left in the end with competing financial statements without having you all at my disposal to tell me which one is the complete one.

So to the extent that you can identify any holes that Mr. Volinsky might leave in exhibit references, please just bring them to my attention at the next convenience in the proceedings.

MR. SATURLEY: Happy to do so.

THE PRESIDING OFFICER: Will that fit?

MR. SATURLEY: That fits.

THE PRESIDING OFFICER: Very good.

Please continue, Mr. Volinsky.

Q. BY MR. VOLINSKY: If I may, let me turn you to page 836. 836, well into the exhibit. And I've put 836 up on the screen.

THE PRESIDING OFFICER: Go ahead.

Q. BY MR. VOLINSKY: We were talking about short tail lines and how health is an example of a short tail line. You mentioned a reference to the 10-year claims development of the Local Government Center HealthTrust, correct?

A. Correct.

Q. In the financial statements, is there a document called 10-year claims development?

A. The outside auditors for the preponderance of the financial information that will be discussed today is Berry Dunn McNeil. The financial information includes the notes -- the financial statements, balance sheet, income statement, reconciliation of cash flows, notes of the financial statement.

There is an additional section to the

financial statement called supplementary information. This piece, which is referred to as the 10-year claims development schedule, is part of the supplemental information prepared or included by Berry Dunn in its audit financials for the year ending December 31, 2010.

Q. So we can see the captions on the left of 836, do you see that?

A. Yes.

Q. Tell us how this relates to short tail lines.

A. Let me start at Arabic 3, Estimated claims and expense. And I just want to note very quickly that back in 2001 and 2002 and 2003, all the way up to 2008 -- if we can go back -- you'll see the word "ceded claims." That simply means that they had reinsurance. And so the claims, however that reinsurance was put together, whether it was on an individual loss basis or aggregate of the portfolio of losses, I don't know. But clearly they ceded some of these claims to the reinsurers. That's why in Arabic 4, you have the word "net paid." "Net" means net after giving effect to ceded claims.

Now, what this schedule does, it's a very common display of losses. If you saw the whole picture at one time, it's a triangular form picture, okay? And if I start way over at the right, just so that the audience has a sense of it -- it should be 2010, I believe, right? Yes. 2010. You only see one number there because this was the 2010 financials.

And loss development, i.e., loss claims coming in, this is what we call an underwriting year in which the losses are still too green. So all we have is losses being reported for that one period, which is the policy period.

Q. And this is in thousands, so that's 345 --

A. $345 million. Okay. So if we switch -- if we toggle back to the left. Okay. Let's start with the nomenclature. What this says is based on time -- can we show the top for a second.

Q. Yes.

A. 2001, all right -- now back down -- all right. For policies issued in 2001 or underwriting year 2001, all right, at the end of the policy period, $131 million of claims were paid. One year later -- so that's one year after the policy period

02:41:26 expired -- again, this is a 12-month policy period, all right? And I can't quite read it. I think it's 128? Am I reading it right? This number right here.

02:41:37 THE PRESIDING OFFICER: 126.

02:41:39 Q. BY MR. VOLINSKY: 126,479.

02:41:42 A. 126,479. Okay. Now, that went down between this number and this number, and I'm guessing there aren't any notes on the financial statements; refunds, rebates, cancellations, other reasons caused this claims paid to drop a bit.

02:41:58 And then two years later, it's 127,253, if I'm reading it correctly?

02:42:07 Q. Yes.

02:42:08 A. And then 127,253, 127,253. What that tells you is that whenever I read a piece like that, there are no new claims that came in beyond the second year after the policy period.

02:42:23 The second thing that should be clear is that the preponderance of the claims, the 131, whatever it is, million, came in during the policy period. There was a little bit of true-up one year after the policy period. And then virtually no change afterwards.

If I switch to 2002, which is this next column -- is that 169? I can't --

Q. 169 and 163.

A. Again, 169. So there's more claims that came in in the second year because there were more writings, all right? There was a slight reduction in the period one year after the expiry of the policy; again, I'm assuming rebates, refunds. And then the number stays flat for the remaining years. That, again, says that after one year following the policy period, there was no statistically significant claims filed.

We can keep going the same way and go through all 10 columns. What this tells you --

THE PRESIDING OFFICER: Excuse me just a moment for clarification. You commented that the -- in the second year it dropped down again because of the ceded or rebates --

THE WITNESS: Well, no, ceded would be up here --

This is net paid. Rebates, refunds, cancellations, other reasons.

THE PRESIDING OFFICER: If there had been none, would that figure remain the same --

THE WITNESS: Yes.

THE PRESIDING OFFICER: -- year one, year two, all the way through?

THE WITNESS: Well, they could have been -- this -- I think this is 2002 I'm looking at.

THE PRESIDING OFFICER: 2002.

THE WITNESS: There could be two things going on here, Mr. Mitchell. There could have been, (a), some new claims coming in, and (b), some credits, all right? This is the net of that.

So I can't say from looking at this chart that we got from 169 to 163 solely because of credits and refunds and rebates. It may have gotten there as the net of some additional claims that came in and other refunds.

But once we got to the third year, the second year following the expiry of the policy, because it stays 163,720, they're out. I know that from this point there were no further new claims that came in.

THE PRESIDING OFFICER: Well, since it's at the beginning, I'll belabor the topic. In 2001, so that I understand what you would have me take from these numbers, you'll see that the first three numbers, 131, 126, and then it goes back up to 127 and stays constant.

THE WITNESS: Right.

THE PRESIDING OFFICER: And your explanation for that was that they were rebates and such that happened in year two that brought the figure down to 126, right?

THE WITNESS: I'm -- that's my hypothetical because there aren't notes and I'm only offering what I believe may have happened.

THE PRESIDING OFFICER: All right. So for some reason, it went to that number.

THE WITNESS: Right.

THE PRESIDING OFFICER: And then in year three, it went to 127,253.

THE WITNESS: And became constant.

THE PRESIDING OFFICER: And it became constant. In 2002, you indicated that in the second year a similar event occurred -- again, hypothetically -- but yet 163 stays constant throughout.

THE WITNESS: Right. That's correct. In this case --

THE PRESIDING OFFICER: Why don't I have that middle step?

THE WITNESS: Because if there was, (a), no additional claims that came in and no credits that splash over into what would be the second year following, then it just bottomed out, if I can use that term, one year earlier in 2002 than it did in 2001.

THE PRESIDING OFFICER: Okay. I'll let it go.

THE WITNESS: All right. In either case, in either case, what this is telling you -- we could do this every year -- is that, (a), the preponderance of the claims comes in during the policy period. And then you have some -- you know, some noise, if I can call it that, occurring one year and two years -- in this case two years; in this case one year -- after the policy expired.

The import of this really is that when these numbers repeat, it really tells you that, (a), this is a very short tail line; that the claim period, claims manifestation period, is mostly within 12 months, a little bit of dribble thereafter, all right? And if I can use 2001 as an example, clearly nothing was happening beyond the second year.

THE PRESIDING OFFICER: I see the noise in 2001, to use your term. I don't see the noise in 2002.

THE WITNESS: Only because of this factor: 169 versus 163.

THE PRESIDING OFFICER: But then all the rest of them stay at 163.

THE WITNESS: That's correct.

MR. VOLINSKY: So it was even shorter during '02 than in '01.

MR. HOWARD: Your Honor -- Mr. Mitchell, it's fine for the witness to testify. We don't need Mr. Volinsky to testify.

MR. VOLINSKY: We'll take as long as we need to go step by step. I'm trying to be of assistance, Mr. Mitchell.

THE PRESIDING OFFICER: That's quite all right.

My question was that in explaining

year two in the 2001 column, the noise -- and you know, you have hypotheticals for it, but "noise" is good enough for me -- that occurred in the second year, and then you've drawn our attention to the fact that it plateaued out and stayed the same, which meant no new claims.

Is that correct?

THE WITNESS: Yes, it is.

THE PRESIDING OFFICER: With respect to 2002, the second year is the number that stays constant. Can I assume that in each one of those years, there was no new claims?

THE WITNESS: Yes. And no noise.

THE PRESIDING OFFICER: Correct. So there's no noise in 2002?

THE WITNESS: Other than within a policy year, which is the 169, if I'm reading that correctly --

THE PRESIDING OFFICER: Right.

THE WITNESS: -- and the 163. So there was a little bit of noise in these two columns. Once it hit one year after the expiration of a policy, from that point to here it plateaued.

THE PRESIDING OFFICER: You can go forward, Mr. Volinsky. Thank you very much.

Q. BY MR. VOLINSKY: Not to belabor it, the next year you have noise for one year and then it plateaus at 216?

A. Again, it's very hard for me to see the numbers. But it's at 196 and 216. And then you'll see it dropped a point between 4 and 3 and 3 and 2. That is pretty statistically insignificant.

Q. And so this establishes by the supplementary document to the financial statements that HealthTrust is what you call short tail?

A. That's correct. And again, the thrust of this exhibit is to demonstrate that it is short tail. But to give meaning to that, number one, preponderance of the claims come within the policy period, within 12 months, and then a little bit of dribble, noise, whatever you want to call it, manifesting one year later. And at least in the case of 2002, it was sort of a final story in one year. There was no dribble and no noise in the second year.

Q. Thank you. Go ahead and sit down.

You were talking about nomenclature

02:50:14 and landscape, and I want to ask you about investment portfolios in insurance companies.

A. Whether it's an insurance company or corporation doesn't make much difference. But the common rule of investments is that the liabilities and the assets have to match up.

It is of particular importance in an insurance company to ensure that you have cash and cash equivalents in sufficient amounts to pay claims when they become payable. That is, the claim's been settled. The obligation to pay the claim is determined. And the amount has been determined and it needs to be paid.

So there are guiding factors with respect to investments. In the insurance world -- and here I'm talking about the insurance world generally speaking, not risk pool specifically -- the overwhelming preponderance of investments are made in, quote, marketable securities, end quote.

Marketable securities are those securities that could be liquidated typically overnight or within a day and converted from a security to cash. Typical securities would include

U.S. government obligations. There are also obligations that are commonplace that are referred to as GSC, government-sponsored enterprise obligations.

Fannie Mac [sic], Freddie Mac would be examples of GSCs. There's also something called Ginnie Mae. Ginnie Mae, however, has full faith and credit of the United States Government. It might --

Q. Let me stop you. Why do you need marketable securities in the insurance business?

A. Liquidity.

Q. Why do you need liquidity?

A. Again, your securities are the cash to pay claims tomorrow.

Q. Okay.

A. If your investments were in real estate, to make a contrasting argument, you wouldn't be able to liquidate the real estate literally overnight if you needed the proceeds from that real estate to discharge claim obligations. So the benefit of marketable securities is that there is a secondary market in which those securities could be sold and converted to cash.

Q. So the business of insurance is in large part to collect premiums and pay claims, and the purpose of investments is to make sure that there are funds available should the claims exceed the premiums. And also is there a lag time in there also?

MR. SATURLEY: I --

THE WITNESS: Between the --

MR. SATURLEY: I --

THE PRESIDING OFFICER: Go ahead, Mr. Saturley.

MR. SATURLEY: Objection. Leading.

THE PRESIDING OFFICER: Well, it's an administrative proceeding. We're going to proceed. Denied.

Q. BY MR. VOLINSKY: Go ahead.

A. Between the time that the premium is collected by the insurance company and the time that it's paid out as a claim, insurance companies, including HealthTrust, will invest those dollars in various securities of various duration. The longer the claims manifestation period, then the longer the duration of those investments. By "duration," I mean maturity.

So if I'm in the business of insurance that's providing casualty coverage where a claims manifestation period is 10 or 15 years, then you would expect those investments to be invested for a duration of 10 to 15 years.

Alternatively, if I insure automobiles, then I may see those investments being a year, maybe a year and a half, but not more.

Q. And if you were in another short tail line like health, where should the investments be?

A. Well, when you look at the loss profile -- loss development profile 10 years, I made the observation that the preponderance of claims manifests within a policy period -- that's 12 months -- and some dribble and noise that was visible in the second year, or the first year following the expiry, and in one case -- 2002 -- and the second year following the expiry of the policy.

Q. Have you made an analysis from the financial statements of the maturity levels, maturity durations of the investments held by LGC HealthTrust?

A. I have.

Q. Have you put together a table that we've marked as BSR 9?

MR. VOLINSKY: So I'll refer everyone to 9.

Q. BY MR. VOLINSKY: And is this your table?

A. Yes, it is.

MR. VOLINSKY: I move to strike the identification on 9 and admit it as an exhibit.

THE PRESIDING OFFICER: Any objection?

No objection. Please proceed, and it is admitted as --

MR. SATURLEY: I have no idea where this information comes from. I don't know how he put it together, so therefore, I do not assent.

THE PRESIDING OFFICER: Let's back up a little bit. Give me a sign that you have an objection before I go further. I understand you have an objection now.

MR. SATURLEY: Yes, sir.

THE PRESIDING OFFICER: Would you please restate it.

MR. SATURLEY: Yes, sir. I have an objection to the admission of the table and the striking of the identification since I have no idea where the information came from nor how it was put together.

THE PRESIDING OFFICER: You understand how it was put together: by the witness, correct?

MR. SATURLEY: I heard that.

THE PRESIDING OFFICER: Okay. Mr. Volinsky, would you please elicit where these figures came from?

MR. VOLINSKY: Yes.

Q. BY MR. VOLINSKY: This table was in your report; was it not?

A. It was.

Q. So it's been disclosed for months?

A. It has.

Q. Where did it come from?

A. The source of this information is the audited financial statements for HealthTrust, in this case for years 2008, 2009, 2010. And actually the information was actually prepared by the outside auditor, Berry Dunn McNeil & Parker.

THE PRESIDING OFFICER: Thank you.

MR. VOLINSKY: Thank you.

THE PRESIDING OFFICER: If that was an

objection, it was denied. And please proceed.

Q. BY MR. VOLINSKY: So this is HealthTrust's investments '08-10. Would you please describe -- and I'll move this as you need -- what's depicted on this table.

A. Staying first with the left-hand notations, nomenclature, these ranges referred to are the maturities of the investment securities. The ranges that have been captured in this exhibit are the same ranges and amounts in a similar table that was constructed by the outside auditors, Berry Dunn.

The first entry is not applicable. The second entry is within one year. Then I have a subtotal less than one year. The next one is one to five. Berry Dunn did not create a more granular table. That is, I don't know what's matured between, let's say, more than one year and, let's say, less than three years or less than two years. They grouped it into one to five.

Then we have investments of five, but less than ten years. And then we have investments that are ten-plus years. Whether that's 15 years, 20 years, longer, I don't know. That information was not detailed in the financial statement.

If we can, counsel, move to the right. Conceptually, what I'm about to explain for 2010 applies to the two prior years, '08 and '09. The math will be a little bit different and the percentages will be a little different. But here is -- these two buckets, which adds up to this number: ten million one, are your very short-term investments defined as those investments which mature within a 12-month period from the statement reporting date. So it's 12 months from 12/31/2010.

This next bucket is investments between one and five. That is more than one year and less than five years. This one here is between five and ten. More than five, but less than ten. And this last bucket is -- at 14.3, is ten-plus years.

Now, if we go back. Now, I've added this number, 8.5 and 14.3, and that equals the 22.8. And I would start off by saying that for a healthcare short tail company to have investments going out five to ten years, in this case ten-plus years, is, (a), unusual; and (b), since those securities have such a long investment maturity date, it tells me that the -- that HealthTrust is not anticipating needing those funds in the short run. The short run is defined as 12 months from the statement date.

The same can be true here. We don't have a breakdown other than to say it's more than one and less than five. But as we demonstrated from the claims loss development exhibit that was here earlier before this one, the preponderance of the claims mature within 12 months. So I would venture to bet that this 12.9, which is the one to five corridor of investments, is likely also funds not needed in the short run. And short run is the 12-month period following 12/31/10.

Q. So what is needed to satisfy the short-term nature of this health insurance operation?

A. If I may answer one question before I get to that one.

Q. Yes.

A. Because it wasn't on the screen. I just want to show that there are some percentages that have been calculated -- and if I can scroll to the right, okay? Investments, first of all, ten-plus years, 31.1 percent of the total invested portfolio is excess of ten years. In the five to ten bracket, 50 percent of HealthTrust's invested assets are invested in securities in excess of five years, but less than ten years of maturity -- ten years to maturity.

Q. Let me just correct you because -- so that number is actually excess of five years.

A. Oh, strike that.

Q. Okay.

A. Okay. So this is excess of five and excess of ten. So this tells me that 50 percent, rounded, of HealthTrust investments is more than five years out, which is a substantial portion of its investments for a company that has a very short tail, it's a lot of tail.

Q. Okay.

A. Now, if we can scroll up, to answer your question, when looking at the -- when looking at the question, what does the company have that could be considered short term, and that is investments which mature in less than 12 months, that's this $10 million number, okay? And if I can, counsel, get you to scroll to the bottom of the page.

Q. Sorry.
A. Got to go up a little higher. No, the other way. Okay.
Now, you'll see here this Footnote 2. The above investments excludes in each year something that is called cash and cash equivalents. So if I scroll over to 2010, in cash -- right here -- cash and cash equivalents was $52.5 million. So if I take this number and the number that I showed you earlier that mature within 12 months at $10 million, I can tell you that on a short-term basis, HealthTrust has $62 million very liquid funds to pay claims or expenses.
So again, the indication of investing in longer than 12 months, and certainly investing 12 -- I mean, excuse me -- 24 to 10-plus years tells me that that is, (a), cash that is not needed in the short term to pay either expenses or claims, and (b), as we'll see in a bit, is also perhaps the leading indicator for a comment that I'll make that says that HealthTrust is over capitalized. Overcapitalized means that there's more surplus on the balance sheet than what is necessary to support the financial

operation known as HealthTrust.

Q. A couple of basic points of clarification. This reference to $52.5 million in cash or cash equivalents for 2010, where did you get that number?

A. That, as well as all the numbers in this chart, other than these percentages that I calculated right here, come from the financial -- those are the financial statement for the audited financials prepared by Berry Dunn, in this case for years 2008, 2009, and 2010.

I think I should make one point so I don't get everybody confused. Just because securities are invested for longer periods does not mean they can't be converted, all right?

Q. What does that mean?

A. If I have a security that's been invested for 10 years and I needed that cash, I could have my broker-dealer sell that security and convert it to cash very quickly.

However, in selling off a security that has a longer-term investment duration, I will incur what is referred to in the business as breakage cost. And breakage cost means that because the maturity is 10 years and I need it to be cashed out immediately, you're going to pay money in order to have that security converted to cash.

So it isn't that marketable securities cannot be converted to cash. They can. But to the extent that you do so prior to the maturity of the underlying investment, you will incur additional costs and charges in order to convert the security to cash.

Q. But to go back to the opinion you stated beforehand, do you have an opinion as to whether HealthTrust, a short tail line company, holding securities with -- or investments with durations excess of five years is appropriate for their capital structure or not?

A. I don't think I'd use the word "appropriate." I would use -- I think the better term would say "not necessary."

Q. Fair enough. Last point of clarification. All of your financial analysis ends with the end of calendar 2010?

A. The 2011 financials for HealthTrust have not yet been promulgated.

Q. And that's why we deal with 2010 numbers?

A. That is correct.

Q. Stay with nomenclature. "Loss" and "claims reserves," what do those terms mean?

A. Some of the confusion which has arisen in connection with the report prepared by Mr. Wingate or the BSR, some of the comments made by LGC, are basically cobbling together two things: one, reserves, and second, I'll call it surplus. They're not the same.

In the business of insurance, you post the reserve based on your statement date equal to, (a), the amount of claims that are reported but not fully settled; (b), an actuarial estimation of claims that have been incurred; that is, the event that gives rise to the claim has happened, but the claim has not been reported; and (c), loss adjustment expenses related to both.

So one, the claims that have not been fully settled is usually the claims handler or handlers that give you an indication of that value. IBNR, incurred but not reported, an actuarial determination based on the practices common in healthcare and the history specific to healthcare, come up with an estimate. And that again is on the reserve side of the balance sheet. "Reserve" means it's a liability.

So the next comment is surplus.

Q. Right.

A. Okay? And if I may start with something that we all have, on an individual basis, we have a home. We likely have a car. We may have other items. In all likelihood, we may have a mortgage; we may have a car loan outstanding. Now, the value of the home and the car less the liabilities owing on account of those two items equals my net worth. So assets minus liabilities equals net worth.

It's not any different in the insurance world; it's just different terms, okay? In the insurance world, it's assets minus liabilities equals net assets, which is what you're going to see in a second. Another term for net assets is surplus, which is what was captured in Chapter 5-B with respect to distributions, and member balances is an older term that was used by LGC prior to 2003.

Q. To mean what?

A. To mean capital. The excess of assets over liabilities.

Q. Okay.

A. Capital or surplus.

Q. One more term: earnings.

A. This is a not-for-profit institution. Not-for-profit does not mean they don't make profits. The HealthTrust, with the exception of 2009, has been a very profitable business. The fact is that it has applied for an exemption for tax purposes at the federal level and enjoys that exemption as well from the state level.

So while they don't pay income taxes, I want to make it clear that they do produce profits. Another word that's used for "profits" is "earnings."

Q. I'm going to take you into some more charts that you prepared, one of which happens to be on the easel there. And before we go to it, I just want to ask you, where does the information come from that are on the charts we're about to discuss?

A. Everything on this chart comes from the audited financial statements, again, prepared by Berry Dunn. And the only thing that doesn't, there's something you can't see but we'll see it on the screen and I'll point it out. But there's a category here that says RBC confidence level. These numbers here came from the Segal Company.

THE PRESIDING OFFICER: Wait for the rest of us to catch up with you. Exhibit number, please?

MR. VOLINSKY: We're about to go to BSR No. 7.

THE PRESIDING OFFICER: Okay. BSR 7. Give us a moment.

MR. VOLINSKY: Yes.

THE PRESIDING OFFICER: Do you intend to request admission of this?

MR. VOLINSKY: Yes.

MR. TILSLEY: 7's already in.

MR. VOLINSKY: 7's already in.

THE PRESIDING OFFICER: Thank you. And it's only day one.

Please proceed.

Q. BY MR. VOLINSKY: So Exhibit 7 is a table that encompasses three years of financial data from the audited financial statements, correct?

A. This is commonly referred to as a

spreadsheet. It seeks to capture multiple entities, multiple years, in a concise, easy-to-compare format.

Q. Is this called spreadsheeting?

A. Yes, it is.

Q. When did you start spreadsheeting financial statements?

A. Well, in the case of HealthTrust, it goes all the way back to 2010.

Q. No, when did you first start personally developing the skills to spreadsheet?

A. Oh. Okay. I don't know if I want to admit that. Probably '72.

Q. You've used the process of spreadsheeting multiple financial statements basically throughout your entire career?

A. I do.

Q. All right. So we have HealthTrust on this particular chart, '08 to '10; Property-Liability Trust, '08 to 10; and Workers' Compensation, '08 to '10?

A. And LGC.

Q. LGC itself. That's the parent organization, correct?

A. Yes. And let me clarify one point while we're talking about it. These numbers here is the holding company without the risk pools consolidating into LGC. In accounting-speak, these numbers are referred to as the consolidating financial numbers, not the consolidated.

So what it does -- and this will become more relevant as we move on through the afternoon -- is that it gives us the opportunity to look at LGC as a standalone entity.

Q. So if we go back to my handwritten chart here, those last three columns deal with only the parent's financial data?

A. That's correct. That's '08 through 2010, LGC parent company standalone.

Q. I want to take you to the information about HealthTrust. And in particular, information about HealthTrust's net assets. Am I displaying the right part of the Exhibit 7?

A. Well, why don't you just keep it there for a second.

Q. Okay.

A. Obviously these nomenclatures apply to all the numbers that go across the page. I did this in essentially a couple buckets. This first piece is the balance sheet of HealthTrust and the other entities. The balance sheet is a snapshot of the company's financial position as of the statement date. In this case, 12/31/08, '09, and '10. And below that is the income statement. It's the summary of revenues and expenses in claims incurred that happened over the 12-month period ending 12/31/08, '09, or '10.

Now, to go back up to the balance sheet -- right there -- you'll remember that I described the word "net assets" as equivalent of "surplus" or "members' balances."

So for '08, HealthTrust had net assets of $92.7 million. In '09 it had net assets of $79.5. And in 2010, it had net assets of $86.8 million.

The significance of the statement is if we're going to make a comment about surplus, I think one needs to begin the journey by saying, that's surplus. Now, within the net assets structure, it also has a series of components.

Board-designated is what the board of LGC decides is the appropriate level of surplus for this business. And in 2008, the board-designated was $68.3 million. In '09, it was $77.9 million. And in 2010, it was $84.4 million.

Mr. Volinsky in his opening comments made the note or the observation that this number here is not at the target rate that the board set of an RBC of 4.2, but actually is higher than that because LGC HealthTrust in years prior to 2010 capitalized the future administrative expenses and used that capitalized figure to bolster the net asset account.

That amount measured on an RBC basis is .5. So if one wants to do a calculation of RBC for '08, '09, and '10, this number here would be 4.7, all right? 4.7. And here it's 4.2. Now, if we would scroll down to the bottom, I have that information. Okay. The administrative expenses in 2008 -- this is what was capitalized and included as designated -- is $7.229 million.

So in effect, what they did is, Let's make an estimate of what our forward admin expenses are. Let's make a provision for it. I'll use the term "reserve." You know, it's just sort of rainy day money. And we'll throw that into the capital base as well. And that's 7.2.

And then in 2009, the capitalized future admin expenses was $8.7 million. And then all of a sudden in 2010, it dropped to $500,000.

Q. You have an RBC calculation overall right underneath that line?

A. I do. But I need to go up and pick up a data point first.

Q. Okay.

A. So one is the administrative expenses are part of the capital calculation board-designated, and I think it's noteworthy that what had been running at $7 or $8 million a year dropped to $500,000 in 2010.

The other thing I want to call attention to is unrestricted. Now, the best way to look at unrestricted is if the board of LGC says, Gee, we need 4.2 RBC plus the .5 for admin expenses, all right, what is that number? And that number is $68 million. Then as it turns out, HealthTrust had another $25.7 million, which was excess of what the board said they needed. So that number, $25.7 million, is above and beyond what the board claimed it needed to support this balance sheet.

Now, if you'll scroll down. And let me just show one thing. In 2009, that number flipped, negative 757. So $26 million was consumed between '08 and '09. And I'll show you that.

Now, to Mr. Volinsky's comment earlier, you have RBC, even though the board set as a target an RBC of 4.2 and even though it has admin expenses for another .5, you would say, Well, gee, shouldn't that be 4.7? No. Because of the unrestricted number that I showed you up above that's just under $26 million, when you take the unrestricted and the board-designated and the capitalized administrative expenses, the actual RBC, the effective RBC for HealthTrust, is 6.4.

Same thing in 2009. It dropped. And it dropped -- began -- that's the year in which the loss occurred at almost $9 million. And the loss notwithstanding, $4.4 million was distributed. But because the admin expense, the capitalized admin expense was still part of the mix in '09, that caused the RBC to be 4.8.

And then in 2010, two things happened. One, in '08, the unrestricted capital account was wiped out. It was also negative in 2010. And the admin capitalized arrangement dropped from $8.7 million to $500,000. So as a result of that, since reaching the target RBC that the board of LGC set back in '05, they didn't get back to their target level of 4.2 until 12/31/10.

Q. I know we'll go into this in more detail later, but is it your expert opinion that 4.2 is what this organization needs --

MR. SATURLEY: Objection.

Q. BY MR. VOLINSKY: -- of this capital --

THE PRESIDING OFFICER: One moment, Mr. Volinsky. There's an objection.

MR. VOLINSKY: I didn't finish the question.

THE PRESIDING OFFICER: Well, it wasn't going to get any better.

Mr. Saturley?

MR. SATURLEY: If I were to cross-examine Mr. Coutu at this point -- and obviously I'm not doing that -- but every part of his background and every expression that he's given with regards to his background and what he's done has to do with the property and casualty side of the insurance business.

This is a health insurance business that he's talking about. He's given you some glimpse into the differences between those two lines of business. Health is very different from property and casualty. He's given you some glimpse of that. I can give you some more and I will during his cross-examination.

But he's not been established as knowing what's an appropriate RBC for a health insurance company. I know they're both in the health insurance industry, your Honor -- or Mr. Mitchell. But I dare say that if I were -- if I -- It's like going to a dentist or an oral surgeon. They both look in your mouth. But they do very different things. It's like going to an internist or an oncologist. They both are concerned about what's inside you. They both have medical degrees. You wouldn't want an opinion from one on the topic of the other.

And you wouldn't want a lawyer who worked in the securities area to be trying a case about securities [sic]. And what I'm suggesting is that this gentleman has not been qualified to offer an opinion on the appropriate RBC for a company in the health line of insurance. That's my objection.

THE PRESIDING OFFICER: Mr. Volinsky, do you want to respond, sir?

MR. VOLINSKY: Yes, sir. You've heard a long explanation of what short tail line is and how you invest related to the maturities of your claims.

THE PRESIDING OFFICER: Correct.

MR. VOLINSKY: Mr. Coutu has an opinion, looking at the short tail line nature of health insurance, to which there is no objection, as to how overcapitalized this company is.

So based on the durations of short tail line insurance where you have a certain short-term need for cash versus having investments that go out three, five, ten years, he can tell us how much capital should be in this balance sheet based on all of their numbers. He's not going to quarrel with how they run efficiently or inefficiently.

He's going to look at the maturity levels of the claims versus the investments and offer an opinion.

THE PRESIDING OFFICER: Mr. Saturley, any rebuttal to that? If necessary.

MR. SATURLEY: Mr. Coutu has talked at great length about being a runoff guy. Mr. Coutu will concede when asked in cross-examination that the difference between the qualities that make you a runoff guy where you are not involved in underwriting and like tasks does not qualify you. They're different tasks. They're different qualities.

And what I am suggesting is that with regards to RBC, we've not heard anything that qualifies him as an RBC expert with regards to HealthTrust. And that's the opinion he's about to offer. Thus, he will acknowledge, if asked, that the RBC formulas that are run to determine those very numbers he's put up are done by complex formula and that they differ between the two industries, between the property and casualty field, the life field, and the health field. So that he -- and that he is not familiar with them.

So for him to skip over that step

with no actuarial training at all and no tendered qualifications in that field, for he has none, for him --

THE PRESIDING OFFICER: In which field, please?

MR. SATURLEY: The actuarial field.

THE PRESIDING OFFICER: Okay.

MR. SATURLEY: Which is what RBC concerns and where it comes from. And for him to then skip over that, that knowledge, that training, and that experience that actuaries have, and just to say, Well, from my lofty perch, I will say that this company in the health insurance industry, where I have never worked, it's appropriate for it to have the following RBC and none other, that, I think, sir, goes far beyond what our law permits with regards to an expert.

THE PRESIDING OFFICER: Okay. Mr. Volinsky, anything further?

MR. GORDON: Your Honor --

MR. VOLINSKY: I can --

THE PRESIDING OFFICER: Anything further in response to Mr. Saturley?

MR. VOLINSKY: Yes. I'm glad to lay as long a foundation as Mr. Saturley likes.

THE PRESIDING OFFICER: Well, then why don't you hold on and I'll recognize Mr. Gordon.

Mr. Gordon, could you come forward just a bit towards the microphone, sir. I'm sorry for that inconvenience.

MR. GORDON: The only point I would like to add --

THE PRESIDING OFFICER: You are objecting?

MR. GORDON: Yes. I am objecting. Because I thought that the question was specifically to LGC. I think the question was for this organization.

THE PRESIDING OFFICER: Um-hum.

MR. GORDON: And I think that the record will demonstrate that while Mr. Coutu has looked at the financials, he has not looked at any of the minutes of the organization, has not looked at any of the minutes that had the discussions as to why they reached the levels that they reached.

He didn't listen to any of the presentations by the actuaries and the consultants who provided information with regard to the establishment of the RBC. That is all part of the minutes of the exhibits here that you will get an opportunity sometime to be shown.

So I take objection to the specificity of the question for this particular organization because the record is that he has not studied at all any of the decision-making process, which is laid out in the minutes, as to why they got to where they got.

Does that make sense?

THE PRESIDING OFFICER: Everything makes sense, Mr. Gordon, but let me ask a question.

MR. GORDON: Sure.

THE PRESIDING OFFICER: Would that not go to the weight of his testimony as opposed to his ability to render the testimony, in that the minutes and other documents that you've just referred to would be specific to this particular operation and, therefore, would bona fide, or if you will, diminish the weight of his testimony?

MR. GORDON: I'm not foolish enough to say that that approach is wrong. But I do believe if you're going to be offering an expert opinion to a particular organization, that you as a gatekeeper in the first sense -- you could say, I'll let it in and give it whatever weight is due -- I understand that the gate can swing wide and open -- but I do think at the preface, at the beginning of that, that there should be a record demonstrated that he has looked at the documents by which this formulation was decided by a board.

It wasn't -- It was not that they were just counting up these numbers and then making that decision. There was a full discrete process by which that was reached. And I think it's a little misleading for him to just look at this chart and then say, This is what I think the RBC should be for this particular organization.

So I would say it is sufficiently off that you are appropriate in denying the introduction of that evidence or, as you suggested, understand that it is a snapshot of information and give it whatever weight it deserves.

THE PRESIDING OFFICER: These other documents that you referred to -- I heard you refer to minutes.

MR. GORDON: Yes.

THE PRESIDING OFFICER: What other documents besides the financial documents were you alluding to?

MR. GORDON: There would be calculations by Mr. Riemer by which he gave information to the board and then the board actually would have a dialogue as to what would be the appropriate RBC and why.

What are the factors that go into establishing the RBC. What are the needs of the organization which need to be addressed. What are the factors that they should be concerned about. What are the risks that they are seeing. All those discussions are taking place in documents that Mr. Coutu has not reviewed.

THE PRESIDING OFFICER: Mr. Coutu, you heard Attorney Gordon go down a list of documents. Are those documents in the realm of your knowledge that would be taken into consideration in calculating an RBC?

THE WITNESS: I actually reviewed the documents that are being alleged that I did not review.

THE PRESIDING OFFICER: All right. Thank you, Mr. Gordon.

Mr. Volinsky, before we -- Well, let me hear some additional foundation from you with respect to -- excuse me?

I'm sorry. Did you have something else to say, Mr. Gordon?

MR. GORDON: No. I actually didn't hear -- did he say that he reviewed them?

THE PRESIDING OFFICER: That was his representation.

MR. GORDON: It was not his deposition testimony, but I'll -- I'll just leave it at that.

THE PRESIDING OFFICER: Well, all I'm going to take for right now is what he's just said.

MR. GORDON: Okay.

THE PRESIDING OFFICER: All right. Was there something -- Were your comments along the same line Mr. Gordon was just reaching?

MR. SATURLEY: Yes. I couldn't understand what his answer was.

THE PRESIDING OFFICER: So we're all settled there then.

Back to you, Mr. Volinsky. Give me a little more foundation, and then we'll take a break. So give me about five minutes of foundation maximum and we'll take a break.

MR. VOLINSKY: Okay.

THE PRESIDING OFFICER: Come to the microphone, please.

Q. BY MR. VOLINSKY: Let's start here, Mr. Coutu. You have a long series of experiences working with RBCs in the companies that you ran; have you not?

A. I do.

Q. Now, the RBCs that appear on the chart, which is BSR 7, how are they determined?

A. The target RBC that is notionally 4.2, but with the administrative expenses is 4.7, is a calculation that's performed by the consulting actuary, Peter Riemer.

Q. That's the LGC consulting actuary?

A. Right. The LGC consulting actuary. The effective --

THE PRESIDING OFFICER: Could you please address the difference between calculating the RBC that you're familiar with and the point that's been raised in the objection about to what extent that might differ when considering a health insurance company?

THE WITNESS: Let me -- one of the minutes of the board -- Peter Riemer, who was, I'll use the word, a sponsor of the risk-based capital and benefits of using an RBC methodology -- Mr. Riemer also suggested various levels that would be appropriate for HealthTrust as respects of the amount of capital or surplus in the business.

And one of the benchmarks that he uses was that which is followed at that time -- this is going back to 2002, I might note, all right? -- that was followed by Blue Cross Blue Shield, which put the RBC calculation for his comments in the notes or the minutes between 4 and 5 percent -- 400 or 500 percent or decimal notation 4 and 5, 4.0, 5.0.

There is a fair amount of discussion at the board level over time, a lot of it in 2002, that talks about the evolution of the RBC and eventually gets to a recommendation made by Mr. Riemer that the board adopt 4.2 as the appropriate RBC level of surplus for the HealthTrust, which amount was ratified by the board, I believe in, again, 2002, maybe early 2003.

THE PRESIDING OFFICER: Mr. Coutu, my question is directed to the point of the objection, which I understand to be you are familiar with RBC calculation in insurance and areas of insurance other than health.

THE WITNESS: That is correct.

MR. VOLINSKY: May I --

THE PRESIDING OFFICER: Would you please explain to me the differences that would come into play from your experience with other lines of insurance and health insurance in this instance.

THE WITNESS: I believe I testified a bit earlier today in my testimony that --

THE PRESIDING OFFICER: Well, refresh my memory, sir.

THE WITNESS: -- that the NAIC Model Act promulgated different mathematical -- mathematical calculations for different lines of insurance.

THE PRESIDING OFFICER: Okay.

THE WITNESS: So the mathematical

calculation of RBC for healthcare is different than for property and casualty, and that both of them are different than life.

This is not a one-size fits all. Thought was given to what are the unique issues associated with healthcare. And based on that, the NAIC tailored the calculation of RBC for healthcare companies, property and casualty companies, and life insurance companies. Mike Coutu didn't. The NAIC did.

Second is there were refinements that were made in the healthcare calculations. And it wasn't until 1998 that those calculations -- that is, the healthcare calculation of RBCs -- were modified based on input from the Casualty America -- Casualty Society -- Actuarial Society and other professionals that are in the business of actuarial practice.

When that got done, then from 1998 to where we are today, that formulation for healthcare companies has not changed, to the best of my knowledge, other than one change. The one change that was made in the healthcare calculation says this. There's a ratio that's used to measure the profitability of insurance companies. It's called a combined ratio.

THE PRESIDING OFFICER: Okay. But we're not involved with that right now.

THE WITNESS: It does involve the RBC calculation.

THE PRESIDING OFFICER: It does. But that RBC calculation standard, if that term can be used, set by NAIC, you are just referencing -- would it be wrong to characterize it as an industry standard?

THE WITNESS: It is an industry standard.

THE PRESIDING OFFICER: Okay.

THE WITNESS: And so to close the comment, the industry standard says, for healthcare, if it's at an RBC of 2.0, or 200 percent, that the NAIC and the regulators which have adopted the NAIC model deem that insurer -- that healthcare insurer to be satisfactorily capitalized.

THE PRESIDING OFFICER: Your testimony was that the RBC was not an appropriate number. If I rephrase that to say that the RBC for the --

MR. VOLINSKY: For the LGC.

THE PRESIDING OFFICER: Yes. For the LGC. Thank you. -- HealthTrust -- or LGC.

MR. VOLINSKY: LGC HealthTrust.

THE PRESIDING OFFICER: If I'm to rephrase that to say that the NAIC standard exceeds or is less than what has been calculated, is that an accurate statement?

THE WITNESS: Well, clearly at 4.2, the 4.2 that was adopted by the board of LGC exceeds the NAIC presumption of capital adequacy at 2.0 by a factor of 2.2.

THE PRESIDING OFFICER: Okay. Thank you. Anything further?

MR. VOLINSKY: I just -- with some risk, let me just clarify what --

THE PRESIDING OFFICER: With some risk.

Q. BY MR. VOLINSKY: RBC in property/casualty is calculated in a particular way. RBC in healthcare is calculated in a different way.

A. Right.

Q. Do they both use the 2.0 or 200 percent standard in the same way?

A. Including life companies, yes.

Q. So they all use 2.0 or 200 the same way?

A. The matrix of how measured is the same.

The mathematical formulation is different.

Q. Got it. So the internal. But the standard is the same: property, liability, health --

A. Life.

Q. -- life? Okay.

THE PRESIDING OFFICER: He can testify. He can testify as to the RBC either meeting, exceeding, or being less than the NAIC standard.

Q. BY MR. VOLINSKY: In this case --

THE PRESIDING OFFICER: So it is denied.

MR. SATURLEY: May I --

THE PRESIDING OFFICER: Hold on. You know, that is my ruling. So let's take a break.

MR. VOLINSKY: Okay.

THE PRESIDING OFFICER: I've heard you both, you know, twice, twice. Take a break. Ten minutes.

(Recess at 3:42 p.m., resumed at 3:57 p.m.)

THE PRESIDING OFFICER: Having returned from the afternoon break, Mr. Volinsky, would you please continue with your questioning.

MR. VOLINSKY: Thank you.

Q. BY MR. VOLINSKY: Mr. Coutu, there's one other piece I wanted to ask you about with Exhibit 7 still up. We discussed that there was $25 million in unrestricted assets in 2008 and then you used the term "flipped" in '09.

Are you able to tell from the financial statements where the $25 million went?

A. I actually have an exhibit which can pencil out exactly those numbers. But to do rough justice --

Q. That's fine.

A. -- the $25,723,000 was supplied against -- or used to fund the loss -- where am I? -- okay. I'll give you another one. It -- $9 million rounded plus the 4.4, let's call that $13 million. Go back up the balance sheet. It also funded the increase here, about $9 million, and the board-designated $68 million to $78 million. And the balance was used in a combination of a decrease in assets -- excuse me -- a decrease in liabilities and an increase --

There are four or five different accounts which change from '09 to '10 -- excuse me -- from '08 to '09.

Q. Thank you. In the chart marked as BSR 7, you looked at three years' worth of financial statements and spreadsheeted them. Let me show you Exhibit 6.

THE PRESIDING OFFICER: Mr. Coutu, did you respond "yes"?

THE WITNESS: Yes. Excuse me.

Q. BY MR. VOLINSKY: Exhibit 6, would you do the same thing for the prior three years for all of the enterprises again?

A. Yes, but I would note just to be crisp, I did not spread financials for the real estate subsidiary. But they're spoken for as part of the LGC consolidated.

Q. So with that one proviso, is Exhibit 6 your spreadsheeting using the audited financial statements for these entities for the period '05 to '07?

A. That is correct.

MR. VOLINSKY: I move to strike the ID on 6 and for its admission.

THE PRESIDING OFFICER: Any objection on Exhibit 6?

MR. SATURLEY: No objection to the characterization of what it is. I do not accept necessarily the accuracy of the statements. But I don't object to it as what it's intended as being his summary.

THE PRESIDING OFFICER: Can I interpret that to be a similar objection that you had to 7; that is, you haven't been able to compare that with yours, see if it is complete?

MR. SATURLEY: Yes, sir, thank you very much.

THE PRESIDING OFFICER: Thank you. Just for my understanding.

(BSR 6 admitted into evidence.)

Q. BY MR. VOLINSKY: One more question on 6, the prior chart. Was that part of your expert report turned over in this case months ago?

A. This chart and the prior chart?

Q. Yes.

A. Yes. They're included in my expert report.

Q. Actually, was it Exhibit C to your expert report?

A. It was.

Q. Let's do one more just so I can get it into evidence. BSR No. 5, same kind of spreadsheeting based on the audited financials for all of the enterprises from '02 to '04?

A. With the same exception, I did not spread the numbers related to the real estate subsidiary.

MR. VOLINSKY: I move to strike the ID on 5 and for its admission.

THE PRESIDING OFFICER: With the same condition, Mr. Saturley?

MR. SATURLEY: Yes, please. Thank you.

THE PRESIDING OFFICER: Very good. Okay. Admitted with condition and we'll clear that up tomorrow or later in the proceedings.

MR. VOLINSKY: Thank you.

(BSR 5 admitted into evidence.)

Q. BY MR. VOLINSKY: I want to ask you about cash and noncash distributions. Did you create a chart of cash and noncash distributions?

A. I created a chart of the cash distributions. And in my expert report, I have a narrative of the noncash transfers.

Q. So let's talk about the cash first, okay?

A. Yes.

Q. Let me show you what we've marked as BSR 8,

04:02:40 Exhibit E to your report from a couple of months ago.
04:02:43 Is this the chart that you prepared about cash
04:02:46 distributions?

04:02:47 A. It is.

04:02:49 MR. VOLINSKY: I'd move to strike the ID of
04:02:52 8 and for its admission.

04:02:54 THE PRESIDING OFFICER: And with the same
04:02:55 proviso, Mr. Saturley; is that correct?

04:02:57 MR. SATURLEY: Yes, sir.

04:02:57 THE PRESIDING OFFICER: Thank you.
04:02:59 Admitted.

04:03:00 (BSR 8 admitted into evidence.)

04:03:03 Q. BY MR. VOLINSKY: As we did with Exhibit 7
04:03:06 a moment ago, or an hour ago, let's have you explain
04:03:09 what this chart is. I'll get it over here. So the
04:03:13 title of it is "Intercompany transfers '03 to '10."
04:03:20 And what's displayed on this chart?

04:03:21 A. What I did is from the time of the
04:03:24 reorganization, which was done in '03, through and
04:03:29 including 2010, by risk pool and, in this case, real
04:03:38 estate as well, is to chart how much in the way of
04:03:44 cash was distributed from these entities, "these
04:03:49 entities" being HealthTrust, Property Trust, Workers'

Comp Trust, Real Estate. And then I have a total distributions.

Q. And did you do that by year?

A. For each year '03 to 2010, inclusive.

Q. So the top line is distributions to LGC. And then the next line is HealthTrust. So distributions to LGC, I assume, means cash going to LGC?

A. In this particular exhibit, what we're looking at is only cash.

Q. And the line referring to HealthTrust, is that money going into HealthTrust or out of HealthTrust to --

A. Out of.

Q. So that we can remember, under the year, it's the amount of money distributed to LGC first and then the amount of money that came from HealthTrust next, right?

A. Correct.

Q. Is that what this shows?

A. Correct.

Q. So in '03 there's a blank line to --

A. No. That's just the title.

Q. Oh, I'm sorry. I apologize.

A. Longer speak, it would be distributions made by risk pools to holding companies.

Q. Got it. Okay. So in '03, what does that -- these are in thousands, so that's $3,900,000 --

A. Right. So in '03, HealthTrust distributed $3.9 million to LGC Holding Company. Property-Liability distributed one million four, rounded. And Workers' Comp Trust, zero.

Q. '04?

A. In '04, HealthTrust just over a million, $34,000 from PLT, $4,000 from Workers' Comp Trust. '05 --

THE PRESIDING OFFICER: Excuse me. The document can speak for itself with respect to those two lines unless you have another question.

MR. VOLINSKY: Let's go to the last line here.

THE PRESIDING OFFICER: Thank you.

Q. BY MR. VOLINSKY: The last column rather. What are those totals?

A. For the years '03 to 2010 inclusive, HealthTrust had distributed $31 million -- I'm going to round everything -- and PLT $3 million and Workers' Compensation Trust $300,000.

Q. And then total distributions are $34 million --

A. $35 million rounded. There was an intercompany transfer made that I picked up in the consolidating financials for Local Government Center, no details given. In the interest of erring on the side of being conservative, I netted that unexplained intercompany transfer from the total to get net distributions as $33 million.

Q. At the same time that these distributions were coming out of the risk pools -- HealthTrust primarily -- some from property, very small from workers' comp -- did you also find that the Local Government Center parent was contributing to any of the risk pools?

A. Yes, I did.

Q. And what did you find on that score?

A. If it pleases your Honor, we can scroll to the end results of all this, if you wish.

THE PRESIDING OFFICER: Whichever point you'd like to make.

Q. BY MR. VOLINSKY: There you go.

A. This line here represents capital contributions made by Local Government Center to the Workers' Comp Trust. Over the years under review, '03 to 2010, $18.3 million was distributed out of this pot monies as capital from LGC to Workers' Comp.

This second number, $3,524,000, is the capital contribution made by LGC in 2008 to its real estate subsidiary, all right? And the total of these distributions says that we can account for at this point between the real estate subsidiary and Workers' Comp of $22 million, part of $33 million collected.

Q. And then that leaves the $11 million figure. Where did that come from?

A. To be explained. I need to go up more.

Q. Yes.

A. This here section of the chart tells you where the remaining 11.7 went. And starting first with '03, for reasons I do not know, there was no income statement produced with respect to LGC on a standalone basis.

The rest of the years, '04 to 2010,

are showing what LGC operating results were on a standalone basis. These numbers here all indicate losses.

So with the caveat that I don't know what happened in 2003, I can tell you that LGC Holding Company -- again, on an unconsolidated basis, so this is a standalone -- has lost $7.5 million. So part of $11 million that was unaccounted in the chart immediately above went to finance the losses in LGC.

The remaining 3.955, call it $4 million, represents the increase in consolidated assets between this ending point in 2010 of $9.2 million, and then if you go to '03, in this starting point in '03 of $5,246,000.

Q. So the term you used, "consolidated net assets," this is what LGC parent --

A. I misspoke. I said "consolidated." This is LGC's carried investment in the underlying entities, not consolidated. Consolidated is a much bigger number.

Q. And so to go from here to here --

A. Is the $3.5 million -- $3.955,000. Then I had 275 that I just could not account for.

04:10:51 Q. So with the exception of the 275, you accounted for all of the $33 million contributed up to the parent?

04:11:00 A. Yes. I mean, in summary, the lion's share of this $33 million did two things. It subsidized the losing business model known as Workers' Comp Trust.

04:11:14 And then secondly, it financed the cost of having the holding company, which was created as part of the '03 reorganization.

04:11:31 Q. You said that you had a chart earlier to explain what happened to the $25 million of unrestricted net assets?

04:11:39 A. Again, this was the unrestricted net assets. Think of it as excess surplus, or excess of the targeted surplus. This was $26 million. And the application of that included, (a), funding the losses in '09, which is the $8.8 million; funding the distribution made by HealthTrust in '09, which is 4.4. Then there was the remaining $13.3 million, $9 million of which was used to bolster the net assets board-designated in the year-to-year review.

04:12:37 MR. VOLINSKY: Thank you.

THE PRESIDING OFFICER: Mr. Volinsky, would this be a good time?

MR. VOLINSKY: I was just going to suggest that this was the time.

THE PRESIDING OFFICER: Very good. Thank you, ladies and gentlemen. You're excused.

And the witness, as you may know, you're excused, expected to return tomorrow to the same place.

9:00 a.m. tomorrow, ladies and gentlemen.

That concludes our hearing for this afternoon. If counsel could remain for some technical feedback, as I am told is their desire.

Thank you.

(Whereupon, at 4:13 p.m., the proceedings were recessed, to reconvene on Tuesday, May 1, 2012, at 9:00 a.m.)

C E R T I F I C A T E

I, KIMBERLY A. SMITH, Certified Shorthand Reporter, Certified Realtime Reporter, and Registered Diplomate Reporter in the State of New Hampshire, do hereby certify that I reported in machine shorthand the proceedings had at the taking of the above-entitled hearing, held on the 30th day of April 2012, and that the foregoing is a true, complete, and accurate transcript of said proceedings as appears from my stenographic notes so taken to the best of my ability, and transcribed under my personal direction.

I further certify that I am a disinterested person in the event or outcome of this cause of action.

THE FOREGOING CERTIFICATION OF THIS TRANSCRIPT DOES NOT APPLY TO ANY REPRODUCTION OF THE SAME BY ANY MEANS UNLESS UNDER THE DIRECT CONTROL AND/OR DIRECTION OF THE CERTIFYING COURT REPORTER.

IN WITNESS WHEREOF, I subscribe my hand and affix my Certified Shorthand Reporter seal this 13th day of May, 2012.

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KIMBERLY A. SMITH, CSR, CRR, RDR