

SUMMARY OF  
REPORT ON LOCAL GOVERNMENT CENTER  
Bureau of Securities Regulation Investigation

August 2, 2011

- LGC illegally changed New Hampshire non-profit corporations into limited liability companies. The law on non-profit corporations does not allow them to merge with anything but another non-profit corporation. LGC “merged” the non-profit Pools with LLC’s.
- LGC used an illegal “umbrella” setup to run the Pools, by putting them under a non-profit corporate parent. Since LLC’s are “business entities” they cannot be deemed “non-profit” by putting them under a non-profit “parent”.
- LGC failed to return surplus to municipalities as required by statute. The very existence of Pools is based on the statute, RSA 5-B. The statute requires the return of “earnings and surplus”. LGC, over time, manipulated its claimed reserve requirement, increasing it by millions. It never directly returned any of the surplus to the municipalities, as the statute requires.
- LGC transferred a percentage of surplus to subsidize one pool at the expense of two others, while also creating a “strategic plan”, in violation of the statutory mandate to return surplus. In doing so, LGC further failed to properly segregate employer contributions from those of employees and retirees.
- LGC spent millions on items not authorized by statute. LGC is supposed to be a member-managed taxpayer-friendly pooling of risk, to reduce costs. However, HealthTrust has distributed millions to its parent and to the workers compensation fund as well as other spending for charitable giving, salaries, benefits, and other questionable spending, as well as contributions to affiliates.
- LGC used an improper “tying” agreement to force municipalities to buy into organizations not related to RSA 5-B. The statute is very clear on what is required to form and belong to a Pool. It does not allow preconditions be set on Pool membership. LGC and its subsidiary the NHMA are not, by their own definition, related to the mission of Pools.

## REPORT ON LOCAL GOVERNMENT CENTER

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This Report follows the Interim Report published October 28, 2010 concerning pooled risk management programs owned by Local Government Center, Inc.<sup>1</sup> Therein, four matters were discussed: 1) that member contributions to the pooled risk management program Local Government Center HealthTrust, LLC (HealthTrust) were being used to fund items and programs not health and employee benefits; 2) that member contributions to HealthTrust were being spent on non-health items; 3) that HealthTrust was using member contributions to fund expenses above and beyond those actually incurred in the running of HealthTrust; and 4) that earnings in excess of amounts required for administration, reserves, and other allowable expenses, were not being returned to political subdivisions. As the investigation progressed, details about the corporate organization of LGC, Inc., LGC Real Estate, Inc., and the limited liability companies formed to house the actual risk pools was reviewed, leading to concerns that their legal organizations were flawed. Additional information on the other LGC-related Pools was found which bore on the propriety of their formation, and especially, management.

In order to be a pooled risk management program, an organization must meet the statutory requirements set forth in NH RSA 5-B. Provided these requirements are met, the Pools are able to offer the insurance coverages noted in RSA 5-B:3, III (a – f) to municipal or public subdivisions, subject to no taxation, or regulation apart from statute.

Prior to 2009, the statute's only requirement was an annual filing with the Department of State, corporations division. There was no "penalty" associated with failing to submit the annual filing; rather, if there was no annual audit or annual actuarial evaluation filed, the Department was required to perform or cause to be performed the required audit or evaluation.<sup>2</sup> It then would be reimbursed the cost by the program. In 2009, for the first time ever, an amendment to RSA 5-B

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<sup>1</sup> Local Government Center HealthTrust, LLC (HealthTrust), Local Government Center Property-Liability Trust, LLC (PLT), the former Local Government Center Workers' Compensation Trust, LLC (Workers' Compensation has been subsumed by PLT.).

<sup>2</sup> RSA 5-B:5, II.

allowed the department of state, bureau of securities regulation to regulate pooled risk management programs. This amendment was challenged by LGC in the superior court and for over 5 months LGC refused to provide documentation requested by the bureau. Ultimately the court forced LGC to provide the requested information, though LGC continued the litigation. It was not until a further amendment to RSA 5-B was implemented, making even clearer the bureau's regulatory oversight did LGC drop the litigation and the investigation continued.

This report concludes that LGC has violated RSA 5-B. As was noted in the interim report, to exist as a pooled risk management program, certain statutory requirements must be met. LGC has not met them. In summary, it has been found that:

- LGC illegally changed New Hampshire non-profit corporations into limited liability companies. The law on non-profit corporations does not allow them to merge with anything but another non-profit corporation. LGC “merged” the non-profit Pools with LLC’s.
- LGC used an illegal “umbrella” setup to run the Pools, by putting them under a non-profit corporate parent. Since LLC’s are “business entities” they cannot be deemed “non-profit” by putting them under a non-profit “parent”.
- LGC failed to return surplus to municipalities as required by statute. The very existence of Pools is based on the statute, RSA 5-B. The statute requires the return of “earnings and surplus”. LGC, over time, manipulated its claimed reserve requirement, increasing it by millions. It never directly returned any of the surplus to the municipalities, as the statute requires.
- LGC transferred a percentage of surplus to subsidize one pool at the expense of two others, while also creating a “strategic plan”, in violation of the statutory mandate to return surplus. In doing so, LGC further failed to properly segregate employer contributions from those of employees and retirees.
- LGC spent millions on items not authorized by statute. LGC is supposed to be a member-managed taxpayer-friendly pooling of risk, to reduce costs. However, HealthTrust has distributed millions to its parent and to the workers compensation fund

as well as other spending for charitable giving, salaries, benefits, and other questionable spending, as well as contributions to affiliates.

- LGC used an improper “tying” agreement to force municipalities to buy into organizations not related to RSA 5-B. The statute is very clear on what is required to form and belong to a Pool. It does not allow preconditions be set on Pool membership. LGC and its subsidiary the NHMA are not, by their own definition, related to the mission of Pools.

The touchstone for existence as a pooled risk management group is the statute, RSA 5-B. The specific statutory obligations, and LGC’s errors, are detailed below.

## **CHAPTER 5-B: POOLED RISK MANAGEMENT PROGRAMS**

### **RSA 5-B:5 Standards of Organization and Operation. –**

**I. Each pooled risk management program shall meet the following standards of organization and operation. Each program shall:**

**RSA 5-B:5, I(a) Exist as a legal entity organized under New Hampshire law.**

Prior to 2003, the HealthTrust and Property-Liability pools were held in New Hampshire non-profit corporations under RSA 292. Each had a separate board of directors. The interim report observed that in 2003, there were anomalies in alterations to the Pools’ corporate format. In 2003, to achieve the end of having Local Government Center, Inc. oversee the Pools, the New Hampshire non-profit corporations then housing them purported to be merged with Delaware Limited Liability Companies (created for the purpose as shell companies). The Delaware LLC’s were themselves then merged with newly-created New Hampshire LLC’s. This scheme likely was used because New Hampshire law does not allow a non-profit corporation to be merged with an LLC (see, below). LGC has claimed that this stratagem of merging the NH non-profit

corporations with Delaware LLC's is both common and proper, given the less-sophisticated nature of New Hampshire law.<sup>3</sup>

Delaware authorities were informed that the New Hampshire entities being merged with the Delaware LLC's were "business trusts".<sup>4</sup> Delaware law allows statutory or business trusts to be merged with LLC's. We believe Delaware law forbids foreign non-profit corporations to be so merged.<sup>5</sup> A definitive answer is forthcoming.

Whether Delaware officials were misled by the erroneous recitation that what were being merged were "business" or "statutory" trusts, at some point in the process, the New Hampshire pooled risk management programs were not held in entities organized under New Hampshire law. This is clear given the explicit language of the Certificate of Merger of the Delaware shell LLC with the New Hampshire LLC's, recorded with the Department of State, corporations division on June 27, 2003, which recited that "[t]he effective date of such merger shall be the close of business on June 30, 2003.". When the New Hampshire non-profit corporations housing the pooled risk management programs were "merged" in Delaware on June 26, 2003, there was ostensibly no other "entity" holding title to the pooled risk management programs but the Delaware LLCs. The explanation given by LGC, that "... such a minor difference in effective dates does not alter the stated intent of the Boards to conduct a simultaneous consolidation ...<sup>6</sup> and that the gap between the Delaware merger and the effective date in New Hampshire "... technically created a gap of one or two business days ... "<sup>7</sup> admits the error. For a period of time, the LGC Pools did not "exist as a legal entity organized under New Hampshire law".

LGC claims further that since the parent corporation is non-profit, the subsidiary LLC is likewise. There are two problems with this claim: First, New Hampshire LLC law shows that an

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<sup>3</sup> Testimony of Mark McCue, Esq. to the House Finance Committee, April 30, 2010, page 56.

<sup>4</sup> Delaware certifications of Certificates of Merger dated 6-27-03.

<sup>5</sup> Delaware certificate of merger of New Hampshire Municipal Association Property-Liability Trust, Inc. into LGC-PLT, LLC dated June 26, 2003 paragraph 2: "An agreement of merger has been approved and executed by each of the domestic limited liability companies **or other business entities** which is to merge." (emphasis added)(A mirror-image form exists for the merger of HealthTrust, Inc. into "LGC-HT, LLC", the Delaware shell LLC.)

<sup>6</sup> LGC Response to the Department of State Interim Report page 3.

<sup>7</sup> Id.

LLC is a “business entity”, i.e., for-profit.<sup>8</sup> Second, the plain language of RSA 5-B:2, II(b) (the annual informational filing statute) requires that a list of current officers and their titles be included in the informational filing. LLC’s have “members” or “managers”,<sup>9</sup> not officers; only corporations have officers.<sup>10</sup>

But a more fundamental organizational problem arises upon a closer review of New Hampshire law. Within the New Hampshire statute governing non-profit corporations, RSA 292:7 limits the merger of a corporation organized under “this chapter”, to a merger with “any other corporation formed pursuant to **this chapter**.” (Emphasis added). Thus, a New Hampshire nonprofit corporation can merge with: 1) another New Hampshire nonprofit corporation; or 2) a foreign nonprofit corporation registered in New Hampshire. This statute does not authorize the merger of a New Hampshire nonprofit corporation with an LLC – either New Hampshire or foreign.

Moreover, RSA 292:7 requires that any merger be approved “by a majority vote of such corporation’s board of directors or trustees, **and by recording a certified copy of such vote in the office of the secretary of state ...**” (emphasis added). Neither HealthTrust, Inc. nor Property-Liability Trust, Inc. filed any such certified copies of their boards’ votes with the department of state, corporations division. Had they done so, the filing would have been rejected as the merger could not be authorized under New Hampshire law. As a result, the merger with the Delaware LLCs violated New Hampshire law.

The result, in law, is that because there was no merger of the New Hampshire nonprofit corporations with the LLC’s, the New Hampshire nonprofit corporations continued to exist. They then failed to file their required 5 year renewal in 2005. As a result, pursuant to RSA 292:25, in 2006 the entities’ charters were involuntarily “repealed, revoked, and annulled”.

RSA 292:29 provides for the disposition of corporate assets following such dissolution. It provides, among other things, that “the superior court may at any time when it shall be made to appear, upon the petition of any interested party, that the protection of proprietary or other rights

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<sup>8</sup> RSA 304-C:1, I-a.

<sup>9</sup> RSA 304-C:1, IX, X

<sup>10</sup> RSA 293-A:8.40

requires the doing of any act or thing by or in behalf of such corporation, order the doing of such acts or things, and for this purpose may appoint and authorize an agent to act for and in the name of such corporation.” RSA 292:29, III.

But more specifically concerning disposition of assets, RSA 292:29, IV notes that “[a]ll corporate assets and property are to be disposed of in accordance with the provision for dissolution as set forth in the articles of agreement, the bylaws, and in accordance with RSA 292:8 and 292:9”.

The original Articles of Agreement of the original organization housing HealthTrust, the New Hampshire Municipal Association Health Insurance Trust, Inc. (a New Hampshire Nonprofit Corporation) discuss distribution of assets upon dissolution. Article 3 provides for distribution of the corporate assets in the event of dissolution as follows:

“Upon dissolution or cessation of operations of the corporation, its assets remaining after payment of all of its obligations shall be transferred to the members of the corporation as provided in the Bylaws of the Corporation. No individual or for profit entity shall, by reason of such dissolution or cessation, receive or be entitled to any of the assets of the corporation.”

Identical provisions exist for the Property-Liability organization as well.

Note that at the time of the attempted merger, HealthTrust, Inc.’s minutes referred to the consideration of a “joint resolution”. The details of this “joint resolution” are recorded nowhere in the minutes. The “joint resolution” is not appended to the minutes. We are thus left to speculate as to what exactly was resolved.

It is for another day to determine the details of the assets held by the former non-profit corporations HealthTrust, Inc. and Property-Liability Trust, Inc. at the time of their demise, or what should properly be done with them, but since LLC’s are business entities and thus for profit, the assets of the original non-profit could not legally be transferred to them.

In sum, no legal entity currently houses RSA 5-B “LGC Pools”.

**RSA 5-B:5, I (b) Be governed by a board the majority of which is composed of elected or appointed public officials, officers, or employees. Board members shall not receive compensation but may be reimbursed for mileage and other reasonable expenses.**

Boards exist in NH in many contexts. Most commonly, a corporation has a board of directors. A trust may have a board of trustees. Prior to the changeover, the pools LGC now holds were each governed by a non-profit corporation, which necessarily had a “board”. These board members were then called “trustees”.

RSA 5-B:2,II requires that each pooled risk management group submit an annual filing with the secretary of state, and outlines what must be in the annual filing.<sup>11</sup>

A review of LGC’s annual filings with the secretary of state for HealthTrust, LLC, Property-Liability Trust, LLC from 2003 through 2010, and Workers’ Compensation, LLC (when it existed as a separate entity.) shows no claim that each LLC has a “board”. Rather, LGC claims that the “board” of LGC, Inc. suffices for its LLC’s as the “board” required under RSA 5-B:5, I(b). Yet this is far from clear. Limited liability companies do not have “boards”. According to the LLC statute<sup>12</sup>, they have “members” or “managers”. When Local Government Center HealthTrust, LLC was formed in 2003, the filing with the Department of State, corporations division showed no claim that LGC, Inc.’s board was the “member” or “manager”; rather, one John B. Andrews is listed as “member”. This is a far cry from the statutory mandate that a board consist of elected or appointed public officials, officers or employees.

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<sup>11</sup> 5-B:2.II” “Informational Filing” means an annual filing with the department made solely for the purpose of providing public access to certain information concerning the nature and organization of pooled risk management programs. Such informational filing shall be limited to the following:

- (a) The name and legal address of each pooled risk management program;
- (b) A list of current officers, their titles and addresses;
- (c) A brief description of the coverage provided;
- (d) The annual audit required under RSA 5-B:5, I(d);
- (e) A written plan of operation or bylaws; and
- (f) The annual actuarial evaluation required under RSA 5-B:5, I(f).

<sup>12</sup> 304-C:1, IX, X

Claimed use of the “board” of LGC, Inc. as the “board” for the governance of each Pooled Risk Management Program limited liability company, as required by RSA 5-B:5,I(b), is improper.

Another facet of the original format for the LGC Pools is that the original board members were considered “trustees”.<sup>13</sup> Trustees are fiduciaries of the organization. As a fiduciary, “... [a] trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. ...”.<sup>14</sup> As each member of the current “board” does not claim trustee status, there is not the same level of obligation to the organization. A board member owes the organization the obligations of good faith and fair dealing.<sup>15</sup> A trustee’s standard is higher.

Furthermore, LGC has consistently claimed in its annual filings that it is governed by a board of “31 members”, listing this obligation in its bylaws<sup>16</sup>. But at no time since its founding eight years ago has the board held its full complement of members, from a high of 30 to a low of 25. In addition, a review of the minutes of the board shows that fewer still show up. For example, the minutes of the Board of Directors Meeting of October 13, 2010 show 16 Board members present and voting.<sup>17</sup>

The statute further forbids board members from receiving compensation for their services. However, current LGC bylaws allow for compensation: “SECTION 6.14 Compensation of Directors. The Directors may pay themselves reasonable compensation for services as Directors and reimburse themselves for reasonable expenses properly and actually incurred in the course of acting as Directors.”<sup>18</sup>

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<sup>13</sup> For example, the minutes of the HealthTrust board of November 25, 2002 is entitled, “Board of Trustees Meeting”.

<sup>14</sup> Appeal of Corporators of Portsmouth Sav. Bank, 129 N.H. 183, 203 525 A.2d 671, 685 (N.H. 1987) citing *Meinhard v. Salmon*, 249 N.Y. 458, 464 164 N.E. 545, 546 (1928) (quoting *Wendt v. Fischer*, 243 N.Y. 439, 444, 154 N.E. 303, 304 (1926)).

<sup>15</sup> RSA 293-A:8.30.

<sup>16</sup> Bylaws Article VI Section 6.1

<sup>17</sup> LGC Board of Directors Meeting of October 10, 2010, Staff and consultants present for this meeting numbered 14.

<sup>18</sup> LGC Website. Note that of the 27 members of the 2011 board (as listed on the LGC website), 14 are professionals, e.g., superintendents, town managers, assistant town managers, administrators, deputy town clerk, register of deeds. If the professionals are recompensed by salary, and part of their duties includes service on the LGC board, they are “compensated” in violation of the statute.

As noted above, the status of the legal entities which house the “LGC Pools” is nonexistent.

**RSA 5-B:5, I (c) Return all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions.**

Measuring “reserves” from “surplus”<sup>19</sup>

As was noted in the interim report, RSA 5-B:5,I(c) allows a pool to retain prudent reserves, while requiring the return of “earnings and surplus” to the member municipalities. Insurers typically engage an actuary to analyze the risks and recommend a reserve. There are different methods of analysis, to determine what is to be prudently retained. These may be based on the differing risks associated with the various insurances described in the statute<sup>20</sup>. Given that different insurance risks require different analyses, there is no one actuarial method which would apply across all insurance lines. Thus actuarial analyses vary both within and across lines. It seems evident that if two different actuarial methods are equally creditable, and one assures sufficient safety at a lower figure than the other, the actuarial method which assures safety at the lower figure is the one to follow.

Who determines the line between surplus and reserve? The statute does not say. It simply says that the Pool **shall return** all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions<sup>21</sup> (emphasis added).

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<sup>19</sup> Much of the following information is taken from the annual filings required by RSA 5-B:1. In the actuarial filings and the accounting filings, the actuaries and accountants have listed significant limitations on the use of the information in the annual filings, due to their being “executive summaries,” or because they were intended for the use of LGC management alone, or because they contain work product, etc. For example, the actuary Towers Perrin’s executive summary actuarial distribution for HealthTrust/PLT annual 5-B:5, I(f) filings allow submission of the report to NH authorities but restricts further distribution. It is the view of this agency that information submitted in response to this statutory obligation is public. Further, as to the cautions that the annual filings to the department of state, corporations division are in some fashion unreliable without the complete report, this begs the question whether, with this limitation, the materials submitted by LGC in an effort to meet the statutory obligation of RSA 5-B:2, fail to do so.

<sup>20</sup> RSA 5B:5, III(a-g)

<sup>21</sup> RSA 5-B:5,I(c)

Historically, HealthTrust (when it was a non-profit corporation) sought to keep 20% of claims as a reserve<sup>22</sup> However, according to LGC's actuary, HealthTrust had not held 20% in reserve since 1994<sup>23</sup>. In 2002, it held approximately 10%. There was no discussion that this figure was insufficient. LGC's actuary then proposed that HealthTrust accept as a measure of reserves the concept "Risk Based Capital" or "RBC".

Risk Based Capital (RBC) is a commercial insurance concept. It was created by the National Association of Insurance Commissioners and finds its most common application in state regulation of for-profit insurance companies, not "non-profit" pooled risk entities<sup>24</sup>. It is meant as a measure of regulatory failure, not health, as it requires regulatory intervention at a 2.0 level, with increasing regulatory intervention up to and including receivership as the level decreases. RBC was intended as a regulatory trigger for state regulators, not for management of surplus<sup>25</sup>. HealthTrust's own actuary noted at one point that "[a] RBC formula is a minimum and not a recommended level".<sup>26</sup>

According to LGC's actuary, in 2002 the health care organization (HealthTrust, Inc., a New Hampshire non-profit corporation), was then holding reserves of \$19 million, approximately 10%, or an RBC of 2.1. In recommending "RBC", the actuary equated HealthTrust with an insurance company. He then recommended HealthTrust maintain a level of RBC of 4.2, raising the reserve to this level by increasing the standard rating risk charge from 3% to 5%.<sup>27</sup> He noted that as HealthTrust built up the surplus, it could then use the this built-up surplus "to invest in other activities normally supported by a surplus, e.g., marketing initiatives and product development"<sup>28</sup> He said that investing in such activities while simultaneously closing the

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<sup>22</sup> Letter from Peter Reimer to Wendy Parker dated November 7, 2002.

<sup>23</sup> Id.

<sup>24</sup> See, e.g., RSA 404-F. Mr. Reimer himself "noted that RBC is a formula-based approach to determining minimum capital and surplus levels for insurance companies" (emphasis added) HealthTrust, Inc. Minutes of the Finance Committee, November 14, 2002, page 5.

<sup>25</sup> See, article, "How Much is Enough? Capital and Surplus Management for Health Entities", in The Record, Volume 29, No. 2.

<sup>26</sup> Letter from Peter Reimer to Wendy Parker dated November 7, 2002. Note also Mr. Reimer's statement that "RBC action levels are minimums intended solely to identify undercapitalized plans and was never meant to be a control." Board of Director's Meeting July 10, 2008, page 4.

<sup>27</sup> Letter from Peter Reimer to Ms. Wendy Parker dated November 7, 2002; see also, minutes, HealthTrust, Inc. Board of Trustees meeting November 25, 2001, pp. 2-3.

<sup>28</sup> Id.

“Member’s Balance gap”<sup>29</sup> would require additional funds. LGC’s board later accepted this recommendation, adding an additional .5 RBC for “administrative” purposes.<sup>30</sup> Despite generalized concern that some catastrophe could occur, again, it was never claimed that HealthTrust has come close to insolvency at a 10% reserve.

In 2002, it was estimated that it would take 5 years to increase reserves to a 4.2 RBC level. Management announced it had reached 4.2 RBC at year’s end 2007<sup>31</sup>.

#### Alternative methods of measuring surplus vs. reserve

Risk Based Capital, though, is not the only measure of “surplus”. The legislature had considered straight percentage limitations on reserves in 2010. It suggested that Pools be limited to 10% over what is required to fund the unpaid portion of the expected losses (approximately the same as held by HealthTrust in 2002). In 2010, according to LGC’s actuary, this would have worked out to a limitation of reserves of \$39.7M. According to LGC’s employee, at the end of 2008 the reserves were \$94M.<sup>32</sup> At the end of 2009 they were \$78M, as a result of planning to return \$13.5M through claimed rate reductions (not return of surplus to the members). In other words, there was surplus not returned because LGC’s management found another use for it.

In 2010, the legislature required this office to contract with a properly qualified actuary to make specific recommendations on the proper method of measuring reserves<sup>33</sup>. After review of qualified organizations, Segal was chosen<sup>34</sup> in the health care context. Their recommendation, detailed below, suggested measuring prudent reserves using a concept called “Stochastic Modeling”.

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<sup>29</sup> Id.

<sup>30</sup> Annual filing, HealthTrust LLC, 12-31-08 pp 8-9. NB: in 2005’s annual filing, there was no mention of the additional “.5 RBC for Administrative purposes”; this was added in 2006 although it was described as a fixed figure (7.1 million) and not as the percentage. In 2010, the Administrative .5 RBC has been replaced by a flat \$500,000.00.

<sup>31</sup> Annual filing, HealthTrust, LLC, 2007.

<sup>32</sup> Testimony of Jonathan Steiner to the House Finance Committee, April 30, 2010, p. 33.

<sup>33</sup> RSA 5-B:5,1

<sup>34</sup> Segal’s actuaries are members of the Society of Actuaries, the American Academy of Actuaries and other professional actuarial organizations, and collectively meet the “General Qualification Standards for Standards of Actuarial Opinion” to render the actuarial opinion requested.

Actuaries from Segal considered RBC and other methods as ways of measuring “surplus”, and compared them with Stochastic Modeling, or Method. As the Segal actuaries noted, Stochastic Modeling represents a more complex and detailed approach to calculating risk. It accounts for variations in factors affecting actuarial models and can attach probabilities to outcomes. As a result, Stochastic Modeling provides more information that can be used to determine appropriate reserve levels. Segal noted that Stochastic Modeling is in wide use in measuring plan solvency and achieving target surpluses.

Segal used Stochastic Modeling to analyze the amount of reserve (or surplus, as Segal refers to it) maintained by HealthTrust in 2009, comparing the RBC method with the Stochastic Modeling method. It found two things: first, that with an RBC ratio of 4.2 (this ignores the additional .5 RBC LGC retained for administrative costs), reserves for 2009 would have been \$69.2 million; second, that HealthTrust actually retained \$79.5 million. Using Stochastic Modeling at a 95% confidence level, Segal found that HealthTrust’s target reserve level should have been \$40.8 million. At a 99% confidence level (the “hundred-year flood” scenario), the target reserve level should have been \$59.1 million<sup>35</sup>.

In late May, 2011, LGC released the March 3, 2011 report of an actuary it hired to critique the Segal recommendation<sup>36</sup>. Among other things, this report again claimed that the insurance standard RBC was appropriate for a pooled risk management plan (which by definition is not an insurance company). Yet among the many facets of this report was the admission that HealthTrust holds an additional reserve amount on its balance sheet called capital, surplus or risk reserve.

First, when a statute entirely separate from insurance laws creates “pooled risk management programs” and specifically defines each as “... not an insurance company ...” (RSA 5-B:6,I), reference to insurance statutes is irrelevant.

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<sup>35</sup> December 29, 2010 Segal Report

<sup>36</sup> Milliman Report “Target Capital/Surplus for Healthcare” dated 3-3-11 by Catherine Murphy-Brown, FSA, MAAA (NB: this opinion cost LGC over \$27,000.00)

Second, there is no dispute that a pooled risk management group needs adequate reserves. As alluded to above, the “million dollar question” is the dividing line between prudent reserves and surplus. LGC’s Milliman report notes that “as a general rule, HealthTrust targets a capital/surplus level of 420% of ACL” (4.2 RBC). Yet in comparing LGC’s surplus to the Segal recommendation, even Milliman notes Segal’s “Maximum Level of Capital (99% Confidence) would have been \$18 million *less* than LGC actually held in 2009. This would have been enough to cover the “bad year” of 2009 with its \$14.3 million loss, even without considering the “good investment returns” that year<sup>37</sup> It is further noted that the “capital” held by LGC, \$77.1 million<sup>38</sup>, were above even LGC’s claimed sufficient level of 4.2 RBC, being 4.64 RBC<sup>39</sup>.

#### Further Analysis by Segal

In view of the LGC Milliman Report, an opinion from Segal was sought as to the propriety of using RBC as a reserve mechanism, and further analysis and comparison of RBC and Stochastic Modeling. Segal’s opinion, dated July 28, 2011, discusses the matter<sup>40</sup>. As can be seen in the accompanying table, in virtually every year since 2003, using a 95% confidence level, Stochastic Modeling would have allowed LGC to hold prudent reserves at levels significantly less than RBC. In view of the fact that LGC often held more in reserve than RBC would dictate, even more significant savings would have resulted. For example, in 2008, Stochastic Modeling would have allowed a reserve of \$34.1M. LGC actually held \$92.7M, a difference of \$58.6M. In 2007, the Stochastic Model would have set prudent reserves at \$31.3M, with LGC holding \$91.5M, a difference of \$60.2M. In 2006, the difference between Segal’s model and LGC’s holdings would have been \$48.6M.

As noted above, different risks require different actuarial analyses. LGC’s Property – Liability Trust, LLC’s actuaries in their annual filings claim to have conducted between 5 and 6 different actuarial analyses. In the workers’ compensation coverage, the LGC actuaries used five<sup>41</sup>. It is

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<sup>37</sup> Note that Milliman does not detail those gains.

<sup>38</sup> Segal concluded HealthTrust held \$79.5 million

<sup>39</sup> December 30, 2010 Segal Report

<sup>40</sup> July 28, 2011 Segal Report

<sup>41</sup> See, e.g., Local Government Center Property Liability Trust Executive Summary – Estimated Liabilities as of December 31, 2006, p.5.

not clear why so many analyses were conducted, nor is it clear why the actuarial method which concluded the least amount of money was sufficient wasn't used.

LGC further claims that a pool is entitled to retain not only "reserves" but also amounts necessary for "projected needs of the plan". It argues that RSA 5-B:5, I(f) allows the pool's management to assess adequacy of contribution. It claims that "the statute does not impose a reserve level, but has traditionally relied upon the risk pool boards, comprising member representatives, in consultation with their qualified actuaries, to determine the appropriate level of reserves for their membership, based on their experience and informed judgment."<sup>42</sup> It is noted that "traditional reliance" is because there was no regulation built into the statute from the beginning.

Read as a whole, the plain language of RSA 5-B supports a contrary view. RSA 5-B:5, I (c) speaks of return of earnings and surplus in excess of amounts required for administration, etc. This clearly contemplates that a dividing line be drawn between those amounts required to run a Pool and those above that level. LGC concedes it has held surplus which it has never directly returned to members. In raw numbers, the breakout for HealthTrust is as follows<sup>43</sup> This compares reserves computed as percentages, RBC and Stochastic Modeling.

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<sup>42</sup> LGC Position Paper dated December 20, 2010.

<sup>43</sup> This is a comparison of what reserves would have been under the four scenarios.

Calculating "Targeting Reserves" using RBC and Segal Methodologies

Year	A		B		C	C/A	D	D/A	Segal Target, 95% Conf. Level (1)
	Claims Incurred	Unrestricted/Restricted Net Assets/Member Balance (2)	RBC Factor Used (3)	Estimated Targeted Reserves at 10%					
2000	\$ 106,767,146	\$ 19,909,840	No	\$ 10,676,715	10.0%	\$ 21,353,429	20.0%		
2001	\$ 128,997,214	\$ 15,888,695	No	\$ 12,869,721	10.0%	\$ 25,739,443	20.0%		
2002	\$ 164,665,996	\$ 18,538,701	2.8%	\$ 16,466,600	10.0%	\$ 32,933,199	20.0%	\$ 16,600,000	
2003	\$ 194,157,534	\$ 23,943,922	2.6%	\$ 19,415,753	10.0%	\$ 38,831,507	20.0%	\$ 19,200,000	
2004	\$ 220,087,671	\$ 39,377,881	3.6%	\$ 22,008,767	10.0%	\$ 44,017,534	20.0%	\$ 21,400,000	
2005	\$ 247,269,588	\$ 56,307,448	4.5%	\$ 24,726,959	10.0%	\$ 49,453,918	20.0%	\$ 26,600,000	
2006	\$ 266,905,251	\$ 77,014,350	6.0%	\$ 26,690,525	10.0%	\$ 53,381,050	20.0%	\$ 28,600,000	
2007	\$ 285,553,084	\$ 89,574,320	6.7%	\$ 28,555,308	10.0%	\$ 57,110,617	20.0%	\$ 31,300,000	
2008	\$ 307,066,394	\$ 94,033,751	6.4%	\$ 30,706,639	10.0%	\$ 61,413,279	20.0%	\$ 34,100,000	
2009	\$ 352,831,908	\$ 77,128,164	4.8%	\$ 35,283,191	10.0%	\$ 70,566,382	20.0%	\$ 40,800,000	
2010	\$ 356,801,759	\$ 83,437,911	N/A	\$ 35,680,176	10.0%	\$ 71,360,352	20.0%	N/A	

(1) 2002 represented the year before HealthTrust began using the RBC Methodology as a reserving benchmark.

(2) Excludes \$31.1 million HealthTrust distributed to LGC between 2002 - 2010

(3) Per Segal Report 7-28-2011

From the above, it can be seen that when reserves were pegged to claims, HealthTrust never came close to its claimed target of a reserve of 20% of claims. Nonetheless it flourished. When RBC became its standard, reserves increased significantly. Listed below are some of the things which were done with the excess surplus, none of which are supported by the statutory language.

## SURPLUS

If one were to accept the analysis of LGC that RBC is the proper measure of surplus, and that 4.2 RBC is the proper level of RBC, then there is no surplus. But note that LGC claims an additional half a percent RBC for administrative purposes. This puts LGC's surplus at 4.7 RBC. For 2009, this additional half percent equaled \$8,732,451.<sup>44</sup>

Recall that in 2002, HealthTrust held approximately 10% of claims as reserve. Had that applied to 2009, HealthTrust's reserve would be \$35,283,191. HealthTrust held in 2009 reserves of \$77,885,039. Thus, with a 10% reserve limitation, HealthTrust would be deemed to hold \$42,601,848 in excess of reserve. Stochastic Modeling would require a reserve of \$40.8 million.

## **MISUSE OF SURPLUS**

### Surplus Used to subsidize Future Rates

LGC notes that it has used "surplus" to subsidize future insurance rates, claiming that the statute's language allowing it to retain "... amounts required for administration, claims, reserves, and the purchase of excess insurance..." contemplates this. Yet the plain language of the statute does not speak to this practice. It says earnings and surplus must be returned. It does not say that subsidizing future rates is an administrative cost, or a claim, or reserves, or the purchase of excess insurance. LGC's position illogically would then mean that a community wishing to leave LGC and secure coverage elsewhere must forfeit its portion of the "surplus", which then gets

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<sup>44</sup> In 2010 LGC has abandoned the .5 RBC and simply added \$500,000 for Administrative Expenses.

applied to reducing the remaining communities' rates. The plain language of the statute does not authorize this year-over-year retention of monies, and these funds must be returned to municipalities.

### The "1%"

LGC has admitted that in 2007 it transferred what it claims was "1% of employer contributions" from HealthTrust to LGC, totaling \$2,746,202.60, plus an additional \$1,754,678.56. It further admits that in 2008 it transferred 1% of its employer contributions from HealthTrust to LGC, totaling \$2,876,145.13 plus an additional \$762,866.32. It admitted that between 2004 and 2008, HealthTrust alone contributed over \$14.5 million to the "strategic plan".<sup>45</sup> Clearly, if a pool has enough money to take 1% from one pool and transfer it to another, or to create a "strategic plan," including salary increases and establishing a defined benefit retirement plan (see below), as opposed to supplying the insurance coverage contracted for, it has surplus. The statute requires the return of surplus to the participating political subdivisions.

That LGC agrees it improperly transferred money is seen in the recent resolutions of LGC's Board of Directors. On June 2, 2011, LGC issued two Votes of the Board of Directors, in which it was resolved that the "1%" taken from HealthTrust and used to support worker's compensation would be returned, via a note, payable over time to HealthTrust, out of workers' compensation surplus, if any exists. Clearly this is an acknowledgement that the money was improperly taken in the first instance. Apart from the illusory nature of the deal, this begs two questions: first, is this surplus money then going to be returned to the cities and towns from which it was taken; and second, how can "surplus" be used for this, when "surplus" is to be returned to the member communities.

Note further that these resolutions do not address the monies taken from Property-Liability Trust, LLC or the workers' compensation fund for the strategic plan. Calculation of these funds together with the HealthTrust takings for the years 2004 through 2008 shows a total of \$19,228,760. Figures for 2009 were unavailable.

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<sup>45</sup> LGC website

LGC must repay municipalities these funds.

The 1% as misuse of employee contributions

When communities purchased health coverage from HealthTrust, they provided funds which came both from the community employer and from the employee. The charge has been made that LGC used employee funds as part of 1% skimmed from both the health and the property-liability funds to start and subsidize a workers' compensation Pool and for other purposes. In answer to this charge, LGC provided information from 2004 and 2007 from which analyses had been done to determine a percentage of the premium which could be attributable to the employee's contribution, and efforts were made not to utilize this percentage in taking the 1%.

LGC explained that the data from which the 2004 determination was made was no longer available due to a computer malfunction. The information LGC provided was from a re-creation of the data. At that time, the percentage LGC attributed to the employee portion of the premium was 12%. In 2007 another determination was made; the supporting data was retained and LGC determined that the employee portion of the contribution was 18%. No calculation determining estimated employee contribution was made in 2005, 2006, 2008, 2009 or 2010. LGC has not explained why this was not done on an annual basis. We are thus left with only the incomplete calculations of LGC supporting the view that no employee or retiree contributions to health care premiums were used to subsidize the creation and support for its workers compensation pooled risk coverage.

Another view has held that since healthcare was a bargained-for benefit, the whole of the benefit belongs to the employee. This is especially true where salary raises were denied due to the rise in healthcare costs, and the value of the health coverage was considered part of the employment "package". Under this scenario, the use of any surplus funds from the healthcare fund would be improper.

As to retirees, between 2004 and 2007 100% of retiree-paid premiums went towards health care costs, as retirees' health insurance is not subsidized by their former employers. Thus any retiree contribution to HealthTrust utilized for the workers compensation Pool was improperly taken<sup>46</sup>.

The LGC board recognized that it was creating a conflict with the interests of employees and employers and said that consideration should be given to segmenting funds. There was concern that employee money could be used to support a property-liability program to defend a town against a lawsuit brought by or on behalf of an employee. Yet, as noted above, no consistently reliable analysis concerning the segmentation or segregation of employee contributions from the 2% taken for workers compensation was done, and the idea that the whole of the health care benefit (whoever paid for it) was part of the employee compensation and thus not to be "borrowed" was not accepted.

Furthermore, as to the "employer" contribution, there is no showing there ever was an agreement by the municipalities that their contributions to one line of coverage to be used for another line, or for purposes apart from the purchase of the specific coverage bargained for. This is evident in the Position Paper issued by the City of Portsmouth on Return of Surplus Health Insurance Premiums under letter dated November 19, 2010, and the Town of North Hampton's publicized demand for return of similar funds. The only discussion of the issue appears to have been at the level of the LGC board. To reiterate, if there is enough money to siphon off sums for purposes apart from health care or property-liability coverage, there is more than is needed for these coverages. This is surplus. For both the reason that this is surplus, and that municipalities did not agree to this diversion of funds, sums used for this purpose must be returned to the cities and towns.

Concerns have been raised that, if LGC is required to repay the monies taken to prop up its workers' compensation line or the strategic plan, LGC could be put in financial peril. As noted above, it would appear that a sizeable sum is immediately available for this purpose, by means of the proposed alternative method of delineating surplus which would immediately free up between 40 and 60 million as measured in 2009, via measuring the reserve by Stochastic

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<sup>46</sup> LGC claims it segregated these funds.

Modeling. LGC's reserves increased in 2010 and more money is available<sup>47</sup>. HealthTrust's 2010 annual filing shows it holds securities and cash and cash equivalents totaling \$104,364,569<sup>48</sup>.

### Improper Spending

One question raised by LGC's record of expenditures has been their propriety. Close analysis of 2006 spending showed many questionable expenses. Following the release of the Interim Report, LGC properly criticized that analysis as focusing only on expenditures, and not on corresponding revenues. Following this criticism, LGC provided a list of offsetting revenues for 2006. These showed that many of the catering and entertainment expenses were offset by receipt of monies from the municipal groups for which the catering and entertainment were provided.

Upon closer review, it appears that the bulk of the 2006 spending is on a "pass through" basis, in that as LGC expended funds, it received funds from the various sources attending the event. For example, many of the catering expenses are expenditures which the various governmental entities that attended the meetings or trainings repaid. The invoices from First Impressions Caterers for catering provided in the May-June 2006 time frame are variously invoiced by LGC to the organizations which attended, such as the NH Association of Regional Planning Committee, the NH Public Works Mutual Aid Program, or the NH Municipal Managers Association. The Red Jacket Resort invoice for \$7,639.01 for the NH Municipal Managers Meeting of 5-25-06 was invoiced by LGC to the NH Municipal Management Association. Other expenses associated with catering are charged off to one or more of LGC entities for various meetings. It is beyond the present scope of this report to determine whether taxpayer funds were provided to these various other associations to repay LGC and if so, whether this was a proper use of these other funds.

Whether certain of these accounts were "pass through", it required the time and efforts of LGC personnel to set up the affairs and to account for their repayment.

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<sup>47</sup> HealthTrust, LLC RSA 5-B annual filing 2010.

<sup>48</sup> Id. In any event, LGC has shown it can consider options for the return of monies, as is evident through the method, weak as it is, it determined to implement in returning money to HealthTrust from Workers Compensation.

But there are also expenses for various charitable sponsorships, such as \$3,000.00 for the 15<sup>th</sup> Annual Special Olympics NH Chief of Police Golf Tournament, marked “4-Way Split”<sup>49</sup> \$2,000.00 for sponsorship for the SEA Road Race & Fitness Walk on 4-7-07 (“Master Sponsor” level, the highest) charged to LGC, and \$5,000.00 “Gold Sponsorship” for a NH Excellence in Education event on 6-10-06, marked “4-Way Split”.

*Any* charitable giving by this taxpayer-funded organization is questionable. These expenses are not justified as “required for administration, claims, etc.” under RSA 5-B:5,I(c) and sums thus spent are to be returned to cities and towns.

Request was made for the same sort of detailed accounting for income for 2007, 2008, 2009 and 2010. Received was an accounting for 2007, 2008, and 2009, though not in the same format as the 2006 income, making it difficult to assess whether and to what extent these sums are proper. A later accounting shall be undertaken to obtain details of this spending.

Complaint has also been made that employees of LGC are overpaid for the positions they occupy. LGC provided a “position paper” on December 20, 2010, in which certain board members express the opinion that salaries for LGC employees are reviewed and compared with similarly-situated outside employees, and that based on the board review, LGC employees are not inordinately compensated. No exhaustive comparison of job title salaries between LGC workers and outside workers has been undertaken.

Analysis of HealthTrust’s RSA 5-B:2 filings between 2002 and 2009 show certain “distributions to parent”. These include distributions to parent for property purchases totaling \$4,302,092 (without note in the financial statement); distributions to parent for “building improvement” of \$100,000.00 (without note in the financial statement); and distribution to parent – investment in LGC Real Estate and workers compensation LLC of \$3,930,370. These expenses, totaling \$8,332,462 are not related to proper purposes as defined by RSA 5-B:5,I(c).

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<sup>49</sup> “4-way split” is LGC’s accounting method whereby the cost is divided among HealthTrust, PLT, WC and LGC (at the time).

Additional questionable spending involves amounts spent on outside experts. For example, despite employing six of its own attorneys, in 2006 LGC spent over \$185,000.00 on lawyers. In litigation on the right-to-know law with the Professional Firefighters of NH, LGC was ordered by the court to repay the firefighters' attorney's fees.

### Creation of Defined Benefit Plan

Prior to 2007, employees of LGC participated in a *deferred compensation* retirement plan, in which employees could divert a certain portion of their compensation away from direct receipt and thus immediate taxation. There was no employer contribution. In 2007, the "board" decided to accept the proposal of then-executive director Andrews to establish a *defined benefit* retirement program. This was done using \$2,561,747 of LGC employer money<sup>50</sup>, matched with the accumulated deferred compensation contribution of any employee wishing to join the defined benefit plan. This money was required to establish a funding mechanism to provide the payments. As an ongoing expense, LGC must now pay 7.25% while employees must pay 5%.<sup>51</sup>

Mr. Andrews receives \$73,500.00 per year in retirement.<sup>52</sup>

The funding to establish and continue this defined benefit plan must be returned to the cities and towns.

### Error in Submission of Medicare Application

LGC HealthTrust had taken responsibility for applying to the Centers for Medicare and Medicaid Services for Medicare Part D subsidy funds in connection with retiree prescription drug plans for certain of its members. In order to receive the Medicare Part D subsidy, HealthTrust was supposed to file an application by a specified deadline. In 2009, HealthTrust filed the application

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<sup>50</sup> Annual filings for 2007 and 2008: includes \$1,798,917 as LGC's contribution to fund the Plan plus \$762,830 to fund past service liability expense.

<sup>51</sup> According to the 5-27-11 NH Union Leader article, this defined benefit plan is only 80.46% funded.

<sup>52</sup> Article, NH Union Leader, May 27, 2011

late. The application was denied. HealthTrust was forced to reimburse those members on whose behalf it was supposed to act, the amount of the subsidy, \$2 million.<sup>53</sup>

After appeal, the subsidy was granted. LGC is now looking for repayment from the members it repaid<sup>54</sup>.

#### Securities Regulation Concerning Funds Entrusted to LGC

As noted above, the specific language of RSA 5-B:5, I(c) speaks of “earnings and surplus” (emphasis added). “Surplus” has been discussed above. However, “earnings” has not been discussed or described further. LGC receives monies from the cities and towns. It does not use all of it immediately for the purposes it is intended, i.e. the purchase of insurance. It thus logically and properly invests some of the unused portion. Cities and towns contracting for insurance know this, if for no other reason than the annual filings LGC is obligated to make under RSA 5:B:2. Cities and towns, involved in this common enterprise with a reasonable expectation of benefits, are thus the beneficiaries of the managerial efforts of LGC. This brings LGC squarely within the obligations detailed in RSA 421-B and subjects LGC to the full regulatory oversight of the bureau of securities regulation.

**RSA 5-B:5, I(d) Provide for an annual audit of financial transactions by an independent certified public accountant. The audit shall be filed with the department and distributed to participants of each pooled risk management program.**

A review of LGC’s submissions for the years 2000 through 2009 for the Pools shows that annual audits were conducted. Whether they were distributed to the participants of each pooled risk management program is unknown. Note that the audit contains limitations both on the sources for its production and on its use.

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<sup>53</sup> Independent Auditors’ Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*, Schedule of Findings and Responses, Finding Number 2008-01, page 43.

<sup>54</sup> HealthTrust’s annual filing for 2010, “Other Receivable”, p. 27.

As far as the audits are concerned, they detail errors by LGC's internal accounting standards. For the year ending 2008 (finding 2001-01), the auditors found that HealthTrust's financial reporting system does not have the ability to report incurred claims and allocated claim adjustment expenses as originally reported and reestimated for each of the years presented at December 31, 2007, as required by the Governmental Accounting Standards Board disclosures requirements. This was corrected for the year end 2008 Nine-Year Claims Development Information.

Additionally, (finding 2007-01), HealthTrust's financial reporting system did not have the ability to report the differentiation of the provision for incurred claims and claim adjustment expenses for covered events of the current year and the change in the provision for covered events of prior years for the years ending December 31, 2007 and 2006. This was corrected.

**RSA 5-B:5, I(e) Be governed by written bylaws which shall detail the terms of eligibility for participation by political subdivisions, the governance of the program and other matters necessary to the program's operation. Bylaws and any subsequent amendments shall be filed with the department.**

As noted above, limited liability companies, and corporations, are different legal entities, and RSA 5-B was written before the advent of LLC's in New Hampshire law. LGC, Inc.'s apparent claim is that its bylaws carry over to cover this statutory requirement is on a par with its claim its board suffices for the actual pool LLC's. There are thus no "bylaws" for the Pools as required by RSA 5-B:5,I(e).

In addition, LGC's bylaws claim that there is a HealthTrust "Operating Agreement" and a PLT "Operating Agreement". Yet in response to questions posed by this office, LGC noted that only the LGC bylaws and New Hampshire Municipal Association Operating Agreements exist.<sup>55</sup> In

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<sup>55</sup> "Question: Provide copies of the NHMA Operating Agreement, the HealthTrust Operating Agreement, the PLT Operating Agreement, and any rules and other agreements pursuant or incident to the operative documents as defined in the LGC bylaws". Answer: "The following documents exist: LGC Bylaws and an NHMA Operating Agreement. These are provided".

other words, LGC admits that HealthTrust, LLC or Property-Liability Trust, LLC have no Operating Agreements.

**RSA 5-B:5, I(f) Provide for an annual actuarial evaluation of the pooled risk management program. The evaluation shall assess the adequacy of contributions required to fund any such program and the reserves necessary to be maintained to meet expenses of all incurred and incurred but not reported claims and other projected needs of the plan. The annual actuarial evaluation shall be performed by a member of the American Academy of Actuaries qualified in the coverage area being evaluated, shall be filed with the department, and shall be distributed to participants of each pooled risk management program.**

HealthTrust, LLC. has used the services of Peter Reimer, LLC as actuary. He is qualified. Property-Liability, LLC and Workers' Compensation, LLC have used Towers Perrin. They are qualified. As has been discussed above, HealthTrust adheres to the "Risk Based Capital" model promulgated by the National Association of Insurance Commissioners (NAIC) noted above.

However, in the "Notes to Financial Statements", the LGC LLC's claim exemption from statutory accounting practices as promulgated by NAIC, because they "are not insurers". Since both RBC and statutory accounting practices are NAIC concepts, and since HealthTrust claims to be exempt from statutory accounting practices because it is not an insurer, HealthTrust should not be claiming NAIC's RBC as a proper method of measuring reserves.

**RSA 5-B:5, I(g) Provide notice to all participants of and conduct 2 public hearings for the purpose of advising of potential rate increases, the reasons for projected rate increases, and to solicit comments from members regarding the return of surplus, at least 10 days prior to rate setting for each calendar year.**

There are no indications this was not done.

**II. If a pooled risk management program fails to provide for an annual audit or an annual actuarial evaluation, the department shall perform or cause to be performed the required audit or evaluation and shall be reimbursed the cost by the program.**

A review of the records of the Department of State, corporations division shows no failures to submit an annual audit or actuarial evaluation. In 2011, after 24 years of submitting these audits and evaluations, LGC requested guidance on what such audits should contain. Initially, LGC refused to submit the 2011 audits until such guidance was provided<sup>56</sup> Ultimately, LGC submitted the 2010 audits and evaluations.

### **ADDITIONAL STATUTORY VIOLATIONS**

Statutory limitations on what organizations may constitute or associate with Pooled Risk Management programs are set forth in RSA 5-B:3. As noted below, LGC has forced a predicate non-qualifying association membership on its Pool members. The statutory language is as follows:

#### **RSA 5-B:3 Pooled Risk Management Authorized and Affirmed; Membership. –**

I. A political subdivision, by resolution of its governing body, may establish and enter into agreements for obtaining or implementing insurance by self-insurance; for obtaining insurance from any insurer authorized to transact business in this state as an admitted or surplus lines carrier; or for obtaining insurance secured in accordance with any method provided by law; or for obtaining insurance by any combination of the provisions of this paragraph. Agreements made pursuant to this paragraph may provide for pooling of self-insurance reserves, risks, claims and losses, and of administrative services and expenses associated with them among political subdivisions. To accomplish the purposes of this chapter, 2 or more political subdivisions may form an association under the laws of this state or affirm an existing association so formed to develop and administer a risk management program **having as its purposes reducing the risk of**

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<sup>56</sup> Letter dated June 21, 2011 from David I. Frydman, Esq., LGC General Counsel to E.F. Wingate, III, Esq., Staff Attorney and email exchange between the same parties dated July 19 and 21, 2011.

**its members; safety engineering; distributing, sharing, and pooling risks; acquiring insurance, excess loss insurance, or reinsurance; and processing, paying and defending claims against the members of such association. (emphasis added.)**

Tying Arrangement that Communities join NHMA or LGC to Obtain Pool Coverage

Beyond simple existence as a government subdivision, the statute does not impose a condition on a member for Pool membership. However, LGC, Inc.'s bylaws contain a requirement that in order to join their pools, a municipality must belong to LGC, Inc. and purchase membership in a non-Pool organization, the New Hampshire Municipal Association, LLC (NHMA). Although there are several levels of membership (full, associate, service), and although the cost of the latter two categories of membership are nominal (ranging from \$70.00 to \$400.00 per year), the costs associated with full membership can be substantial. (2010 total: \$880,769.89.)

LGC points to language in RSA 5-B:3 to justify the requirement. But NHMA describes itself as *“a non-profit, non-partisan membership organization of municipalities ... provid[ing] advocacy support for member municipalities, plus educational and training programs for local government officials and employees ...”*<sup>57</sup> LGC's mission is *“... to strengthen the quality of its member governments and the ability of their officials and employees to serve the public ...”*<sup>58</sup>.

Comparison of these words with the plain language of RSA 5-B:3, I demonstrates no connection between them. Since NHMA and LGC have nothing to do with risk management programs, requiring communities to pay to belong to either or both violates RSA 5-B:3, I. These are supposed to be public pools. There is no need to join the “club” to use the pool.

This is not to say that membership in LGC or in NHMA is not valuable. But because this predicate is not authorized by statute, any LGC Pool member which was forced to pay for membership in the nonqualifying associate organization is entitled to reimbursement of the costs imposed by this improper tying condition, beginning with 2010's \$880,769.89.

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<sup>57</sup> LGC website.

<sup>58</sup> Id.

## Taxation of the Entities

**RSA 5-B:1 Purpose.** – The purpose of this chapter is to provide for the establishment of pooled risk management programs .....and that **pooled risk management programs which meet the standards established by this chapter should not be subject to insurance regulation and taxation by the state** (emphasis added).

As part of this investigation, tax records for all of the related businesses were sought. In answer, LGC, Inc. claimed that these entities were “exempt from filing annual Federal returns as affiliates of governmental units” as defined in IRS Revenue Procedure 95-48, and not subject to New Hampshire business profits taxes as they “only apply to business organizations organized for gain or profit”.

Yet in response to questions raised during the litigation between the Professional Firefighters of New Hampshire and LGC in 2004 and 2007, then-Executive Director Andrews claimed under oath that HealthTrust’s operations are “[i]n virtually every respect”, “separate and distinct from the political subdivisions and other entities that comprise its membership”, and that “it has not asserted governmental immunity”. LGC did not claim that they were exempt from taxation because the statute says that if they met the RSA 5-B standards, they would be.

Before the 2003 changes, management had taken great care to confirm tax exempt status with state and federal authorities. This was not done before, during or after the changeover.

## SUMMARY

In accordance with RSA 5-B:4-a, demand is hereby made that LGC do the following:

1. LGC, Inc. shall cause each of its’ RSA 5-B Pooled entities to return to non-profit status.
2. LGC, Inc. shall detail the holdings of the former HealthTrust, Inc. and Property-Liability Trust, Inc. at the time of the purported “merger”.

3. LGC, Inc. shall cause the return of surplus of at least \$40 million. This shall be returned to each of the municipalities from which it was taken in proportion to its contribution, year by year, from 2003 through and including 2011.
4. LGC, Inc. shall cause to be repaid to HealthTrust and to Property-Liability Trust, the monies which it diverted to its workers compensation Pool. LGC, Inc. shall then cause HealthTrust and Property-Liability Trust to return sums thus returned, to the communities. These sums total at least \$20 million.
5. LGC shall provide complete details and justifications for its “distributions to parent” of all of its subsidiary and associated affiliates, which sums exceed \$27 million.
6. LGC shall submit details of its spending on items not related to the mission of the Pools, such as entertainment, charitable giving, salaries, benefits, and similar expenses.
7. LGC, Inc. shall detail the cost for each community since 2002 of the forced membership of LGC, Inc. and NHMA, LLC and return it to the municipalities from which it was obtained.

Respectfully Submitted,

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