

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF STATE
BUREAU OF SECURITIES REGULATION**

IN THE MATTER OF:

Local Government Center, Inc.; et al.

Case No.: C-2011000036

**LGC'S SUPPLEMENTAL OBJECTION
TO THE BUREAU'S (AMENDED) MOTION TO COMPEL, PRESERVE,
AND ENFORCE SUBPOENA**

This pleading highlights for the Hearing Officer the current status of the dispute over the Bureau's desire for unfettered access to LGC's premises and its employees. LGC deems it necessary to file the pleading, in light of the multiple filings by the Bureau since the Hearing Officer's December 1 memorandum.¹ LGC focuses here on the actual statutory authority granted to the Bureau, rather than the authority the Bureau wishes it had, and LGC lays out the due process violations that would attend the Bureau's desired course of action. Finally, LGC concludes with an offer to make available to the Bureau some of the information it seeks – not because LGC is required to do so, but as a way to resolve the dispute.

This pleading contains the following content:

- I. The status of the actual discovery dispute, based on the Bureau's requests to date (starting on page 2 of this pleading)
- II. The factual and procedural history, demonstrating that the purported securities claim is nothing but an add-on to the Petition (page 3)
- III. A statutory analysis of the differences between RSA 5-B and RSA 421:B, perhaps demonstrating why the securities claim was added on (page 5)
- IV. An explanation why 'interviews' are not permitted (page 5)
- V. A demonstration why the Bureau's request violates due process (page 7)
- VI. An analysis of the cases cited by the Bureau (page 8)
- VII. A proposed discovery compromise (page 10)
- VIII. Conclusion (page 11)

¹ Since December 1, the Bureau has filed a Motion to Amend its Motion to Compel, etc., and a Response to LGC's Motion to Compel.

I. A Summary of the Discovery Dispute Over the Bureau's Requests.

The Bureau's Motion, as amended (the "Motion"), seeks five specific types of relief.

(a) Financial records: moot. The request to order the preservation of financial records is moot. LGC negotiated a data storage plan with the Bureau in February 2011. See attached Exhibits A and B.

(b) Non-redacted minutes containing attorney/client communications: previously argued. The Bureau seeks the production of non-redacted versions of documents which LGC contends are protected by the attorney/client privilege. The Bureau also seeks an *in camera* review of the documents by the hearing officer. LGC has already produced redacted and unredacted versions of the documents for the Hearing Officer's review. This part of the Motion was argued on November 21. Nothing further has been offered by either side.

(c) "Interviews" of LGC staff: Objection by LGC. The Bureau seeks to conduct 'interviews' of LGC's staff. LGC has repeatedly offered to make its staff available for interviews -- as long as they are under oath, transcribed, and arranged with sufficient notice so that all Respondents have an opportunity to attend. The Bureau refuses to conduct them in this fashion.

(d) On-site audit: Objection by LGC. The Bureau also seeks an "on-site inspection," contending it has "visitorial" authority to conduct special audits and inspections. LGC has never denied the Bureau's authority to conduct investigations, but only the means by which they are conducted, now that the hearing process is underway.²

² The Bureau misstates the history of its own requests in its Motion to Amend:

- 1) Contrary to the statement in Paragraph #3, the 9-13-11 Subpoena never sought or requested an "onsite examination." The Bureau requested documents and interviews (without ever referencing where).
- 2) Contrary to the statement in Paragraph #3, the letter request dated 10-19-11 sought no onsite examination. It was only a document request.

(e) Production of documents demanded on November 15: Excessively burdensome.

The Bureau served a 28-category demand for documents on LGC on November 15, returnable on December 5. The Bureau's December 2 amendment to the Motion incorporates this demand. LGC repeatedly pointed out the burdensome nature of the request (the first category alone calls for the production of *hundreds of thousands* of documents), and asked the Bureau to modify the request, with little result. Kevin Bannon, the Bureau's forensic examiner, acknowledged that he would like to examine, for fiscal year 2010 alone, approximately 404,415 pages of material. The Bureau's November 15 Document Request seeks similar documents for ten (10) years. The document request is plainly intended to leverage an onsite inspection, as the Bureau wrote: "Should the LGC Entities change their positions with respect to the onsite examination, the Bureau may be in a position to limit its request for documents."

II. The Procedural History of the Petition Underlying this Hearing Demonstrates that the Securities Claim is a Very Late Addition.

This action began with a complaint of July 22, 2009, asking the Secretary of State to (a) investigate expenses LGC had incurred, which allegedly were unauthorized for pooled risk management programs, and (b) determine the reasonableness of LGC's reserves -- both RSA 5-B concerns.

The Bureau began its investigation under the guidance of Attorneys Wingate and Moquin. There were multiple meetings with LGC, both formal and informal. Over 10,000 pages of documents were provided to the Bureau. LGC's multiple offers to allow the Bureau to review additional documentation, on LGC's premises, went unanswered. At no time during any of the meetings or any of the exchanges of communications between LGC and the Bureau was the word "securities" ever mentioned.

An Interim Report was released to the legislature on October 28, 2010, expressing four concerns. Each of those concerns was a 5-B issue.

The Bureau's report of its investigation is dated August 2, 2011. In addition to the four concerns expressed in the Interim Report, this version included additional concerns regarding the legal organization of the entities. The Summary of the report highlights the following issues:

- Alleged illegal corporate changes and forms, not permitted under 5-B;
- Failure to sufficiently return surplus, as required by 5-B;
- Subsidization of one risk pool with another, resulting in inadequate return of surplus, contrary to 5-B;
- Expenditures that were unauthorized by 5-B; and
- An improper tying arrangement, requiring municipalities to belong to an organization related to the risk pool, which the Bureau contends is unauthorized under 5-B.

Note that each issue springs from RSA 5-B. One, single paragraph in this 29-page report mentions RSA 421-B (the securities law), without expanding on its significance. Nowhere does the Report, in either its opening Summary, or in the Summary and demand made at its conclusion, refer to securities, violations of the securities law, or RSA 421-B.

The Staff Petition introduced to the public and LGC on September 2, 2011, by contrast, devotes 36 of its 108 paragraphs to alleged securities violations. This was the first disclosure that the Bureau contended that any of the investigated activities violated any section of 421-B. It was also the first time, in the more than two years since the original Complaint, that individual respondents were ever mentioned.

The Bureau has recently acknowledged that, in the two-plus years of its investigation, culminating in a multiple-count, multiple-paragraph Petition, seeking \$110 million in reimbursement from 21 individually-named Respondents, it failed to record a single individual interview. The Bureau supplied a grand total of 131 pages of documentation to LGC on its claims. The great majority of those pages consists of an independent, third-party report,

generated not at the request of the Bureau but by order of the legislature, considering the appropriate type and amount of reserves to bind all of the risk pools.

III. A Possible Explanation for the Late Addition of the Securities Claims: The Broader Discovery Available to the Bureau.

The Secretary's investigative power under RSA 5-B is limited to subpoenaing witnesses, administering oaths and taking evidence, and requiring the production of books and records. RSA 5-B:4-a, III. By contrast, RSA 421-B contains broader investigatory powers, and specifically uses the terms "audit" and "inspection".

LGC submits that the Bureau seeks to conduct this 5-B investigation using its 421-B powers, because it was dissatisfied with the results of its own report after two years of investigation, and wants a "do over". Hence, the last minute addition of the securities claim, and the request, now, for on-site inspections and interviews.

LGC also submits that, to the extent the Bureau seeks to use its RSA 421-B powers to investigate 5-B claims, its appetite exceeds its authority. See *Appeal of Monsieur Henri Wines, Ltd.*, 128 N.H. 191, 193-94 (1986) (stating that an administrative agency's "powers and authority are conferred upon it entirely by statute.").

IV. "Interviews," as Proposed by the Bureau, are not Permitted.

The Bureau wishes to freely interview any LGC entity staffer that it finds convenient. There is no authority under any of the statutes for such a procedure. Further, such a process would be inefficient and violate the due process rights of LGC and the other Respondents.

For any investigation under 5-B, the secretary can only:

Administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence and require the production of any books, papers, correspondence, memoranda, agreements or other documents or records

RSA 5-B:4-a, III. The secretary has no power under 5-B to indiscriminately interview LGC employees. LGC will, of course, submit its employees to depositions, taken under oath, properly transcribed, with notice to the individual Respondents. This process precludes any controversy over what questions were asked and what answers were given, and preserves the testimony for use by all parties in this proceeding.

To be clear, RSA 421-B, the securities statute, provides no broader authority on the topic of interviews. Under RSA 421-B:9,III,(b), the secretary is granted the power to “examine under oath” any individual as to any matter relevant to the affairs under examination. (Emphasis supplied). Any individual who refuses without just cause to be “examined under oath” shall be guilty of a misdemeanor. RSA 421-B:9,(III),(f)(emphasis supplied). Upon completion of an examination, the examiner is to make a true report thereof, the contents of which are derived from the books and records examined by the examiner, “or as ascertained from the sworn testimony” of the officers or agents of the persons examined. RSA 421-B:9, IV (a) (emphasis supplied).

Finally, under 421-B:22, II, in any investigation under the securities title, the Secretary only has power to:

Administer oath and affirmations, subpoena witnesses, compel their attendance, take evidence and require the production of any books, papers, correspondence, memoranda, agreements, or any documents or records....

Note that this language is identical to that contained under RSA 5-B.

It is manifestly clear that the secretary has no authority to conduct “interviews,” as the Bureau desires to conduct them.

V. **Once the Hearing Process is Begun, the Secretary's Demand for Onsite Examinations Violates the State and Federal Constitutional Due Process Rights of All Respondents.**

The Bureau argues that it has unrestricted power to investigate individuals and entities suspected of securities violations. The Bureau argues that this includes the right to perform onsite inspections of businesses “at any time and without prior notice”, “irrespective of whether there is a pending administrative action.” Taking these arguments to their logical conclusion, the Bureau’s investigatory power is eternal, and extends to any individual or entity it chooses to investigate. Such claims of unrestrained investigative authority violate due process and are contrary to well-established United States Supreme Court precedent.

It is well settled that, once an administrative agency commences an adjudicative proceeding, the subjects of that proceeding are afforded the full due process protections traditionally associated with the judicial process. The United States Supreme Court has stated this plainly: “[W]hen governmental agencies adjudicate or make binding determinations which directly affect the legal rights of individuals, it is imperative that those agencies use the procedures which have traditionally been associated with the judicial process.” Hannah v. Larche, 363 U.S. 420, 442 (1960). For example, the full protections of due process are required where an investigatory body “hold[s] trials or determine[s] anyone’s civil or criminal liability,” where it “issue[s] orders,” or “indict[s], punish[s], or impose[s] any legal sanctions,” or “make[s] determinations depriving anyone of his life, liberty, or property.” Id. at 441. That is the case here.

The Supreme Court affirmed the strength of the doctrine in Jenkins v. McKieithen, 395 U.S. 411 (1969), when it examined Louisiana’s Labor-Management Commission of Inquiry. The Court found that the Commission “exercises a function very much akin to making an official

adjudication of criminal culpability.” Therefore, its procedures were required to meet the minimal requirements of the Due Process Clause of the Fourteenth Amendment. *Id.* at 427-28.

The First Circuit Court of Appeals has spoken to this point as well, stating that where the “specific characteristics” of an administrative proceeding make it “more like an adjudicatory body than an investigatory body[,] due process rights attach.” *Aponte v. Calderon*, 284 F.3d 184, 193 (1st Cir. 2002). Where an adjudication will affect legal rights, as will the instant proceeding against LGC, due process requires that “the full panoply of judicial procedures be used.” *Id.* (quoting *Hannah v. Larche*, 363 U.S. at 442).

In the instant case, the Bureau commenced an adjudicative proceeding against LGC and its co-Respondents. This proceeding will determine their legal rights, and thus due process requires the “full panoply of judicial procedures be used.” While the Bureau argues that it may continue to examine LGC using its preferred methodology, regardless of the ongoing adjudicative proceeding, the Bureau’s concept of its investigative authority is contrary to the law and offensive to due process.

VI. The Cases Cited by the Bureau Have Little Relevance to this Proceeding.

In support of its argument that an administrative agency has investigatory powers which persist through an adjudicative proceeding and are free of the restrictions of due process, the Bureau cites a number of cases from other jurisdictions. Those cases are factually distinct from the instant situation, and their legal reasoning inapplicable.

Several of the cases cited by BSR, including *Sutro Bros. & Co. v. Securities and Exchange Commission*, 199 F.Supp. 438 (S.D.N.Y. 1961), *American Microtel, Inc. & Others v. The Secretary of State of the Commonwealth of Massachusetts*, 1995 WL 809575 (Mass.Super. 1995), *Porter v. Mueller*, 156 F.2d 278, 279-80 (3rd Cir. 1946), and *Bowels v. Bay of New York*

Coal & Supply Corp., 152 F.2d 330, 331 (2nd Cir. 1945), only address the specific wording and application of the statute at issue in each case. Furthermore, the questions presented in those cases do not touch on any due process restrictions on administrative investigatory powers.

Similarly, in Federal Trade Commission v. Browning, 435 F.2d 96 (D.C. Cir. 1970), and In re Ronald G. Sorrell, 1981 WL 38135 (S.E.C. 1981), the decisions' analysis did not address any due process arguments. In Browning, the court concerned itself with the appropriate interpretation of the Federal Trade Commission's analysis of its own rules from a previous administrative decision. 435 F.2d at 102. In Sorrell, the SEC only examined the decision of the National Association of Securities Dealers and did not address any due process arguments. Furthermore, in Sorrell, the objected-to investigatory conduct had been consented-to by Sorrell's lawyer. Id. at *4.

In re Federal Exploration, Inc., No. 71,965. Blue Sky Reporter (Mass., 1984), examined the investigative actions of the Massachusetts Securities Division. Citing Hannah v. Larche, 363 U.S. 420 (1960), the court recognized the line between the Division's investigatory and adjudicatory functions and determined that the testimony given to the Division's enforcement staff was provided as part of a fact-finding investigation, and not an adjudicative proceeding. In re Federal Exploration, at *3. Therefore, the due process protections and the accompanying procedures traditionally associated with the judicial process, guaranteed in an adjudicatory matter, did not apply, though the principle was recognized. Id.

The Bureau cites Cuomo v. Clearing House Ass'n, LLC, 129 S.Ct. 2710 (2009), for the proposition that "a sovereign's visitorial powers and the powers to enforce the law are two different things." This is an accurate summation of one of the conclusions from Clearing House,

but the Bureau's treatment of the case ignores another fundamental conclusion, which LGC now quotes in full:

When, however, a state attorney general brings suit to enforce state law against a national bank, he is not acting in the role of sovereign as-supervisor, but rather in the role of sovereign as-law-enforcer. Such a lawsuit is not an exercise of "visitorial powers" and thus the Comptroller erred by extending the definition of "visitorial powers" to include "prosecuting enforcement actions" in state courts. Id.

In the instant case, similarly, the Bureau is no longer acting in a supervisory capacity. Rather, it has commenced an adjudicatory proceeding and is acting in a law-enforcement capacity. Therefore, due process demands that the "the full panoply of judicial procedures be used." See Hannah v. Larche, 363 U.S. at 442; Aponte v. Calderon, 284 F.3d at 193.

VII. A Proposed Discovery Compromise.

While RSA 421-B contains no definition of an investment contract, "the Bureau has adopted the four prong test for investment contracts established in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946)." See, Staff Petition, ¶ 67. "The four prongs are: (1) investment of money; (2) in a common enterprise; (3) with the expectation of profit; (4) to come solely through the efforts of the promoter or some third party." Id.

The Bureau wishes to investigate LGC for imagined violations of RSA 421-B. LGC objects to the wildly intrusive scope of the proposed investigation, for the multiple reasons laid out above. LGC also proposes a compromise, however; it will provide the Bureau an onsite conference room and make available those documents, requested in writing, that do not contain confidential information and that are reasonably related to the four prongs of the *Howey* text, including:

- Details of LGC's investments since 2003, as those investments are described and categorized in its annual 5-B filings with the Secretary of State.

- Copies of the contracts between members and risk pools, and authorizing resolutions of each member political subdivisions, to respond to the Bureau's claim these amount to an investment of money or a common enterprise.
- Details of the investment income generated by LGC's investments, as described and reported in its annual 5-B filings, as the Bureau claims this qualifies as the necessary expectation of profit.
- Copies of the contracts with and reporting of Wellington Management, the investment manager, the so-called "promoter or third party."

LGC recently invited the Bureau to meet to discuss a limited onsite visit, focused on limited document production. The Bureau, however, continues to insist on conducting a securities audit.

LGC plans an early dispositive motion on the whole securities aspect of the Petition. Providing access to these documents in the meantime is its effort to find a way through the discovery dispute.

VIII. Conclusion.

For the reasons outlined above – mootness, prior argument, and the over-broad, overly intrusive nature of the inquiry – the Bureau's Amended Motion to Compel should be denied. Nevertheless, if an accommodation can be reached that complies with due process and does not overly burden LGC, it will make available reasonable (though unnecessary) access to certain categories of documents.

Respectfully submitted,
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Dated: December 5, 2011

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CERTIFICATE OF SERVICE

I hereby certify that I have, this 5th day of December 2011, forwarded copies of this pleading *via* E-mail to counsel of record.

/s/ William C. Saturley