

**STATE OF NEW HAMPSHIRE**  
**INFORMATION STATEMENT SUPPLEMENT**

**DATED APRIL 20, 2007**

*Information Statement Supplement. The following information is provided by the State of New Hampshire (the "State") to supplement the information contained in the State's most recent Information Statement dated December 13, 2006 (the "Information Statement"). The Information Statement is available on the New Hampshire Treasury Department website as Part II of the Official Statement entitled "State of New Hampshire General Obligation Capital Improvement Bonds 2006 Series A" and may be found at the following website address - <http://www.nh.gov/treasury/Divisions/DM/DMdocs.htm>. The headings set forth in this Supplement (the "Supplement") correspond to the same headings in the Information Statement. This Supplement sets forth additional information concerning the matters described below as of the date of this Supplement and is subject to change without notice.*

**STATE FINANCES**

**General**

*GASB Statements 43 and 45.* In addition to pensions, many state and local governmental employers provide other postemployment benefits ("OPEB") as part of the total compensation offered to attract and retain the services of qualified employees. OPEB includes postemployment healthcare, as well as other forms of postemployment benefits (for example, life insurance) when provided separately from a pension plan. From an accrual accounting perspective, the cost of OPEB, like the cost of pension benefits, generally should be associated with the periods in which the exchange occurs (matching principle), rather than with the periods (often many years later) when benefits are paid or provided. However, in current practice, most OPEB plans are financed on a pay-as-you-go basis, and financial statements generally do not report the financial effects of OPEB until the promised benefits are paid.

GASB Statements 43 and 45 address the reporting and disclosure requirements for OPEB. GASB Statement 43 is effective fiscal year 2007 and GASB Statement 45 is effective fiscal year 2008. Legislation recently adopted in the House of Representatives and now pending in the Senate, if enacted into law, would establish a State Retiree Health Plan Commission charged with reviewing and approving periodic actuarial retiree health valuations and establishing a State retiree health fund to account for all assets accumulated for purposes of funding retiree health benefits. Budgets currently under consideration for the next biennium (fiscal years 2008 and 2009) do not pre-fund any OPEB costs. See also "HEALTH CARE INSURANCE FOR RETIRED EMPLOYEES."

**Financial Controls**

After a number of feasibility studies in recent years, the State determined that replacing its existing general ledger, human resources and budgetary systems that had been in place since 1986 was necessary. In the fiscal years 2002-2003 capital budget and in subsequent laws the Legislature has appropriated approximately \$22 million to purchase and implement a new enterprise resource planning ("ERP") system. ERP is a single computerized system that supports the common business functions of all State agencies (accounts payable, assets and inventory, budgeting, financial accounting grants and projects, human resources, payroll, benefits administration, purchasing, revenues and receipts and treasury functions). The contract with Ciber/Lawson calls for a phased implementation over a two and a half year span with the first phase due to go live during fiscal year 2008. While both the State and the vendor initially planned for the first phase to go live on July 1, 2007, both agree now that the go-live date should occur later in fiscal year 2008.

## **Fiscal Year 2007 Budget**

Since April 2005, auditors from the Office of the Inspector General (“OIG”) of the Federal Department of Health and Human Services have been conducting an audit of the State’s Department of Health and Human Services (“DHHS”). The primary focus of their audit has been to review the State’s Medicaid disproportionate share hospital payments (“DSH”) for federal fiscal year 2004. See also “Medicaid General and Rehabilitative Disproportionate Share Hospital Program” below. The State believes that the audit work being conducted in New Hampshire is similar to other audits, both past and present, of disproportionate share hospital programs in other states. As with all audit processes there are various discussions ongoing between the State and federal representatives and while the auditors have expressed concern with the process by which the State applies the Medicaid Enhancement Tax and pays hospitals for Uncompensated Care, it is unknown what the final audit comments or recommendations will be from the federal government.

On February 1, 2007, DHHS received a draft report from the OIG regarding this audit. The draft report concluded that approximately \$44 million of DSH payments for federal fiscal year 2004 were unallowable and recommended that the amount be refunded to the federal government. The State has responded to the draft report contending that its DSH payments are consistent with Federal law. The State has not yet received a final audit report and cannot predict the outcome of this matter. There has been no official finding that the State is not in compliance with the rules pertaining to its Medicaid disproportionate share program and any final findings and recommendations will be made by OIG to the federal Centers for Medicare and Medicaid Services (“CMS”), which has the responsibility of determining whether to accept the OIG findings and how the findings should be implemented or remedied. The State believes that if OIG rejects the State’s position on the draft findings and CMS were to concur with some or all of the findings, any final resolution of this matter would be a lengthy process. The audit only pertains to federal fiscal year 2004, although it also recommends that the State work with CMS to review DSH payments claimed after the audit period and refund any similar overpayments. The State believes any amounts at issue for later periods would be less than the 2004 amount.

The State general fund currently receives approximately \$80 million per year as a result of the Medicaid Enhancement Tax. It is unclear whether any portion of this unrestricted revenue would be in jeopardy or if any financial impact on the State would be retroactive or prospective or both. In addition, in August 2005, CMS issued proposed rules concerning the DSH program that DHHS believes may become final shortly. DHHS believes that the proposed rules, if adopted without change, could significantly adversely affect the DSH program or possibly lead to its elimination, which would result in the loss of approximately \$90 million of annual unrestricted revenue in fiscal year 2008 and 2009. The State cannot predict when any final rules will be published or what impact they may have on the State’s DSH program and related revenues.

*Year-to-Date Revenues.* The following table compares on a modified cash basis, for the nine months ended March 31, 2007, General Fund and Education Fund unrestricted revenues for the fiscal years 2006 and 2007 and a comparison to the revenue estimates for fiscal year 2007. The revenue estimates reflected in the plan are based on those revenues defined in Chapter 176, Laws of 2005, the State budget law for fiscal year 2007. Due to the combined filing of the business profits tax and business enterprise tax, it is not possible to measure accurately the individual effects of each of these taxes. They should be evaluated in their entirety. All information in this table is preliminary and unaudited.

**GENERAL FUND AND EDUCATION FUND UNRESTRICTED REVENUES  
FOR THE NINE MONTHS ENDED MARCH 31, 2007  
(Modified Cash Basis-In Millions)**

Revenue Category	FY06	FY07	FY07	FY07 vs Plan		FY07 vs FY06	
	Actual	Actual	Plan	Variance	% Change	Variance	% Change
Business Profits Tax	\$154.2	\$233.4	\$181.7	\$151.7	28.5%	\$79.2	51.4%
Business Enterprise Tax	<u>202.5</u>	<u>164.1</u>	<u>151.7</u>	<u>12.4</u>	<u>8.2</u>	<u>(38.4)</u>	<u>(19.0)</u>
Subtotal	356.7	397.5	333.4	64.1	19.2	40.8	11.4
Meals & Rooms Tax	155.6	161.3	168.1	(6.8)	(4.0)	5.7	3.7
Tobacco Tax	111.0	106.8	108.8	(2.0)	(1.8)	(4.2)	(3.8)
Liquor Sales and Distribution	91.6	96.0	98.0	(2.0)	(2.0)	4.4	4.8
Interest & Dividends Tax	33.1	44.8	32.2	12.6	39.1	11.7	35.3
Insurance Tax <sup>(1)</sup>	70.5	95.0	95.1	(0.1)	0.1	24.5	34.8
Communications Tax	52.9	54.5	55.5	(1.0)	(1.8)	1.6	3.0
Real Estate Transfer Tax	124.2	107.1	137.7	(30.6)	(22.2)	(17.1)	(13.8)
Estate and Legacy Tax	4.2	0.6	2.9	(2.3)	(79.3)	(3.6)	(85.7)
Transfers from							
Lottery/Pari-Mutuel	53.8	53.9	52.0	1.9	3.7	0.1	0.2
Tobacco Settlement	0.5	0.4	-	0.4	100.0	(0.1)	(20.0)
Utility Property Tax	10.5	11.3	12.0	(0.7)	(5.8)	0.8	7.6
State Property Tax	363.4	363.3	363.0	0.3	0.1	(0.1)	0.0
Other	<u>100.2</u>	<u>111.0</u>	<u>103.3</u>	<u>7.7</u>	<u>7.5</u>	<u>10.8</u>	<u>10.8</u>
Subtotal	1,528.2	1,603.5	1,562.0	41.5	2.7	75.3	4.9
Net Medicaid Enhancement							
Revenues	73.5	82.8	75.4	7.4	9.8	(9.3)	12.7
Recoveries	<u>18.3</u>	<u>9.7</u>	<u>12.7</u>	<u>(3.0)</u>	<u>23.6</u>	<u>(8.6)</u>	<u>(47.0)</u>
Total	<u>\$1,620.0</u>	<u>\$1,696.0</u>	<u>1,650.1</u>	<u>\$45.9</u>	<u>2.8%</u>	<u>76.0%</u>	<u>4.7%</u>

<sup>(1)</sup> Fiscal year 2007 actual excludes insurance tax payments of approximately \$41.0 million. These were recorded as deferred revenue and will be recognized in fiscal year 2008.

Revenues for the first nine months of fiscal year 2007 are \$1,696.0 million, which is \$45.9 million or 2.8%, ahead of plan. Year-to-date revenue is ahead of fiscal year 2006 by \$76.0 million, or 4.7%, which can be attributed mainly to increased collections from the Business Profits Tax, the Insurance Tax, and the Interest and Dividends Tax. Business tax revenue exceeded the year-to-date plan by \$64.1 million, or 19.2%, and was \$40.8 million, or 11.4%, above fiscal year 2006 due to audit settlements and strong collections for estimated payments. In addition, a significant one-time extension payment was received during March. Insurance Tax revenues of \$95.0 million were below plan by \$0.1 million, or 0.1%, but ahead of fiscal year 2006 by \$24.5 million, or 34.8%. The increase in revenues over fiscal year 2006 is due to Chapter 277 of the Laws of 2006, which statute reduces the insurance premium tax effective July 1, 2007 in order “to spur economic development and reverse the State’s recent losses of domestic insurers.” It also changed the timing of collection of the tax. The statute provides that on or before March 15 of each calendar year, each authorized insurer is required to pay to the State an amount equal to 100 percent of the previous calendar year’s tax. Previously, insurance companies made quarterly estimates with final returns due in March of the next succeeding calendar year. As a result, actual collections for March were \$87.2 million. In accordance with accounting standards, approximately \$41.0 million of these collections will be recorded as deferred revenue and recognized as unrestricted revenue in fiscal year 2008, and are therefore not reflected above. Interest and Dividends Tax revenues of \$44.8 million are ahead of plan by \$12.6 million, or 39.1%, and ahead of fiscal year 2006 by \$11.7 million, or 35.3% consistent with stronger investment returns on savings. Real Estate Transfer Tax collections have been significantly lower than plan and fiscal year 2006 year-to-date due to the slowdown in the housing market.

## **Proposed Fiscal Year 2008-2009 Budget**

*Operating Budget.* The Governor's proposed operating budget for the 2008-2009 biennium forecasts a fiscal year 2007 General Fund surplus of \$15 million, thereby increasing the balance in the Rainy Day Fund to \$84.3 million, with a forecasted additional \$35.6 million in the Education Trust Fund for total equity in both funds of \$119.9 million. The Governor's proposed budget projects that total fund equity will grow to \$133.8 million by the end of fiscal year 2009 with \$44.4 million of that amount in the Education Trust Fund. A tobacco tax increase of \$.28 per package of 20 cigarettes (increasing New Hampshire's per pack cigarette tax to \$1.08) is projected to generate \$52.3 million over the biennium. Revenue increases beyond normal growth are also projected to occur in Business Taxes due to increased auditing positions and in Liquor and Lottery receipts due to increased marketing and advertising efforts. The Governor's proposed budget would increase total General Fund expenditures for the 2008-2009 biennium by approximately \$388 million or 13.9%, as compared to the 2006-2007 biennium. General Fund expenditures for fiscal year 2008 are proposed to be \$1.562 billion, an increase of \$148.9 million or 10.5% over fiscal year 2007. General Fund expenditures for fiscal year 2009 are proposed to be \$1.619 billion, or an increase of \$57.6 million or 3.7%, as compared to the proposed fiscal year 2008 expenditures. Examples of major General Fund cost increases include employee salary and benefits of \$93 million, retirement contributions to cities and towns of \$38 million, healthcare provider payments of \$36 million, catastrophic and building aid of \$22 million, retiree's health insurance of \$19 million, room and meals tax payments to cities and towns of \$17 million, fuel costs of \$18 million and debt service of \$15 million.

Other items in the Governor's budget include funding for increased enrollment targeted at 10,000 children into the New Hampshire Healthy Kids program over the next three years, over \$36 million for rate increases to healthcare providers, \$16 million for the University of New Hampshire, \$10 million for the Community Technical College, \$12 million for the Land and Community Heritage Investment Program, \$5.9 million for early intervention services for children at risk of developmental delays, \$5.7 million for a reduction in the developmental disabilities waiting list, and \$1 million to replace reduced federal funding for AIDS programs.

State agency budget requests were \$291 million higher than the Governor's proposed budget for the biennium. In addition to reducing these requests, the Governor reduced State vacant positions by 321, improved marketing and advertising in revenue producing agencies, tightened management control of State vehicle purchases by limiting the size and cost of vehicles that State agencies can purchase, cut \$32 million from current expense requests, centralized certain State functions, and reduced Information Technology spending.

The House of Representatives adopted its proposed budget for fiscal years 2008 and 2009 on April 11, 2007 and it is now under consideration by the Senate. The House budget combines the Education Trust and General Funds effective June 30, 2007. It combines the surplus fund balances into the Rainy Day Fund thereby increasing the June 30, 2007 Rainy Day Fund balance to \$112.4 million. The House budget projects the June 30, 2009 Rainy Day Fund balance to be \$121.0 million. The House budget proposal increases the tobacco tax another \$.17 per package of 20 cigarettes in addition to the Governor's proposal for a total per pack tobacco increase of \$.45 to a total of \$1.25 per pack. The House also proposes to raise the Real Estate Transfer tax by \$.30/\$1,000 for purposes of funding the Land and Community Heritage Investment Program, which increase is projected to raise \$12 million over the biennium. Overall, the House increased the Governor's proposed General Fund spending by approximately \$30 million over the biennium primarily to fund additional Health and Human Services costs.

*Capital Budget.* The Governor's proposed capital budget for the 2008-2009 biennium recommends \$86.0 million in General Fund supported bonding authorization and \$219.6 million in total appropriations with \$87.3 million of that amount to be federally funded over the biennium. Capital projects include, but are not limited to, improvements to the Adjutant General's training institute, improvements to state owned buildings, \$6 million for improvements to state parks, and environmental matching funds to capture federal dollars. An earlier appropriation of \$35 million for the University System's "UNH-KEEP NH" program would continue in the next biennium. In addition, the Governor's proposed operating budget for the next biennium included \$60 million of bonding for certain highway projects, which had previously been funded on a pay-as-you go basis within the State's operating budget.

The capital budget passed the House on April 11, 2007 and is now under consideration in the Senate. While the House made changes, the Governor's version is largely intact, except as described in the following paragraph. The

General Fund supported bonding increases to \$90 million with total appropriations at \$218 million, exclusive of the \$60 million in highway projects and the UNH KEEP previously appropriated and authorized.

Sixty million dollars of bonded highway projects over the biennium were moved from the Governor's proposed operating budget to the House passed capital budget. The Governor originally proposed including these bonded highway projects in the operating budget. The debt service on these projects will be supported by the Highway Fund over the short term by \$.01 on the gas tax which nets approximately \$7.5 million annually. In addition to increasing the State's Municipal Bridge Program by \$13.6 million over the biennium, this short term solution will allow the State to more accurately assess its long term highway needs. The bonding of these highway projects previously funded with current revenues significantly increases the bonds authorized in the proposed capital budget to \$210 million as compared to the prior capital budget which had a total bond authorization of \$164 million.

The Legislature is currently considering the proposed operating and capital budgets for the 2008-2009 biennium and the actual budgets to be adopted may differ from those proposed by the Governor or approved by the House. There can be no assurance that the projected revenues and expenditures described above will occur or that any of the projected fund balances as of the end of fiscal year 2009 will be achieved.

### SCHOOL FUNDING

*Litigation.* In 2005, the Legislature passed House Bill 616, now known as 2005 New Hampshire Laws Chapter 257, as the new education funding bill. Chapter 257 provides funding to schools based on four types of aid and revenue from the statewide enhanced education tax. Chapter 257 does not generally provide aid to municipalities on a per pupil basis. The four types of aid are: local tax capacity aid, targeted per pupil aid, statewide enhanced education tax capacity aid, and transition grants. Chapter 257 also includes the statewide enhanced education tax which is assessed at a uniform rate across the State at a rate necessary to raise \$363.0 million. For fiscal year 2006, the total State education aid under Chapter 257 is more than \$819.0 million.

Two lawsuits were filed challenging the constitutionality of Chapter 257. The first is *City of Nashua v. State*, Docket No. 05-E-257, and the second is *Londonderry School District, et al. v. State*, Docket No. 05-E-406. Both of these suits were filed in August, 2005 in the Supreme Court. Both were dismissed from the Supreme Court with direction to the Superior Court that they be tried on an expedited basis.

Nashua's Petition included four general claims: 1) a challenge to Chapter 257 for not providing for an adequate education by failing to "relate the taxes raised by it to the cost of an adequate education," 2) a claim that Chapter 257's transition grants create disproportional and unequal taxes, 3) a claim challenging Chapter 257's "reliance upon three-year old data to fund the cost of an adequate education today," and 4) a claim questioning whether Chapter 257 requires the use of data from April, 2003 for 'Equalized Valuation With Utilities' in order to correctly calculate the education grants under Chapter 257.

Londonderry's Petition included the following four general claims: (1) an alleged facial challenge to HB 616 that "it fails to provide for an adequate education" because there is "nothing in the legislative record [that] would support a determination that the total funds to be distributed are 'lawfully and reasonably sufficient' to fulfill the State's constitutional obligation," (2) a claim that targeting aid to some municipalities has imposed on many of the remaining municipalities the burden of funding education through a local education tax, (3) a claim which asserts that HB 616 violates Part II, Article 5 because it results in property taxes that are not "proportional across the State" due to the transition grants, and (4) an equal protection claim.

The State moved to consolidate both cases but the Court allowed the cases to proceed on different tracks. The Nashua case was tried in mid-December 2005. The Londonderry case proceeded with a motion for summary judgment filed in January, 2006, with the State filing a timely response in February, 2006. On March 8, 2006, the Superior Court issued orders in both cases declaring Chapter 257 unconstitutional due to the State's failure to reasonably determine the cost of an adequate education. The Superior Court also found that the State has not defined an adequate education and has not enacted a constitutional accountability system.

The Supreme Court scheduled the Londonderry case for expedited briefing and argument. The parties

briefed the matter and argued it on June 22, 2006. The Supreme Court issued its decision on September 8, 2006, holding that the State failed to define an adequate education and staying all remaining issues. The Court noted in its decision that any definition of constitutional adequacy must allow for an “objective determination of costs” and that “[w]hatever the State identifies as constitutional adequacy it must pay for. None of that financial obligation can be shifted to local school districts, regardless of their relative wealth or need.” The Court gave the Legislature until the end of fiscal year 2007 to enact a definition.

Petitioners also moved for attorneys’ fees, without disclosing the requested amount, and the State objected. The Court denied this request at this time.

The Nashua case is currently stayed by an order of the Court based on a motion filed by the State requesting that it be stayed until the end of fiscal year 2007.

In January 2007, the Governor organized a working group to draft the criteria and substantive programs for an adequate education. That draft definition was the basis for House Bill 927 (“HB 927”). HB 927 includes a detailed statement of purpose explaining its interaction with all of the State’s education statutes and regulations. HB 927 defines nine essential opportunities for education from the State’s school approval standards in: English/language arts, mathematics, science, social studies, art education, world languages, health education, physical education, technology education including information and communication technologies. HB 927 also adopts the State’s curriculum frameworks in these essential opportunities as guides for teaching these subjects. A legislative oversight committee is also established in HB 927 to provide more direct input into modifications or additions to the State’s school approval standards. HB 927 was the subject of at least seven public hearings across the State where legislators from both houses met and listened to comments from educators and the public. After editing by the House Education Committee, the House passed HB 927 on March 27, 2007. The Senate is now considering HB 927.

On April 12, 2007, the Senate passed a proposed amendment to the New Hampshire Constitution that would add an article allowing for targeting education aid to communities and require a minimum of 50% funding by the State of the total statewide cost of an adequate education. The proposed amendment is now under consideration by the House. If passed by a 60% margin in the House, the proposed amendment will appear on the November 2008 statewide election ballot.

The State is unable to predict the outcome of these matters at this time.

### **STATE RETIREMENT SYSTEM**

Two bills are currently pending in the Legislature relating to the State Retirement System (the “System”). The first bill, HB 876, would establish a commission to make recommendations to ensure the long-term viability and sustainability of the System. If enacted into law, the commission would be charged with, among other matters, studying the history of funding and benefits in the System, analyzing the current financial status of the System and the future challenges facing the System, assessing the potential effect of changes to accounting standards on the System and making recommendations for ensuring the long-term viability of the System. The current version of the bill sets a November 1, 2007 deadline for delivery of the commission’s findings and recommendations for any proposed legislation. The second bill, HB 653, amends various provisions of State law pertaining to the benefits, funding and administration of the System. In particular, among other matters, this bill would make the State Treasurer a nonvoting member of the Board of Trustees of the System rather than a voting member, add to the board a local government representative, change the funding methodology from the current, “open group aggregate” method to the “entry age normal” method, require amortization of the unfunded accrued liability over 30 years or the maximum period allowed by GASB standards, whichever is less, and limit funding of the special account for additional benefits to periods in which the overall funded ratio of the System is at least 85% and the earnings for a particular year exceed 10.5%.

Both bills have been passed by the House and are now pending in the Senate. Both bills are subject to change and there can be no assurance that the bills will be enacted into law at all or in the form passed by the House.

## HEALTH CARE INSURANCE FOR RETIRED EMPLOYEES

In addition to providing pension benefits, state law provides health care benefits for certain retired employees. Substantially all of the State's employees who were hired on or before June 30, 2004 may become eligible for these benefits if they reach normal retirement age while working for the State and receive their pensions on a periodic basis rather than a lump sum. During fiscal year 2004, legislation was passed that requires State Group I employees hired on or after July 1, 2003 to have 20 years of State service in order to qualify for health coverage benefits. These and similar benefits for active employees are authorized by RSA 21-I:30 and provided through the Employee Benefit Risk Management Fund, which finances the State's self-funded employee and retiree health benefit program. The Fund, which was established in October 2003, is in turn financed through payments by the State of actuarially determined working rates. The State paid approximately \$30.7 million to fund health care benefits for approximately 9,375 State retirees and covered dependents receiving a periodic pension benefit for the fiscal year ended June 30, 2006. Of the amount paid, \$14.8 million was received from self-supporting State agencies. An additional major source of funding for retiree benefits is from the New Hampshire Retirement System's "medical subsidy" program for Group I and Group II employees, which totaled approximately \$13.5 million for the fiscal year ended June 30, 2006.

The Governmental Accounting Standards Board ("GASB") recently promulgated its Statement Nos. 43 and 45, which will for the first time require public sector entities to report the future costs of these non-pension, post-employment benefits in their financial statements, also referred to as OPEB. The State recently received a draft actuarial OPEB valuation providing various alternatives the State will choose from in determining an appropriate valuation of the State's OPEB liability. The State is currently in the process of reviewing these various alternatives, including methodology, discount rates, and other assumptions. The draft actuarial valuation reports that the State's OPEB liability ranges from \$1.5 billion to \$2.9 billion, depending upon whether the liability is prefunded. To date, the State has made no decisions regarding the funding of the liability.

## LITIGATION

General Electric ("GE") appealed a decision by the Department of Revenue Administration ("DRA") claiming that the dividends received deduction allowed under RSA 77-A:4, IV should be invalidated because the statute discriminates against foreign commerce in violation of the commerce clause of the United States Constitution and results in unfair taxation out of proportion to GE's activities in New Hampshire in violation of the Due Process and Commerce Clauses of the United States Constitution.

In 2001, GE and DRA executed two settlement agreements substantially resolving GE's business profit tax liability for multiple tax years. The settlement agreements did not resolve the foreign dividend issue, which is the issue in this appeal, concerning tax years 1990-1999.

On August 19, 2005, the Merrimack County Superior Court issued an order granting DRA's Motion to Dismiss and its Motion for Summary Judgment. GE appealed the case to the New Hampshire Supreme Court, and on December 5, 2006, the New Hampshire Supreme Court issued an order affirming in part and reversing in part the lower court's decision. The Court reversed the lower court's order dismissing the case because the Supreme Court found that GE did have standing to challenge the statute. Nevertheless, the Supreme Court affirmed the lower court's grant of summary judgment in favor of DRA and concluded that RSA 77-A:4, IV is not facially unconstitutional, finding that the statute does not facially discriminate against a dividend-paying foreign subsidiary that does not conduct business in New Hampshire. GE filed a Petition for Writ of Certiorari with the United States Supreme Court in March 2007. DRA is filing an objection to the Petition by April 2007. If the decision stands favorable to DRA, GE will be required to pay \$639,836 to DRA within 60 days of when the decision becomes final. If the decision is overturned, DRA would be required to refund \$3,154,738 to GE. The State cannot predict the outcome of this matter at this time.

*Verizon NE v. Public Utilities Commission*, Civil Action 05-94-PB (USDC) is an action by Verizon challenging the Public Utilities Commission's (PUC) orders requiring it to share its lines and make other unbundled network elements available to Verizon's competitors at rates that Verizon claims are confiscatory. Verizon claimed that the PUC's orders violated federal law and sought declaratory and injunctive relief as well as unspecified damages.

On August 22, 2006, the United States District Court for the District of New Hampshire granted summary judgment in favor of Verizon and enjoined the PUC from enforcing its orders to the extent that they require Verizon to offer unbundled network elements to their competitors. The Court's Order did not contain an award of damages to Verizon. Verizon did not appeal the decision, but the State did. Both parties have filed their briefs and oral argument is scheduled for May 9, 2007. The State cannot predict the outcome of this matter at this time.

In *New Hampshire Association of Counties, et al. v. Commissioner of Department of Health and Human Services*, some of the State's ten Counties (the Plaintiff Counties) challenged the Department of Health and Human Services' ("DHHS") decision holding them responsible for paying a share of the cost of Medicaid payments for clients receiving Old Age Assistance ("OAA") or Aid to the Permanently and Totally Disabled ("APTD"). Under RSA 167:18-b, the counties are liable for one-half of the State's expenditures for OAA and APTD recipients who are "in nursing homes." DHHS believed that RSA 167:18-b also allowed it to bill the Counties for nursing services that are provided to recipients who are in institutions, such as rehabilitation hospitals, that are not licensed as "nursing homes" but are certified under Medicaid as nursing facilities authorized to provide nursing level care. DHHS has been billing the Counties for these services since at least 2002.

The second issue raised by the Counties in their suit is whether DHHS exceeded the statutory cap on the total amount that the Counties can be billed under RSA 167:18-b in fiscal year 2004. RSA 167:18-b establishes a \$60 million cap on the total liability for the Counties under this section of the statute. The legal dispute in this case involves whether that figure should be interpreted as a gross amount or a net amount. In 2004, the total amount of the bills sent to the Counties for their share of payments under RSA 167:18-b was approximately \$62.1 million. However, DHHS gave the Counties approximately \$2.1 million in statutory credits, thereby bringing the total owed to \$60 million. The Plaintiff Counties refused to pay the total amount, claiming that the statute limits the total amount that can be "billed" to the Counties at \$60 million, and therefore the credits should have been subtracted from the \$60 million, thereby limiting their liability to \$57.9 million.

The parties filed cross-motions for summary judgment and on October 27, 2006, the Merrimack County Superior Court granted summary judgment in favor of the Plaintiff Counties on both issues. DHHS filed a notice of appeal in November, 2006. Both sides have filed their briefs. The Court will schedule the matter for oral argument in the next few months.

It is difficult to predict the likely fiscal impact to the State at this time. If the ruling stands, the current estimate is that the Plaintiff Counties have withheld approximately \$5 million in payments billed by the State between 2002 and the present. Those moneys, which remain in those Counties' coffers, constitute an outstanding "account receivable" in DHHS's budget which would be written off if the ruling stands. In addition, the State estimates that, if ordered, it might have to refund, probably by means of a credit on future obligations, approximately \$1 million that has been paid in the past by the non-Plaintiff Counties.

It is not possible to ascertain the likely fiscal impact on the State in future years. RSA 167:18-b is set to "sunset" in 2007, and therefore, the Legislature will need to review the issue of the Counties' responsibilities for their share of Medicaid payments.

There are two cases currently pending in the New Hampshire Supreme Court involving rates paid by the Division of Children, Youth and Families ("DCYF"). The first, *Appeals of: Chase Home for the Children, Child and Family Services; Hannah House, NFI North, Odyssey Home, Orion House, and Pine Haven Boys Center*, docket number 2006-070, involves the fiscal year 2004-2005 rates paid to residential child care facilities. The Hearings Panel, established pursuant to RSA 170-G:4-a, ruled that DCYF should have set the rates in accord with certain administrative rules. The hearings officer ordered DCYF to pay the higher rates but determined that he had no authority to order DCYF to pay them retroactively. The facilities appealed the ruling regarding denial of the retroactive payments. Both sides filed their briefs and the matter was argued in March, 2007. A decision is expected by late summer. The second case is *Petition of the Division of Children, Youth and Families*, docket number 2006-510, in which DCYF is challenging a decision by the Hearing Panel ruling that DCYF is required to pay a 5% rate increase using the administrative rules rate as the base rate. And, the Hearings Panel ordered DCYF pay the higher rate retroactive to July 1, 2005. DCYF appealed so that the issues on appeal include whether the 5% rate increase should be calculated from the administrative rules rate as the base rate and whether the State may be

required to pay retroactively. Both sides filed their briefs and oral argument is scheduled for April, 2007. It is not possible to predict at this time the outcome of these cases or the amount, if any, that DCYF will be required to pay.

*Holiday, et al v. Stephen Curry, Commissioner, NH DOC, et al.* This is a class action filed in the Merrimack County Superior Court against the New Hampshire Department of Corrections (“DOC.”) The plaintiffs’ class, made up of all inmates of the New Hampshire State Prison, brought an equity petition to enforce various settlement agreements related to a comprehensive “conditions of confinement” suit dating back to 1976. The plaintiffs’ class alleged, and the court found, that the DOC materially breached certain elements of the settlement agreements relating to the provision of mental health care to inmates. In brief, the plaintiffs asserted that the DOC lacked a number of mental health programs and the staff to implement those programs. The matter was tried and the court ruled against DOC ordering it to develop an implementation plan and that the plan be executed. In particular, the court ordered the creation of a residential treatment unit to house and treat a sub-set of the class. Full implementation will require capital improvements, the hiring of correctional and mental health staff and operating expenses to sustain the program.

DOC has submitted its plan for the court to review. DOC also appealed parts, but not all, of the court’s order asserting that the court exceeded its authority under the settlement agreements. The parties settled the matters on appeal and the appeal has been withdrawn. The trial court scheduled a status conference for the end of June, 2007 to discuss the progress of implementation. DOC estimates that full implementation of the court’s order will require approximately \$9,000,000 over the next biennium.

*Bel Air Associates v. Department of Health and Human Services* was decided by the New Hampshire Supreme Court in September, 2006 involving certain restrictions on the rates paid by the Department of Health and Human Services (“DHHS”) to nursing home providers. The Supreme Court held that DHHS’ capital costs cap and its budget neutrality factor should have been created by administrative rule. The Supreme Court further held that because they were not created as rules, they could not be applied against Bel Air Associates. The Supreme Court did not order any damages against DHHS as it did not allow a late attempt by Bel Air Associates to add a breach of contract claim. Bel Air filed a petition for attorney’s fees with the Supreme Court which was denied. Bel Air Associates, however, filed a breach of contract claim in Merrimack County Superior Court in late November alleging approximately \$600,000 in damages. In December, 2006, DHHS also issued an emergency rule authorizing the capital costs cap and the budget neutrality factor. Various nursing homes have threatened to file injunctions preventing enforcement of the emergency rule. At this time, it is not possible to predict the outcome of these matters or the amount, if any, that DHHS will be required to pay.

*The State of New Hampshire v. Phillip Morris USA, RJ Reynolds, Inc. and Lorillard Tobacco Company.* This is a petition for a declaratory order. The defendants are signatories to the Tobacco Master Settlement Agreement under which the defendants are required to make annual payments to all of the states, including the State of New Hampshire. The payment received in 2006 was approximately \$5,000,000 below the required amount. On June 5, 2006 the Superior Court ordered the case to arbitration under the terms of the Master Settlement Agreement. A notice of appeal was filed to the New Hampshire Supreme Court on August 11, 2006. Briefs have been filed with the Court and oral argument occurred in March, 2007. The State is unable to predict the outcome at this time.

*New Hampshire Internet Service Providers (NHISPA) and Destek v. Department of Revenue Administration (DRA).* Plaintiffs claim that Verizon’s and other carriers’ collection of the Communications Services Tax on T-1 and T-3 services/lines is illegal as it is pre-empted by Federal law. DRA believes that collection of the tax is legitimate because DRA’s right to collect the tax is grandfathered under Federal law. This lawsuit was filed in Federal Court and appears to be subject to dismissal on the jurisdictional ground that the Federal Tax Injunction Act does not allow tax lawsuits against states in Federal court. However, this suit could be re-filed in State court. DRA estimates that the loss of revenue, if the tax were declared invalid or the grandfathering provision were repealed, would be between \$1,000,000 and \$3,000,000 in regards to the T-1 and T-3 services and other similar lines. If broadband and ISP access telephone were also included, the amount of lost revenue is estimated to be an additional \$3,000,000 to \$5,500,000. The State cannot predict the likely outcome of this case at this time.

*Carter, Celluci, and Durgin v. Department of Health and Human Services (DHHS).* This class action lawsuit, filed in the Federal District Court under 42 U.S.C. sec. 1983, seeks injunctive relief against DHHS for failure to make determinations relating to individuals seeking Aid To the Permanently and Totally Disabled within

the 90 day time limit set by Federal regulations. The lawsuit also alleges that DHHS fails to provide a required notification for appeal if the determination is not going to be made within 90 days. The lawsuit was filed on January 30, 2007. On April 9, 2007, DHHS filed a Motion for Entry of Judgment acknowledging that it was not meeting the 90 day determination period and requesting 45 days to file a plan with the Federal Court detailing how it will comply with the Federal regulations. The cost of implementation of the plan is estimated to be less than \$300,000 annually. However, the cost of attorneys' fees for the class' attorneys could be substantial if litigation proceeds. It is not possible to predict the outcome of this matter at this time.

*ACF Notice of Disallowance of FFP for Title IV-E Training Costs.* On February 26, 2007, the New Hampshire Department of Health and Human Services (DHHS) received a notice of disallowance of federal financial participation (FFP) in the amount of \$1,761,128.00 from the federal Administration for Children and Families (ACF). The disallowance was based on an audit report entitled Review of Title IV-E Training Costs in NH for the Period July 2000 through June 2003 issued by the Office of Inspector General (OIG) on or about January 25, 2007. ACF determined that DHHS did not properly allocate training costs for foster care and adoption assistance between state and federal programs. DHHS strongly disputes the asserted grounds for the disallowance and on March 28, 2007 appealed the notice of disallowance to the federal Departmental Appeals Board (DAB). The DAB has received the appeal and issued a briefing schedule, which DHHS received on April 16, 2007. The State is unable to predict the outcome at this time.

For additional information relating to litigation involving the State, see also Note 13 to the State's fiscal year 2006 audited financial statements, which are available as described below.

## **FINANCIAL STATEMENTS**

The preparation and release of the audited financial statements for fiscal year 2006 was delayed due to difficulties encountered in providing adequate and accurate data to the State's accounting department and the State's auditors. The State expects to receive by the end of May a management letter detailing many of the problems and issues identified during the fiscal year 2006 audit. The State has now released its audited financial statements which are contained in the Comprehensive Annual Financial Report for fiscal year 2006 (the "FY 2006 CAFR"), which is being filed on the date hereof with each nationally recognized municipal securities information repository ("NRMSIR" currently recognized under Securities and Exchange Commission Rule 15c2-12 (the "Rule"). The State had undertaken pursuant to the Rule to provide its draft financial statements or audited financial statements for fiscal year 2006 to each NRMSIR by March 27, 2007. On March 29, 2007, the State filed a notice of its failure to file such statements by the required date and stating its intention file the State's audited financial statements for fiscal year 2006 by April 13, 2007.

## **THE STATE OF NEW HAMPSHIRE**

APRIL 20, 2007

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