Business Law Section
Newsletter

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A MESSAGE FROM THE CO-CHAIRS

As my tenure as Co-Chair of the BBA's Business Law Section draws to a close, I find myself reflecting nostalgically on the countless opportunities that I have enjoyed over the past two years. Time and time again, I return to my interactions with your intelligent, witty and often harried Steering Committee members from each of our active committees. I want to thank each one of those Steering Committee members, as well as each member of the tremendous BBA staff, for their commitment and dedication to the BBA and its Business Law Section. Without their commitment and dedication, the exciting and innovative events and programs at the BBA simply would not happen.

We are truly fortunate to have an organization like the BBA that allows lawyers from all walks of life, all areas of practice focus, firms of all sizes, corporate law departments, governmental agencies and the like to work together as members of the Boston legal community. Considerable thought and energy is invested in trying to meet your needs as members and to evolve the BBA to keep pace with our rapidly changing industry. As stewards of the BBA, I encourage you to provide your feedback on BBA initiatives and to do your part to ensure the BBA continues to thrive and fulfill the needs of the Boston legal community.

Thank you for all of your support over the past two years.

I look forward to seeing you soon.

Enjoy the Summer!

MTB

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Featured Committee: Energy & Telecommunications

Sponsored Events by the Energy and Telecommunications Law Committee (September 2010 – June 2011)

• October 7, 2010 - CLE – Renewable Energy in Massachusetts: Financing and Building Projects in the Current Environment
  Co-Sponsor: Air Quality and Climate Change Committee

  Co-Sponsors: Environmental Litigation Committee; Wetlands, Waterways and Water Quality Committee; Air Quality and Climate Change Committee

• January 4, 2011 - Energy Efficiency in Massachusetts: Issues and Opportunities
  Co-Sponsor: Environmental Law Section

• January 11, 2011 - BACT for GHGs: EPA’s PSD and Title V Permitting Guidance for Greenhouse Gases
  Co-Sponsor: Air Quality and Climate Change Committee

  Co-Sponsor: Environmental Law Section

• February 8, 2011 – The Massachusetts Clean Energy and Climate Plan for 2020
  Co-Sponsors: Air Quality and Climate Change Committee; Real Estate Section; Land Use and Development Committee; Environmental Law Section

• March 31, 2011 – Meet the New EEA Leadership: Richard Sullivan, Secretary of Energy and Environmental Affairs and Gary Davis, General Counsel
  Co-Sponsor: Environmental Law Section

• April 19, 2011 – The Legislature’s Energy Agenda: Views from the Senate
  Co-Sponsor: Environmental Law Section

• May 3, 2011 – The Legislature’s Energy Agenda: Views from the House
  Co-Sponsor: Environmental Law Section


• June 21, 2011 -- What is “Clean” Energy? Policy and Science Perspectives on Defining Criteria for “Clean” and on Current Energy Options, Risks, and Costs
  Co-Sponsor: Environmental Law Section
Introduction

In 2008, the Massachusetts Department of Public Utilities (“Department”) issued a generic order that adopted a new ratemaking policy to decouple rates for Massachusetts gas and electric local distribution companies.1 The Department pursued the new policy as a means to remove barriers to deployment of energy efficiency. The 2008 generic decoupling order also recognized the potential to allow utilities to recover capital investment-related costs on an annual basis through a new ratemaking mechanism, a capital cost tracker. Although the Department sought to have all local distribution companies adopt decoupled rates by December 31, 2012, the Department recognized the need to implement decoupled rates on a case-by-case basis in a fully litigated base rate case. Therefore, the Department directed each utility to submit a proposal to implement decoupled rates within each utility’s next base rate case.

An article jointly-authored by Jed Nosal, Jamie Tosches DeMello and Laura Bickel entitled Cost Trackers and Decoupling: Recent Changes and Trends in Regulatory Ratemaking was published in the 2010 Spring Edition of this newsletter.2 That article discussed the first two base rate case orders in which the Department reviewed and approved implementation of decoupled rates and a capital cost tracker for two utilities in 2009, namely Bay State Gas Company (“Bay State Gas”) and Massachusetts Electric Company and Nantucket Electric Company d/b/a/ National Grid (“National Grid Electric”). This article provides an update to discuss the progress of implementing decoupled rates for the Massachusetts utilities since the Department issued the 2009 rate orders. Therefore, this article focuses on the Department’s four most recent base rate case orders issued in 2010 and 2011.3 This article also discusses the annual rate adjustments made in 2010 and 2011 pursuant to the decoupling and capital cost tracker mechanisms previously approved in 2009 for Bay State Gas and National Grid Electric.

Context for Adoption of Decoupled Rates

In issuing the 2008 generic decoupling order, the Department sought to implement a revenue decoupling ratemaking framework for each utility. It sought to implement decoupling to remove disincentives to deployment of energy efficiency by severing the link between the level of revenues that a utility collects from customers and the level of sales. By removing the link between sales and revenues, the Department sought to make the utilities “revenue neutral” so that a utility would not be impacted by decreased sales.

At the time the Department adopted its decoupling policy, Massachusetts had begun to elevate the importance of energy efficiency in meeting the energy needs of the Commonwealth’s customers. Then, in the summer of 2008, the Massachusetts Legislature passed a mandate within the Green Communities Act that required the Department to direct Massachusetts natural gas and electric local distribution companies to deploy all energy efficiency and demand reduction resources that are cost effective or less expensive than supply. St. 2008, c. 169, § 21. Pursuant to this mandate, on January 28, 2010, the Department approved plans that called for electric and gas utilities to invest approximately $2.2 billion in efficiency measures over three years.4 The plans commenced on January 1, 2010 and represented a significant ramp up of the utility energy efficiency programs.

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1 The Massachusetts local distribution companies include: Bay State Gas Company d/b/a Columbia Gas of Massachusetts; Boston Gas Company, Essex Gas Company and Colonial Gas Company, each d/b/a National Grid; Blackstone Gas Company; Berkshire Gas Company; Fitchburg Gas and Electric Light Company d/b/a/ Unitil; Western Massachusetts Electric Company; Massachusetts Electric Company and Nantucket Electric Company d/b/a/ National Grid; New England Gas Company; NSTAR Gas Company; and NSTAR Electric Company. The term local distribution company is used interchangeably with utility and company in this article.


4 Funding for the programs will include existing charges on ratepayer bills, carbon allowance auction proceeds from the Regional Greenhouse Gas Initiative, and other customer contributions.
Reports indicate that, on an aggregate basis, the utilities have met their 2010 goals set out in the three year plans.

The Department recognized the need to implement its decoupling policy on a case-by-case basis in the context of a fully adjudicated base rate case pursuant to G.L. c. 164, s. 94. That law provides that a utility’s distribution rates must be set at just and reasonable levels. Each base rate case filing evokes a separate six-month adjudicatory proceeding that involves a full review of a company’s financial status to set the appropriate base rate. These proceedings are litigated before the Department, and the utilities and Attorney General are the primary litigants, the latter representing customers’ interests.

Under traditional ratemaking methods, base rates get set at a level that provides a utility an opportunity to recoup operating costs from customers for providing distribution service to those customers and to earn a reasonable rate of return on its capital investments. The base rate remains in effect until the next rate case. Revenues collected from customers fluctuate if sales go up or down during the period between rate cases. In contrast, under a decoupling mechanism, the Department sets a base rate and target revenues in a base rate case. The target revenue level is set at a level designed to allow the utility an opportunity to recoup its operating costs for providing distribution service and earn a reasonable rate of return on its capital investment. Utilities make annual and semi-annual filings to reconcile revenues to the target level of revenues which are reviewed by the Department. Annually, base rates change to reflect the reconciled amounts of revenues.

Implementation of Decoupling and Capital Cost Trackers

In 2009, Bay State Gas and National Grid Electric became the first two utilities in Massachusetts to obtain Department approval to implement decoupled rates and a capital cost tracker, each in the context of a base rate case. In 2010 and 2011, four other utilities sought Department approval to implement decoupled rates and a capital cost tracker in the context of a base rate case. These included: Western Massachusetts Electric Company (“Western Mass.”); New England Gas Company (“New England Gas”); Boston Gas Company, Essex Gas Company and Colonial Gas Company, each d/b/a National Grid (“National Grid Gas”); and Fitchburg Gas and Electric Light Company d/b/a/ Unitil (“Fitchburg”) (collectively “the Companies”). Each of the Companies filed a single base rate case with exception to Fitchburg. The latter company filed two base rate cases, one involving its electric division and the other its gas division.

All of the Companies received the Department’s approval to implement decoupled rates. Each of the Companies put forth a decoupling proposal that was largely consistent with the decoupling proposals previously approved by the Department for Bay State Gas and National Grid Electric in 2009. In some cases, the Department made selected modifications to the decoupling proposals before approving them.

In contrast, only two of the four Companies received the Department’s approval to implement a capital cost tracker. Two gas utilities, New England Gas and National Grid Gas, received the Department’s approval to implement a capital tracker that was similar to tracker approved in 2009 for Bay State Gas. These capital cost trackers targeted the replacement of aging gas mains and services prone to leaks or breakage. Western Mass. and Fitchburg did not have the same successful outcome. The Department rejected Western Mass.’s and Fitchburg’s request to implement capital cost trackers. It found that their proposed capital cost trackers would not serve the best interest of customers. As a result, Western Mass. and Fitchburg would have to defer collection of its capital investments until each utility’s next rate case.

Western Mass.’s requested to implement a capital cost tracker to recover $289 million dollars over a ten-year period to support various capital programs. The Department denied the request for a number of reasons. First, the Department found that Western Mass. failed to show that implementation of decoupling would likely result in the loss of future revenue streams (from increased sales) that the Company needed to finance capital investments. Second, the Department found that roughly 75 to 80 percent of the reliability-related benefits that Western Mass. claimed would result from the implementation of programs paid for through the capital cost tracker would be attributed to only 16 percent of the proposed ten-year capital program budget of $289 million. Therefore, the Department stated that it was not persuaded that the proposed capital cost tracker and associated programs would have a significant impact on reliability.

Third, the Department found that a $64 million program for replacement of aging overhead wires over ten years old was poorly designed, and therefore, should not be subject to a capital cost tracker.

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5 Many distribution related costs have been removed from base rates and are recovered through separate reconciling mechanisms.

6 The Department has authorized the gas utilities to use a “revenue-per-customer” decoupling approach and the electric utilities to use a “total revenue” decoupling approach. See D.P.U. 11-01, 11-02, p. 103.

7 D.P.U. 10-70, p. 49.
Similarly, the Department rejected Fitchburg’s proposal to implement capital cost trackers for its electric and gas divisions. Like in the case of Western Mass., the Department found that Fitchburg failed to show it needed a capital cost tracker to substitute for lost future revenue from increases in sales. The Department also found that the Fitchburg’s electric division had a significant stream of revenue from depreciation of assets that could fund capital investments. With respect to Fitchburg’s gas division, the Department found that Fitchburg did not intend to accelerate its replacement of gas mains. In approving capital cost trackers for other gas companies, the Department reasoned that capital cost trackers were warranted when a gas company sought to increase the pace of capital investments. That was not the case with Fitchburg.

The Western Mass. and Fitchburg cases make clear that the Department will not necessarily grant use of a capital cost tracker to a utility in conjunction with proposal for adoption of decoupled rates.

**Base Rate Increases & Return on Equity**

In their respective base rate cases, the Companies each requested a significant increase in base rates. They claimed the increase was justified to pay for the increased operating and maintenance costs and the return on investment. By law, utilities’ rates must provide them an opportunity to earn a reasonable return. The level of return that a utility may recover from customers in base rates depends on the allowed rate of return on equity set by the Department within a base rate case.

In all of the base rate case proceedings involving decoupling, the utilities and Attorney General debated whether the Department should significantly lower each utility’s proposed return on equity to reflect a reduction in utility risk from the implementation of decoupling proposals (and to a lesser degree the capital cost tracker). The Department determined that, all other things being equal, adoption of a revenue decoupling mechanism reduces the variability in a utility’s collection of revenue from customers. It further reasoned that such reduces the risk to investors’ required return. Consistent with its 2009 base rate orders, the Department significantly reduced each utility’s proposed return on equity for the Companies.

Prior to the adoption of decoupling in Massachusetts, a review of selected rate case orders shows that the return on equity was set between 10 percent and 10.25 percent. In 2009, the Department had allowed Bay State Gas a return on equity of 9.95 percent (versus 11.00 percent requested), and National Grid Electric a return of 10.35 percent (versus 11.06 requested). In its 2010 and 2011 base rate orders, the Department set the return on equity considerably lower: 9.6 percent for Western Mass. (versus 10.5 percent requested), 9.75 percent for National Grid Gas (versus 11.3 percent requested), 9.45 percent for New England (versus 10.6 percent requested) and 9.20 percent for Fitchburg.

Fitchburg earned a return on equity infamously ranked as the lowest rate of return set by the Department in 50 years. The Department justified assignment of a comparably low rate of return to Fitchburg based on its continued subpar management performance.

The effect of these 2010 rulings on base rates was significant. ‘Western Mass.’ request to increase customers’ electric base distribution rates by approximately $28.4 million was reduced by $11.6 million increase or by 41 percent; National Grid Gas’ request to increase rates by $106 million was reduced by $46 million or by nearly 50 percent of the original rate request; New England Gas received a $5.1 million increase in base rates compared to its request for an increase of $6.2 million representing a 17 percent decrease in the base rate request; and Fitchburg’s combined request to increase rates by $11,597,158 was decreased by $4.6 million or 40 percent of what was proposed.

**Annual Decoupling and Capital Cost Tracker Filings**

As previously noted, utilities that have decoupled rates must make annual or semi-annual filings to modify base rates to reflect the reconciliation of revenues to the target level of revenues. In addition, utilities must make annual filings to establish the annual rate increase for recovery of capital-related costs and returns through its capital cost trackers. Bay State Gas and National Grid Electric have adjusted base rates and made a request for a rate increase under its capital cost tracker.

**Modification of Base Rates Through Decoupling Mechanisms**

National Grid’s first annual filing under its decoupling proposal approved in D.P.U. 09-39 sought to implement a customer credit because the company collected more than percent set in D.P.U. 07-71.

9 In 2009, the Department had reduced Bay State Gas’ proposed rate increase request by 45 percent, and National Grid Electric’s request by 60 percent.
its required target revenues. On the other hand, Bay State Gas sought to increase its base rates to collect an additional $5.6 million from customers to make up for target revenues not collected. Of the $5.6 million Bay State Gas under-collected, $4.5 million resulted from lost sales due to warmer weather in the heating season, not energy efficiency. The Attorney General opposed collection of the $4.5 million weather-related amounts primarily arguing that that loss in revenue did not further the objectives of the Department’s decoupling policy goals to facilitate deployment of energy efficiency and demand resources, and if collected, would result in unjust and unreasonable rates. The Department allowed the adjustment but noted that it did not have sufficiently robust data and information about the Company’s rates to modify the decoupling mechanism at the time. The Department stated it would continue to closely evaluate the implementation of the decoupling mechanism to ensure it operates as intended.

**Capital Cost Tracker Annual Filings**

In 2010, Bay State Gas and National Grid Electric filed the first annual petitions to recovery capital-related costs through their capital cost trackers. Bay State Gas and National Grid Electric each sought to include an annual revenue requirement of $2.1 million and $6.8 million in rates, respectively, in order to recover an annual revenue requirement for capital related costs. The revenue requirement is the dollar amount that gets put into rates to recover capital-related costs (e.g. depreciation, taxes, and a return on the investment). Final orders are pending in both cases, however, on June 15, 2010 the Department issued an interlocutory order in the National Grid Electric case that stated that it would not issue a final order until an audit of the company’s records and processes to record and report on capital expenditures was completed. The Department stated that the audit results would inform its decision of whether it can “reasonably rely upon the documentation provided” by National Grid Electric in support of its capital recovery request.

**Conclusion**

By now, a majority of Massachusetts utilities have implemented decoupled rates; NSTAR Gas Company, NSTAR Electric Company and Berkshire Gas Company have yet to file a rate case to do so. Fitchburg is in the process of implement decoupled rates pursuant to the Department’s August 2011 base rate case order. The decoupling proposals filed by the Companies in 2010 and 2011 and later approved by the Department resembled those approved by the Department in 2009. In the 2010 base rate orders, the Department continued to recognize that decoupling and to a lesser degree implementation of a capital cost tracker reduces the risk to a utility and consequently issued lower returns on equity for each of the gas and electric utilities in 2010. Although reports indicate that the Massachusetts utilities have each met their 2010 targets for deployment of energy efficiency, the connection between decoupling and deployment of energy efficiency is unclear at this early stage in implementation of decoupling. Decoupling revenue adjustment filings made by one company demonstrate a significant portion of the revenue losses were weather driven, not energy efficiency driven.

The capital cost trackers filed by the gas companies resemble one another and have been approved by the Department. The Fitchburg and Western Mass. cases show that the Department will not necessarily grant use of a capital cost tracker to a utility, even when the utility adopts decoupled rates. Though capital cost trackers are in use, concerns about the reviewability of the capital investments within the annual proceedings led to one audit of a company’s record keeping and reporting on capital investments. Moreover, the extent to which the capital cost trackers will improve system reliability and public safety is unknown at this time and in the early stages of implementation of capital cost trackers.

**Disclaimer:** The views and opinions of author expressed herein do not necessarily represent or reflect the views of the Attorney General of the State of Massachusetts and are solely the views and opinions of the author.

**Credits:** The author wishes to thank Jed Nosal and Laura Bickel for their work on the predecessor article entitled “Cost Trackers and Decoupling: Recent Changes and Trends in Regulatory Ratemaking.”

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10 Massachusetts Electric Company and Nantucket Electric Company, each d/b/a National Grid, D.P.U. 10-152 (2011). The credit would be applied by a negative $0.00015 per kilowatthour (“kWh”) charge effective for the twelve-month period beginning March 1, 2011.


12 Subsequently, Bay State Gas filed a second decoupling adjustment that indicates that of the $2.6 million adjustment it seeks, approximately $576,000 or 28 percent is due to forecasts of warmer than normal weather. The proceeding was docketed as In D.P.U. 11-31 and is in the discovery phase.

13 Notably, when the Department held its generic proceeding to review and adopt decoupling, the Attorney General opposed inclusion of weather related revenue losses in the decoupling adjustment for these reasons.


15 To be conducted pursuant to G.L. c. 25, s. 5E.
Nearly three years ago Governor Deval Patrick signed into law the Green Jobs Act\(^1\), creating the Massachusetts Clean Energy Center (MassCEC) to accelerate the growth of Massachusetts’ clean energy sector. Historically, resources aimed at supporting this critical industry spanned multiple state and quasi-public agencies. Today, MassCEC serves as a central clearinghouse and support center for the entire clean energy industry, providing assistance to generation projects, technology companies, research institutions, and workforce programs as well as other partners in clean energy community. We are dedicated to accelerating the success of clean energy development and implementation, while creating high quality jobs and long-term economic growth for the people of Massachusetts. Our goal is to grow Massachusetts’ clean energy sector in order to secure a clean energy future for future generations.

## Continuing a History of Support for Clean Energy

Whereas clean tech, renewable energy and energy efficiency have dominated the national energy conversation more recently, Massachusetts has been leading the way for well over a decade. With the restructuring of the Commonwealth’s energy market in 1997, the General Court created the ratepayer-funded Renewable Energy Trust Fund\(^2\) (RET) to support the development, commercialization and deployment of renewable energy generation technologies. These programs, however essential to starting Massachusetts down a path toward greater energy and environmental security, addressed only a portion of the clean energy ecosystem. Thus, legislation\(^3\) passed in 2009 placed administration of the RET within the newly-formed MassCEC, creating a “one stop shop” for project developers, entrepreneurs, communities and other stakeholders.

## Executing MassCEC’s Mission

MassCEC’s broad mandate is carried out through its four divisions, which work together to increase indigenous clean energy generating capacity, reduce market barriers, accelerate technology commercialization and create good jobs that contribute to Massachusetts’ clean energy future.

### Clean Energy Sector Development

MassCEC’s Clean Energy Sector Development division seeks to build a sustainable community of clean energy partners that support the Commonwealth’s world-class cluster of clean energy companies. While other divisions generally provide project- or company-specific support, the Sector Development division looks for opportunities to accelerate the growth of the sector as a whole. In some cases, we accomplish this by partnering (formally or informally) with industry leaders such as the New England Clean Energy Council (NECEC), the University of Massachusetts, Fraunhofer USA as well as clean energy entrepreneurs to bring federal funding into Massachusetts. Among our marquis achievements is the opening of the world’s largest wind turbine blade testing facility, the Wind Technology Testing Center, in Charlestown, Massachusetts. The WTTC, which is owned by MassCEC and operated with assistance from the National Renewable Energy Laboratory, offers a full suite of certification tests for turbine blades up to 90 meters in length to help the wind industry deploy the next generation of land-based and offshore wind turbine technologies. This first-of-its-kind facility, completed on time and on budget, opened this May.

### Workforce Development

A well-trained workforce, from entry- to C-level, is essential for growing a robust clean energy industry. MassCEC makes investments in workforce training programs throughout the state and played a lead role with the Executive Office of Labor and Workforce Development and Commonwealth Corporation in applying for American Reinvestment and Recovery Act funds focused on workforce. Through its work and partnerships with the various Workforce Investment Boards, colleges and universities and vocational technical schools, and other state agencies, MassCEC connects people with the information they need about clean energy and its impact on the workforce. Among our most recent initiatives, MassCEC (in partnership NECEC) launched a clean energy internship program dedicated to connecting students throughout the Commonwealth to internships at Massachusetts-based clean energy companies. In addition to compensation, this

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program gives interns meaningful employment experience such as networking opportunities, mentoring, and industry knowledge only gained from working within clean energy companies. To date, the program has been incredibly successful, placing 50 students at 28 clean energy companies in round one.

Investments in Clean Technology
MassCEC’s Investments in Clean Technology division directly invests in companies across the development spectrum that are bringing to market game-changing clean energy technologies. MassCEC’s current portfolio demonstrates the breadth of the clean energy marketplace, including wind, solar, efficiency, biofuel and energy storage companies. MassCEC’s investment strategy is to identify high-potential clean energy companies seeking to establish themselves and create value in Massachusetts. The Investments team does this through rigorous due diligence into a company’s team, financials and technology, and by intelligently structuring a deal based on its needs and expected returns. A typical early-stage investment might include a $400,000 equity investment, made alongside other leading venture or strategic investors as part of a larger funding round. Debt investments are often more appropriate for mature companies, where additional value is created through job creation commitments. Each company MassCEC invests in has the potential to create local jobs, foster clean energy careers, increase the state tax base, and provide opportunities in the clean energy industry to graduates of the state’s world class universities.

Renewable Energy Generation
Accelerating the deployment of renewable energy generating technologies is critical to Massachusetts meeting its energy and environmental goals. The Renewable Energy Generation division is responsible for supporting projects throughout the Commonwealth that maximize the environmental and economic benefits of renewable energy for Massachusetts citizens, businesses and communities. To date, MassCEC has supported more than 2,000 wind, solar, hydro, biomass, and other clean energy projects in more than 275 communities. The type of support offered by MassCEC varies based on the type of technology, project characteristics and market needs. Among the first solar programs offered was Commonwealth Solar, which provides rebates to owners of solar photovoltaic systems based on the size of the system. As a result of the Commonwealth Solar program, the Commonwealth is in the midst of a 25-fold increase in solar photovoltaic -from 3.5 megawatts of solar installed in 2007 to approximately 90 megawatts of installed or in design and construction by the end of 2011. Over the past few years, solar has become substantially more cost competitive with conventional power, and MassCEC has responded by reducing rebate levels and introducing new mechanisms to drive adoption. Most recently, MassCEC launched the Solarize Massachusetts pilot that utilizes combination of consumer education and group purchasing to dramatically accelerate the installation of residential solar PV systems throughout the Commonwealth. Early signs indicate that this goal could be accomplished at substantial (as much as 15 percent to 20 percent) cost savings compared with a typical installation.

Fiscal Year 2012: A Look Forward
In addition to continuing the initiatives mentioned above, in the coming year we seek to establish ourselves as the go-to source of clean energy information and resources for the people and professionals in Massachusetts. This will include projects such as an analysis of the clean energy sector in Massachusetts, a database of federal, state and local incentives and policies related to clean energy and manufacturing and case studies on success stories from our own clean energy community.
Smart Grid: Quick Fix or Staying Power?  
By Laura C. Bickel

In recent years, testing and implementation of smart grid technology for the electric grid has received an extraordinary amount of media and customer focus in the United States. While the concept of smart grid implies overall modernization, many different types of technology can constitute a part of smart grid, making it difficult to define.

The “smart grid” generally refers to an upgraded distribution network for electricity that allows for much more than a traditional, one-way delivery of power that originates from a generating station and travels through a distribution system to a customer. A smart grid typically includes advanced metering infrastructure that can collect, store, and communicate electricity consumption data from a home or business, thereby enabling both two-way communication between the central grid operator and customers as well as dynamic (i.e., time-based) pricing. Also, smart grid often includes distribution automation, which involves the installation of sensors on the distribution system to monitor the amount and flow of power on the grid and report the location of any outages to the central grid operator. These sensors, along with reclosers, make it possible to isolate problems and re-circulate power along alternative paths to shorten the duration of outages, what is often called the “self-healing” aspect of smart grid. Smart grid also encourages the interconnection of more complex sources of generation and electricity consumption like renewable energy units and plug-in electric vehicles. The ultimate goal of these improvements is to ensure that the electric grid is efficient, robust, and able to accommodate modern needs and policies with regard to the provision of electricity.

The collection of real-time information on electricity consumption and grid operations is progressing from theory to practice, and unprecedented numbers of customers are beginning to access their electricity consumption information in their homes, on the internet, and through handheld devices. Early advocates for the deployment of smart grid technology have already experienced victories and setbacks in petitioning state public utility commissions, both of which provide useful guidance for others.

In Massachusetts, the Legislature’s enactment of the Green Communities Act in 2008 included many new energy policy mandates for the both Department of Public Utilities (“Department”) and the electric distribution companies to pursue. One such mandate is for each electric distribution company to conduct a Department-approved smart grid pilot program, and it includes specific requirements on metering, distribution automation, dynamic pricing, a minimum number of customers to enroll, and load reduction objectives.¹ Also, this statute requires the Executive Office of Energy and Environmental Affairs to report to the Legislature in August 2012 with an assessment of the pilot programs and whether they should be modified and further implemented.

Two smart grid pilot programs have been approved by the Department and are beginning in summer 2011. On June 1, 2011, Unitil began its three-month study of 304 customers in Massachusetts and New Hampshire, including 96 customers in Massachusetts.² NSTAR Electric Company has been bringing customers into its pilot program in phases and, by the end of the summer, it will be studying 3,000 customers in Newton, Hopkinton, and Jamaica Plain over almost two years.³ Both Unitil and NSTAR will be using a combination of new and upgraded technology to include advanced metering, dynamic pricing, and distribution automation in their pilot programs. Two more pilot programs have been withdrawn by National Grid and Western Massachusetts Electric Company in order to be redesigned and re-filed for review. Each pilot program has been unique in terms of its timeline, number of customers, approach to technology, pricing, and other elements. To minimize incompatibilities between the results of the pilot programs, the Department in 2010 initiated a Smart Grid Collaborative with members from the electric distribution companies, the Attorney General’s office, low-income customer advocates, and others. To date, the Smart Grid Collaborative has developed four tools that will be jointly implemented in the smart grid pilot programs: (1) a common evaluation framework for collecting qualitative and quantitative data on customer responsiveness; (2) a pre-pilot customer survey; (3) a post-installation customer survey; and (4) a non-participating customer survey.⁴ These tools are expected to enhance the information that will be collected through the pilot programs and help answer a central question for smart grid: what factors make customers respond

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2. See Fitchburg Gas and Electric Light Company d/b/a Unitil, D.P.U. 09-31 (2010).
differently to the provision of electricity consumption information, pricing, and technology?

Beyond Massachusetts, public utility commissions across the country have been reviewing numerous proposals for testing and implementing smart grid infrastructure and rate design. Some proponents have sought funds to match awards received pursuant to the American Reinvestment and Recovery Act for pilot or demonstration projects, while others have sought approval for wider deployments of smart grid technology to initiate long-term goals such as facilitating dynamic pricing for all customers, improving the efficiency of the electric grid, and meeting environmental objectives.

Not every attempt at a broad deployment of smart grid technology has met with wide customer acceptance, however, and there have been notable examples to the contrary in both California and Maine. Some Pacific Gas & Electric Company (“PG&E”) customers with smart meters complained of gross miscalculations of monthly bills, which were later determined by an independent evaluator to be unrelated to the new technology.\(^5\) Instead, PG&E customer service was found to have been underprepared for the transition. Also, some customers of PG&E and Central Maine Power (“CMP”) have voiced concerns about health effects resulting from additional radiofrequency radiation associated with smart meters. In response to such complaints, the public utilities commissions of Maine and California have been considering whether broad deployments of smart grid technology should include the ability for some customers to opt-out of smart meters, possibly at the customer’s own expense, and directed PG&E and CMP to file proposals. The Maine Public Utilities Commission has already determined that CMP customers should have the ability to opt-out of mandatory smart meters, and it has approved a relatively moderate list of charges.\(^6\) The California Public Utilities Commission is still considering PG&E’s proposal, which includes somewhat less moderate charges, and it is expected to issue a decision in September 2011.\(^7\)

Despite these early setbacks, the deployment of smart grid technology seems like more than merely a passing fad for the electric industry. The American Reinvestment and Recovery Act of 2009 (“ARRA”) committed $3.4 billion in smart grid investment grants (“SGIG”) projects with an additional $600 million for smart grid demonstration projects (“SGDP”). The 99 SGIG projects are expected to result in 15.5 million smart meters, along with in-home energy management displays, smart thermostats, plus a number of advanced circuits, transformers, and load management devices. The 32 SGDP grants will fund regional smart grid demonstrations and energy storage demonstrations. Because both the SGIG and SGDP grants require recipients to provide at least 50 percent matching funds for the costs of the project, the $4 million in ARRA funding will result in $9.5 billion in overall smart grid investments. Also, on June 11, 2011, the White House announced a commitment to smart grid initiatives, a report titled, “A Policy Framework for the 21st Century Grid,” and a $250 million loan program for smart grid technology development in rural areas.

As the volume and precision of data collected through smart grid technology increases, so does the potential for opportunities and harm. Customers will be able to access more refined information about their electricity consumption than ever before and self-manage their energy use or invite others to manage it for them. At the same time, these new capabilities open the door to innovative forms of mischief and crime, an important topic that is worth more detailed attention than this article can provide. Certainly, educating customers about the potential advantages and risks inherent in the collection and sharing of their electricity consumption data is of paramount importance. Some jurisdictions already have policies in place to determine the two fundamental questions about privacy and security: who “owns” and who should have access to such consumption data? The Colorado Public Utilities Commission requires customers to sign an extensive consent form before a utility can release a customer’s data. On May 6, 2011, the California Public Utilities Commission released for comment a 140-page proposed decision addressing smart grid privacy and security issues.\(^8\) Given the importance of maintaining the privacy and security of customers’ information and the growing number of smart grid projects that will be collecting data over the next several years, other jurisdictions will undoubtedly begin developing their own policies addressing these issues.

If smart grid technology is here to stay, other changes are likely to follow too. Advanced energy management devices, smart appliances, plug-in electric vehicles, and renewable energy installations may become common among all customers. If fully realized, all of these innovations will substantially change the way that customers use electricity and will determine to what extent they are responsive to system peaks and dynamic pricing. In turn, the evolution of smart grid will also determine to what extent utilities, regulators, and legislators are responsive to customers’ needs for information, choice, and adequate protection.

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5 See CPUC Application A.07-12-009.
7 See CPUC Application A.11-03-014.
8 See CPUC Rulemaking R.08-12-009.
The Public Policy Committee (the “Committee”) focuses on examining public policy questions in the area of business law and regulation. As all public policy proposals endorsed by the BBA must first be approved by each of the BBA’s Sections, including the Business Section, the Committee draws on both the substantive and technical expertise of its members to propose innovative responses to such questions. The Committee’s members represent a number of industries within the public and private sectors, as well as a cross-section of litigation and transactional business lawyers.

Committee members have been traditionally responsible for the following:

- Attending monthly Committee meetings;
- Identifying, analyzing and proposing policies regarding the practice of business law to be endorsed by the BBA, reviewing the potential impact to the practice of business law of such policies, and responding on behalf of the Business Section in connection with proposals of peer sections;
- Representing the Committee and the Business Section on ad hoc BBA committees (such as Consumer Finance Protection Committee, Office of Attorney General Regulatory Review and New Lawyer Committee) or serving as a liaison to such committees;
- Attending Brown-Bag or other events sponsored by the Committee;
- Attending meetings with BBA staff regarding public policy initiatives of the BBA; and
- Recruiting additional members to the Committee and the BBA at large.

In the past few months, the Committee has reached out to several members of the State House for input on legislation that affects our community. In December 2010, the Committee held a brown bag on the evolving employee noncompetition legislation in the state House of Representatives. In March of 2011, the Committee took a legislative field trip to visit members of the state Senate for input on consumer protection and affordable housing laws. In its new role as a joint committee between the new Business Transactions and Financial Services Sections, the Committee plans to expand such activities as well as determine whether it will make any formal proposals that the BBA endorse relevant business-related legislation.

The current Co-chairs of the Committee are Pratt Wiley of Nutter McClennen & Fish, LLP, Lourdes German of Fidelity Capital Markets, and Lindsey Burton of Litle & Co., LLC. Incoming Co-chairs for the 2011-2012 BBA term are Lindsey Burton and Robert Amara of Krefetz Law Firm.
Overview of L3Cs

On June 1, 2011, the Massachusetts State Legislature’s Joint Committee on Community Development and Small Business held a public hearing on House Bill 1868, An Act Relative to Creating Low Profit Limited Liability Companies, filed by committee co-chairperson Representative Linda Dorcena Forry (D-12th Suffolk District). This legislation seeks to amend the Massachusetts Limited Liability Company Act to allow the formation of Low-Prof- it Limited Liability Companies (L3C) in Massachusetts. Currently, eight states have implemented legislation allowing the organization of L3Cs.

An L3C is a for-profit entity that retains many of the characteristics that make a limited liability company (LLC) so popular, such as relative ease to operate and limited liability for its members; however, the principal objective of an L3C is to serve a socially beneficial purpose, with the profit motive being of secondary significance to the entity. The proposed legislation defines a “socially beneficial purpose” as one that significantly furthers one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the Internal Revenue Code. This was done intentionally to be consistent with Internal Revenue Service (IRS) regulations that allow private foundations to make investments to support charitable or educational activities, known as Program Related Investments (PRI), without jeopardizing their nonprofit status.

A major advantage of the L3C form is that private foundations and for-profit investors would be able to accept different levels of risk and return. Private foundations could make high risk investments with little return on their PRI, allowing the foundation to support the socially beneficial goals of the L3C and meet the requirements of PRI, while reducing the risk to other investors and increasing the incentive for for-profit investors to invest. The favorable distribution of risk among investors with different objectives has the potential to spur increased investment in community development and socially beneficial industries.

“What the L3C does is bring resources and therefore capacity to resource starved areas in any state and the nation and therefore creates capital where capital doesn’t exist,” according to Steve Gunderson, CEO of Council on Foundations.

Unfortunately, the IRS has not yet made any definitive ruling as to whether foundation investment in L3Cs will qualify as PRI. This may serve as a source of concern for private foundations in making investment decisions that could jeopardize their nonprofit status. However, even if L3Cs cannot attract foundation PRI in the short term, the choice of an L3C form may give credibility and marketing appeal, while keeping open the possibility of future PRI funding.

How can L3Cs be used?

L3Cs can be used as a tool to aid the development of a diverse spectrum of socially beneficial projects, from re-developing unused warehouse space into business incubators to the creation and operation of charter schools. There were 175 L3Cs organized in the United States as of the spring of 2010, with at least one operational in Massachusetts. Prosperity Candle, a foreign-registered L3C organized under the laws of Vermont, invests in the candle-making enterprises of women who live in the

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1 G. L. c. 156C, § 1-72
2 L3C enabling legislation has been enacted in Illinois, Louisiana, Maine, Michigan, North Carolina, Utah, Vermont, and Wyoming.
3 This is particularly true when compared to a Section 501(c)(3) nonprofit organization, which has very specific requirements.
4 I.R.C. § 4944(c)

LC3s: Are For-Profit/Nonprofit Hybrids Coming to Massachusetts?
By Robert Amara

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5 For more information about Council on Foundations, please visit http://www.cof.org/
7 See, www.properitycandle.com
world’s conflict zones and markets these candles locally and internationally. The main mission of *Prosperity Candle* is encouraging entrepreneurship and empowerment of women in distressed areas of the world, while the profit motive is of lesser significance. This L3C has been operating since 2008 and completed a successful pilot program in 2010 providing more than 50 women in a place of conflict the opportunity to start their own businesses.

According to Robert M. Lang, Founder of Americans for Community Development,8 “the L3C is a vehicle that can help the poor and the underserved parts by providing a way to manage and fund the solutions to these problems. The key is that unlike so many solutions that are on the table today the L3C will not cost the government a dime and in fact, as viable businesses are developed, the L3C as a tax paying entity would actually contribute to the revenue stream.”

Given the potential opportunities the L3C form provides, the BBA Business Law Section Public Policy Committee will continue to closely monitor the progress of House Bill 1868 in the Massachusetts Legislature. The bill currently remains in the Community Development and Small Business Committee, and the Committee welcomes any comments BBA members may have on this legislation.

The author wishes to thank Jessica Manganello, Esq. of New Leaf Legal, LLC for her contributions to this article.

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8 For more information about Americans for Community Development, please visit [http://americansforcommunitydevelopment.org/](http://americansforcommunitydevelopment.org/)
While the jobless rate slowly improves in the Bay State,¹ the debate on noncompetition agreements as a potential barrier to employment continues on Beacon Hill. In 2009, State Representatives Lori Ehrlich (D – 8th Essex District) and Will Brownsberger (D – 24th Middlesex District) embarked on a journey to codify employee noncompetition law, which currently exists only in case law dating back to the 1800s. The BBA Business Section Public Policy Committee (the Committee) has followed the legislation over several iterations and continues to take an active role in discussing the legislation. In December 2010, the Committee held a Q and A Forum at 16 Beacon, where Brownsberger and Ehrlich, along with Representative Alice Peisch (D – 14th Norfolk District) and local attorney Russell Beck, Founding Partner of Beck Reed Riden LLP (with whom the representatives have worked closely on the bill), fielded questions and concerns.

This article discusses current employee noncompetition law, the evolution of the legislation, and how the Committee has thus far participated in an ongoing dialogue on the topic.

Current Employee Noncompetition Law in Massachusetts

The Supreme Judicial Court first officially recognized enforceability of employee noncompetition agreements in 1837, when it implemented a reasonableness standard.² Over the years, the concept evolved into a common law principle that essentially states that “a covenant not to compete is enforceable only if it is necessary to protect a legitimate business interest, reasonably limited in time and space, and consonant with the public interest.”³ However, as with any reasonableness standard, the current law forces the court to make a highly fact-specific determination regarding enforceability in each instance.⁴ Plus, that factual determination only occurs if a case ever reaches the court, well after an employee likely experienced the damaging effects of a noncompetition agreement.

While many professions are exempt from these agreements through statutes and industry-specific rules,⁵ such exemptions leave out most of the workforce. It was this and other gaps in the current law that enticed Brownsberger and Ehrlich to explore codifying, clarifying, and updating the law.

The Evolution of Recent Employee Noncompetition Legislation

After individually filing bills relative to employee noncompetition agreements, Ehrlich and Brownsberger eventually joined forces on House Bill 4607⁶ in April of 2010, which was sponsored by Representative Cheryl A. Coakley-Rivera (D – 10th Hampden District). That bill not only codified the “reasonableness” parameters derived from case law, but further quantified that a noncompetition agreement would be enforceable only if the following parameters were met:

- The agreement was in writing, in a separate document signed by the employee;
- The employee against whom the agreement was enforced had an average annualized federal gross

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¹ According to “Mass. Unemployment rate drops to 7.6%,” by the Boston Globe (June 16, 2011) the Massachusetts jobless rate for May 2011 was 7.6%, down from 7.8% in April. The article indicates the national average currently stands at 9.1%. Available at: http://www.boston.com/Boston/businessupdates/2011/06/mass-unemployment-rate-drops/index.html.
⁴ Id. at 8 citing Blackwell v. Helides, 368 Mass. 225, 228 (1975).
⁵ Id., at 62-77, discussing the various statutory and industry exemptions given to certain professionals such as physicians, nurses, psychologists, lawyers, social workers, those in the broadcast industry, and certain members of the financial services industry.
⁶ Available at: http://www.malegislature.gov/Bills/186/House/H4607
income of $75,000 or more, plus $1,500 for each full year from the effective date of the bill;

• The period after which the employee was restricted from work was no greater than one year (with a six month period considered presumptively reasonable);

• The agreement was necessary to protect one or more of the following legitimate business interests: 1) trade secrets, 2) confidential information not otherwise constituting a trade secret, and 3) the employer’s goodwill; and

• If a condition of employment, the agreement was provided to the employee at least seven days prior to the start of employment; or if the agreement was entered into after employment, the agreement was provided at least two weeks before it became effective and was supported by adequate consideration (a 10 percent salary increase considered presumptively reasonable).

The bill also awarded mandatory attorneys’ fees to an employee if a court reformed or failed to enforce a material part of the agreement (that was not presumptively reasonable in accordance with the above guidelines), or found that an employer acted in bad faith. Additionally, a choice of law provision in a noncompetition agreement would not allow an employer to avoid the parameters set forth above. Plus, the legislation eliminated inevitable disclosure doctrine as a basis for a claim.

When the Committee held its Q and A session in December 2010, a lively lunchtime debate ensued between the speakers and the attendees, most of whom were management-side attorneys. To provide some background, the speakers opened with a few anecdotal examples of constituents, such as hair stylists and contractors, who were laid off and unable to work in their trades due to their restrictive agreements. However, as most were familiar with the legislation, the attendees quickly launched into a substantive discussion on the merits of the bill.

The provisions considered most controversial among those in attendance were the $75,000 salary minimum and mandatory attorneys’ fees imposed upon employers.

Attendees also questioned the motivation behind requiring a separate document (which could create logistical issues), and the presumption that a 10 percent salary increase was reasonable (given that most increases would likely fall short).

Participants were also vocal with specific examples that did not, in their opinion, fit within the purview of the legislation. One example given was the amount of trade secrets and/or confidential information to which an employee in a recruiting firm is exposed. In that industry, commented one attendee, salary level does not correlate to whether an employee is exposed to such information; thus the $75,000 salary minimum would presumably leave recruiting firms and other similarly situated companies with no protection. On the other hand, some expressed concern that the legislation remained too strict, citing experiences with frustrated clients who were unable to hire talent away from competitors. Still other members did not want to change the current law, preferring to continue to rely on established case law.

House Bill 4607 closed out the 186th legislative session without reaching the State House floor for a final vote. It was endorsed by the Massachusetts Employment Lawyers Association and according to the drafters, had gained favor with the New England Venture Capital Association.

Where the Legislation Stands Today

As a result of the Committee’s December event and other feedback received on the legislation, Brownsberger and Ehrlich introduced a new version of the bill in the House for the current 187th legislative session. The new bill, House Bill 2293 contains much of the requirements stated above, with the following significant changes:

• The agreement need not be in a separate writing;

• There is no longer a salary minimum required for an agreement to be valid;

• Garden leave clauses (a clause that allows a restricted period to last up to two years if the employer compensates the former employee during the restricted period) are permitted;

7 A discussion of a recent case involving hair dressers and noncompetition agreements can be found on Russell Beck’s Fair Competition Law blog, available at: http://faircompetitionlaw.com/category/massachusetts-noncompete-bill/


9 Available at: http://www.malegislature.gov/Bills/187/House/H02293
For agreements entered into during employment, there is no percentage attached to reasonable consideration; and

An employer may avoid payment of attorneys’ fees if a court determines the employer made “objectively reasonable efforts to draft the rejected or reformed restriction so that it would be presumptively reasonable”.

The legislation currently remains within the Joint Committee on Labor and Workforce Development. A recent conversation with Will Brownsberger indicated that a hearing will be held on the legislation in the fall of 2011.

It is worth mentioning that Representative Sheila Harrington (R – 1st Middlesex District) recently proposed House Bill 2296, which would make employee noncompetition agreements unlawful. The approach is the same as initially introduced by Will Brownsberger in 2009, but which he abandoned in 2010 in favor of a more balanced approach, after concluding that such an approach failed to take into account the legitimate business interests of Massachusetts employers. At this time, the Committee has not engaged Ms. Harrington regarding her bill, but may do so in the coming months as both bills progress.

Conclusion

The December event appeared to reinforce the concept that the varying opinions on employee noncompetition agreements are largely attributable to different industry perspectives. Still, codifying noncompetition law remains a priority for Representatives Brownsberger and Ehrlich, and the Committee remains focused on their efforts to do so. While the current legislation seems to strike a fair balance between all sides, the Committee continues to invite BBA member commentary on the legislation to determine whether to propose an official BBA position.

Featured Committee: Investment Companies & Advisers

The Investment Companies & Advisers Committee is co-chaired by James E. Thomas, Partner at Ropes & Gray LLP and John V. O'Hanlon, Partner at Dechert LLP. The committee focuses on the regulation of investment companies and advisers. The committee considers, among other topics, proposed legislation and other developments in federal and state regulation, evolving legal issues, and compliance challenges. Prior programs included:

- A presentation by David Bergers, District Administrator of the U.S. Securities and Exchange Commission’s Boston District Office, and Michael Garrity of the Boston District Office, regarding regulatory developments and the top deficiencies identified during SEC examinations.

- A presentation by Bruce H. Goldfarb and Laura Bissell of Okapi Partners, LLC, regarding current issues in proxy solicitation.

- A presentation by Rachel Graham, Senior Counsel, Investment Company Institute, regarding the Institute’s current initiatives and priorities.

- A presentation by Geoff Bobroff, President, Bobroff Consulting, regarding the practical implications of Jones v. Harris and proposed Rule 12b-2.

- A panel discussion on the impact of Dodd-Frank on investment advisers with Kathleen Massey, Partner at Dechert LLP, and Jason Brown, Partner at Ropes & Gray LLP.

Our programming will resume in the fall of 2011. Please look for notices as all are welcome to attend.
Earlier this year the Securities and Exchange Commission (“SEC”) issued a settlement order1 (the “Settlement Order”) against AXA Rosenberg Group LLC, AXA Rosenberg Investment Management LLC and Barr Rosenberg Research Center LLC (collectively, “AXA Rosenberg”), which suggests that investment advisers that employ quantitative investment models should consider developing enhanced compliance policies and procedures designed to identify and mitigate risks related to the models.

On February 3, 2011, the SEC settled securities fraud charges against AXA Rosenberg stemming from coding errors in a quantitative investment model that AXA Rosenberg used to manage client assets. The Settlement Order states that senior AXA Rosenberg management became aware of the coding error in June 2009, but did not correct or disclose the error to clients until April 2010. The Settlement Order states that, in the interim, AXA Rosenberg falsely attributed the model’s underperformance to other factors such as market volatility and misrepresented the model’s ability to control risks in client portfolios. The SEC also alleged that AXA Rosenberg breached its fiduciary duty to its clients by willfully concealing the coding error. Without admitting or denying the SEC’s findings, as part of the settlement, AXA Rosenberg agreed to pay a civil penalty of $25 million and compensation of $217 million to affected clients. AXA Rosenberg also agreed to hire an independent compliance consultant to improve its compliance reporting and disclosures.

In the press release relating to the settlement2 (the “Press Release”), Bruce Karpati, Co-Chief of the Asset Management Unit in the SEC’s Division of Enforcement, stated that “[q]uant managers must be fully forthcoming about the risks of their model-driven strategies, especially when errors occur and the models don’t work as predicted.” In addition, Rosalind R. Tyson, Director of the SEC’s Los Angeles Regional Office, noted that “[q]uant managers need to ensure that their compliance policies and procedures are tailored to the risks of their model’s strategies, and that compliance personnel are integrated into the development and maintenance of their investment models.” The Settlement Order and Press Release also state that AXA Rosenberg was charged with failing to adopt and implement appropriate compliance policies and procedures to identify and mitigate risks relating to the quant model. The Settlement Order notes that AXA Rosenberg’s coding process lacked sufficient quality controls and that the compliance program failed to “…identify and mitigate the risks associated with the [m]odel’s development, testing, and change control procedures....”

The charges and related remarks have raised concern in the industry, particularly among compliance officers, because compliance programs adopted pursuant to Rule 206(4)-7 under the Investment Advisers Act of 1940, as amended (the “Advisers Act”) typically do not focus on specific oversight of quantitative investment models. The Settlement Order and Press Release suggest that advisers that employ quant models should develop and adopt written compliance policies and procedures designed to ensure that the models are properly developed and operate as disclosed. Because the compliance programs of many advisers do not contemplate this type of oversight, the SEC’s position represents a departure from current views of the role of the compliance program. Generally, the oversight of the operation of quantitative models has been considered an investment advisory function, handled by investment professionals, rather than compliance personnel.

The remarks of the staff of the SEC (the “Staff”) regarding integrating compliance personnel into the development and maintenance of investment models raise related concerns. Compliance personnel may not have the necessary resources or expertise to participate in the development and maintenance of quant models. In addition, quant models typically are proprietary, complex, and developed by a small number of employees. Advisers may be reluctant to expand the number of internal staff members with access to information relating to the models or to engage third-party vendors for review and analysis. The Staff acknowledged this tension in the

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Press Release, but stated that “[t]he secretive structure and lack of oversight of quantitative investment models...cannot be used to conceal errors....”

It is possible that the “bad facts” involved in the AXA Rosenberg charges resulted in somewhat overbroad Staff commentary. It is also important to note that the language of the Settlement Order is somewhat less expansive than that of the related Press Release. The Settlement Order emphasizes accurate disclosure and states that AXA Rosenberg violated Section 206(4) of the Advisers Act by “…failing to adopt and implement policies and procedures reasonably designed to ensure that it did not make false and misleading statements and/or omissions to clients and investors, including failing to ensure that the [m]odel performed as represented [emphasis added].” The Press Release, on the other hand, states that AXA Rosenberg failed to adopt compliance polices and procedures “…to ensure that the model would work as intended [emphasis added].” Compliance policies and procedures designed to ensure accurate disclosure would appear to be more consistent with the current approach of most advisers’ compliance programs.

The Settlement Order and related Press Release provide little guidance to assist quantitative advisers in avoiding future disciplinary action. Clearly, an adviser that discovers a coding or other error in a quant model should immediately correct the error and accurately attribute any impact on performance resulting from the error. In light of the complexity of quant models, coding errors are not uncommon and an adviser may consider developing a framework and escalation process for determining whether a particular error is “material.” Moreover, advisers should work to develop a strong culture of compliance to reduce the risk that management will conceal model errors. Advisers utilizing quant and other model-driven strategies should also consider creating or tailoring compliance policies and procedures to address risk factors inherent in the development and use of a particular model. The policies and procedures should specifically address aspects of a model subject to representations and disclosures to clients and shareholders. Compliance officers should also meet periodically with portfolio managers and closely scrutinize any “red flags” raised by model testing. Compliance personnel should also require internal reporting of the reasons for any formula adjustments. Finally, in light of industry concern and the lack of guidance surrounding the SEC’s position in AXA Rosenberg, advisers employing quant and other model-driven strategies should stay apprised of further Staff pronouncements and regulatory developments in this area.
The Insurance Law Committee has held a number of brown bag luncheons. The first luncheon included a presentation by Matson, Driscoll & Damico, a forensic accounting firm, regarding the valuation of business entities using the asset, income, or market approach for the purpose of quantifying economic damages for insurance or legal assessments. A second luncheon included a presentation co-sponsored with the Securities Enforcement and Litigation Committee that featured a presentation on D&O insurance, including recent case law developments, coverage issues, allocation issues as well as the impact of the financial crisis on the insurance industry. Lastly, the Insurance Law Committee recently held a brown bag luncheon featuring a presentation by Licata Risk Advisors, which delved into the property/casualty insurance sales and delivery process, how the process can cause gaps in coverage, excessive premiums and the need for litigation in order to obtain claim payment. The presentation also addressed how these problems can be avoided, examined cases involving claim settlements, and discussed how insureds and their lawyers can avoid entanglements with insurers and plaintiff lawyers through understanding of policy structure and the claims process.
A standard general liability insurance policy imposes on the insurer two distinct duties: (i) the duty to defend the insured against any claim that is potentially covered under the policy; and (ii) the duty to indemnify the insured against any claim that is actually covered by the policy. Inherent in the obligation to defend is the insurer’s right to control the defense, including the right to retain counsel of its choice to defend the insured. However, this right is not absolute. Where an insurer agrees to defend its insured under a reservation of rights, for example, the insurer may lose its right to control the defense including the right to retain counsel of its choice. Under these circumstances, the insured may elect to control its own defense, including retention of its counsel. Still, the insurer must pay for the insured’s defense counsel or risk liability, including bad faith damages, as a result of its breach of the duty to defend.

A recent decision of the Appeals Court of Massachusetts provides clear guidance as to the remedy afforded policyholders under the Massachusetts’ Consumer Protection Statute, G.L. c. 93A, for an insurer’s unwarranted refusal to pay reasonable attorneys’ fees incurred defending the policyholder against potential liability. In Northern Security Insurance Co., Inc. v. R.H. Realty Trust, 78 Mass. App. Ct. 691 (2011), the Appeals Court of Massachusetts affirmed a verdict in favor of a policyholder and its attorneys against its insurer, finding that the insurer’s refusal to pay reasonable attorneys’ fees to a private attorney hired by the insured, who had refused the insurer’s representation conditioned upon a reservation of rights, constituted a violation of G.L. c. 93A.

Background

This dispute originally arose out of a claim brought against the policyholder, a real estate trust and owner of a residential property, by the lessees of the property alleging damages from their alleged exposure to mold. The trust timely notified its insurer, Northern Security, and sought a defense of the claim. Northern Security responded with a reservation of rights, noting that the trust was covered for only one of several counts alleged in the complaint. The trust rejected the insurer’s conditional representation and retained its own attorney to defend the case. The trust and the attorney agreed on a rate of $225 per hour.

During the course of the defense of the case, the attorney submitted bills to the insurer for payment. The insurer delayed payment of the bills, and when it did pay, it paid the bills at the reduced rate of $150 per hour, which was the insurer’s panel rate. The attorney then sent the insurer a G.L. c. 93 a demand letter seeking payment of the balance between $225 per hour and $150 per hour. The insurer denied this request and disputed the claimed Chapter 93A violation.

Trial Proceedings

After the underlying case had settled, the insurer brought suit against the insured and the attorney seeking a declaratory judgment that its decision to pay $150 per hour was reasonable. The insured and attorney countered, alleging breach of contract and a violation of G.L. c. 93 A.

After hearing a motion on the pleadings, the motion judge ruled that $225 per hour was a “per se reasonable attorney fee” in the Boston-area legal market. In response to this ruling, the lawyer sent a second Chapter 93A letter to the insurer, offering to dismiss the counterclaim in exchange for the insurer’s agreement to pay the amount of the reasonable attorney fee. The insurer did not respond to this demand.

The case then went to trial, where the trial judge held that the fair and reasonable hourly rate for services rendered by the attorney was actually $350 per hour. The trial judge also found that the insurer’s refusal to pay $225 per hour, which the insurer’s own claims manager, as well as the motion judge, previously had deemed to be reasonable, violated G.L. c. 93A, thus justifying an award of attorneys’ fees.

Appeal

The insurer appealed. On appeal, the court cited to the established Massachusetts rule that where an insurer seeks to defend an insured under a reservation of rights, and the insured is unwilling to do so, the insured may
require the insurer to either defend without reservation or relinquish its defense of the insured and reimburse the insured for its reasonable defense costs. Thus, the court concluded that the insured was within its rights to retain its own counsel, and that the evidence supported a $225-per-hour rate. The court recognized that the insured is entitled to have a reasonable fee paid based on market rates and not the insurer’s panel rates, which “may be at odds with an insured’s desire to pay more for legal representation in hope of minimizing legal expenses.” Further, the insurer’s delay of 14 months in payment of the undisputed attorneys’ fees, despite acknowledging that it owed at least $150 per hour, warranted a finding of a G.L. c. 93A violation. In response to the insurer’s challenge relating to the award of $350 per hour, the court concluded that the proper fee was $225 per hour, which represented the insured’s agreed-upon rate and thus its actual damages. The case was remanded for a proper calculation of damages.

**Implications**

While this decision does not alter existing precedent deeming the mere nonpayment of a debt to constitute a violation of G.L. c. 93A, the court clarified that non-payment or a delay in payment coupled with additional misconduct may justify Chapter 93A liability. Specifically, the court cautioned against an insurer’s withholding of undisputed amounts and unreasonable delay in payment, particularly where undertaken to secure an advantageous financial outcome.
Editors

Gregory S. Fryer

Gregory S. Fryer, a partner in the business law department of Verrill Dana, heads the firm’s securities law practice. He serves as general counsel to many companies, and a substantial part of his practice focuses on M&A and venture capital. Areas of particular interest include the fiduciary duties of directors of troubled companies. Since 1993 Greg has served as chair of the Securities Law Subcommittee of the Maine State Bar Association. He also has been actively involved in Bar committees responsible for reviewing and drafting various business-related statutes, including the Maine Business Corporation Act and the Maine Uniform Securities Act. Since 2007 Greg has served as a Board member of the Maine Small Enterprise Growth Fund, a state-funded venture capital firm. He has been an active member of the Business Law Section of the Boston Bar Association, and is currently a co-chair of its Communications Committee. Greg for many years has received recognition in Best Lawyers in America, Chambers USA and New England Super Lawyers. He is a graduate of Dartmouth College and Cornell Law School.

Peggy S. Tirrell

Peggy Tirrell is Senior Corporate Counsel at EMC Corporation, the world leader in information infrastructure solutions. Peggy has extensive experience as a transactional and corporate attorney. While at EMC, she has been lead counsel in acquisitions and strategic investments totaling over $2.5 billion. Before joining EMC in 2006, Peggy was a corporate attorney with Goodwin Procter in its Boston and New York offices. Peggy received a B.A. in English Literature (with honors) and Political Science from Miami University of Ohio, a J.D. from Northeastern School of Law and a MBA/MS in Accountancy from Northeastern University, Graduate School of Professional Accounting. Peggy is the Co-Chair of the Communications Committee of the Business Law Section of the Boston Bar Association.
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Laura Bickel has been an attorney at the Commonwealth of Massachusetts Department of Public Utilities since 2006, focusing mainly on cases and policies for smart grid, renewable energy contracts, net metering, and revenue decoupling. Prior to joining the Department, Laura worked in the City of Boston Environment Department for two years, where she implemented and enforced local air quality programs. After graduating law school, Laura served as the first Fellow to the school’s Center for Law and Social Responsibility in its Environmental Advocacy Project. She received her B.A. in History from McGill University in Montreal, Canada, and her J.D. from New England Law Boston in 2003.

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Sarah Colao is Associate General Counsel at the Massachusetts Clean Energy Center (MassCEC), a quasi-public agency that supports the growth and development of the clean energy sector in Massachusetts. Prior to joining MassCEC, Sarah was a tax attorney in the Boston office of a prominent international law firm, where her practice focused on the tax issues associated with the formation of, and investments in, U.S. and non-U.S. private equity funds and other investment partnerships, as well as tax planning for corporate and other transactions. Sarah received a bachelor’s degree in government from Wesleyan University in Connecticut and her law degree from the University of Connecticut School of Law.

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Jamie Tosches DeMello currently serves as an Assistant Attorney General in the Office of Ratepayer Advocacy representing ratepayer interests in electric and gas rate proceedings primarily before the Massachusetts Department of Public Utilities. Prior to joining the Office of the Attorney General, Ms. Tosches DeMello held a summer law clerkship with the U.S. Environmental Protection Agency where she worked on a variety of environmental legal issues. Prior to law school, she held a position as an environmental planner with the Rhode Island Department of Environmental Management focusing on asset management and planning. She holds a Juris Doctor from the Suffolk University Law School and a Bachelor of Science with a focus on environmental science from the University of Massachusetts Amherst.
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John O’Hanlon is a partner in Dechert’s financial services practice group. He represents investment managers, investment funds and their boards of directors, and other financial institutions in corporate, regulatory, compliance, and enforcement matters. He has 20 years of securities legal experience, including five years on the staff of the U.S. Securities and Exchange Commission’s Division of Investment Management. A graduate of Georgetown University Law Center (J.D., cum laude), Mr. O’Hanlon is Co-Chair of the Boston Bar Association’s Investment Companies and Advisers Committee and a member of the American Bar Association’s Federal Securities Law Committee.
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Section Leadership 2010-2011

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