Boston Bar Association

Business Law Section Newsletter

Volume 3
Spring 2010

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A PUBLICATION OF THE BOSTON BAR ASSOCIATION BUSINESS LAW SECTION

Spring 2010 Volume 3

Section Co-Chairs' Corner

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Spring 2010

The Business Law Section's educational programs continue to be a tremendous resource for our members' business law practices and personal growth. Through these programs, our members stay informed about current and emerging issues and "best practice" advice for clients on these issues. Our Section is a diverse community made up of lawyers practicing in myriad environments – academia, government, in house corporate legal departments, and law firms (big, medium and small) representing consumers and businesses in all facets of business law. The number and breadth of our Section's active committees highlights this diversity.

As the current co-chairs of the Business Law Section, we invite all of our members who are not currently taking advantage of the educational, professional development and relationship building opportunities offered through active participation in our Section's 15 active committees to take a moment to visit the Boston Bar Association's website at www.bostonbar.org, click on "Sections" at the top of the page and scroll down to the Business Law Section where each of our committees are identified with links to the committee co-chairs and descriptions of their committees.

We pride ourselves on our openness, conviviality and collegiality. Come give us a try, get involved, get engaged and most importantly, take a moment to learn more about the work of the Banking & Financial Services, Investment Companies and Advisors, Energy & Telecommunications, and Insurance Committees featured in this issue of our Section's Newsletter.

Paula K. Andrews
Mark T. Bettencourt

Editors: Gregory Fryer and Sarah Curtis Richmond

Inside this Issue:

Upcoming CLE Programs

Meet the Regulators: A Discussion with the Enforcers of HIPAA/HITECH, the Mass. Security Regulations, and the FTC Red Flags Rule
Monday, May 3, 2010 - 3:00 PM

Boston Bar Association - 16 Beacon Street
Registration Link

Corporate Reorganization & Immigration: Is Your Client Buying Millions in Revenue or Millions in Government Fines?
Tuesday, May 18, 2010 - 3:00 PM

Boston Bar Association - 16 Beacon Street
Registration Link

Stranger in a Foreign Land: Taking discovery outside of Massachusetts and outside of the United States
Wednesday, May 19, 2010 - 3:00 PM

Boston Bar Association - 16 Beacon Street
Registration Link

The Fundamentals of Partnership Taxation
Thursday, May 20, 2010 - 3:00 PM

Boston Bar Association - 16 Beacon Street
Registration Link

Employment Law Basics
Friday, May 21, 2010 - 9:00 AM

Boston Bar Association - 16 Beacon Street
Registration Link

Thriving in Challenging Times: A Law Practice Toolbox
Wednesday, June 16, 2010 - 4:00 PM

Boston Bar Association - 16 Beacon Street
Registration Link

For more information: To register for any of the foregoing CLEs, please contact Katherine Elmore at the BBA at kelmore@bostonbar.org.

Featured Committee: Banking & Financial Services Committee

The Banking and Financial Services Committee is co-chaired by Stefan L. Jouret, Partner at Jouret & Samito LLP, and Kevin J. Handly, Partner at Pierce Atwood LLP. The committee focuses on issues affecting the U.S. financial services industry, including state and federal regulatory and judicial developments. In the time since the current financial crisis hit a critical stage in the fall of 2008, the Committee and the Morin Center for Banking and Financial Law at BU Law School have jointly presented numerous programs to discuss the causes of the crisis and the government's response. Prior programs include:

- "Update on Federal Financial Regulatory Reform," a Jan. 19, 2010 Boston Bar Association Continuing Legal Education panel featuring Richard P. Hackett and Kevin J. Handly of Pierce Atwood LLP and Stefan L. Jouret of Jouret & Samito LLP.
- An Aug. 19, 2009 "Buck Starts Here" panel with the Morin Center discussing the Consumer Financial Protection Act featuring Richard P. Hackett of Pierce Atwood LLP, Lynne B. Barr of Goodwin Procter LLP and Barbara Anthony, Undersecretary, Office of Consumer Affairs and Business Regulation, Commonwealth of Massachusetts.
- A June 10, 2009 "Buck Starts Here" (with the Morin Center) panel focusing on Deleveraging the Global Economy, featuring Prof. Perry Mehrling, Ph.D., Barnard College, Columbia University, Grant Butler of Goodwin Procter LLP and Brian J. Gilmore, Executive Vice President of Associated Industries of Massachusetts.
- A May 8, 2009 "Buck Starts Here" (with the Morin Center) panel focusing on the Massachusetts Budget Debate, featuring Cornelius Hurley of the Morin Center, Stephen J. Coukos of Chu Ring & Hazel, and Rep. Charles A. Murphy, Chairman, Massachusetts House Ways and Means Committee.
- An April 22, 2009 "Buck Starts Here" (with the Morin Center) panel focusing on Regulation of Hedge Funds with Richard A. Goldman and Neal Curtin of Binham McCutcheon and Patrick Moscaritolo, President and CEO of the Greater Boston Convention and Visitors Bureau.
- "Federal Preemption and the Future of the Dual Banking System," a Nov. 13, 2007 Boston Bar Association Brown Bag lunch panel featuring Stefan L. Jouret (currently of Jouret & Samito LLP), Kevin Handly (currently of Pierce Atwood LLP), Margaret M. Pinkham (currently of Pinkham Busny LLP) and Paul Shaw (currently of K&L Gates).

Business Law Section Endorses House Bill No. 1000 – A Bill to Update the Corporation Law References in the Massachusetts Banking Laws

By Kevin Handly

The Steering Committee of the Business Law Section of the Boston Bar Association recently voted to recommend endorsement of H.B. No. 1000, a bill now pending before the 186th General Court that would amend certain corporate law provisions of the Massachusetts banking laws. The BBA Council has also endorsed this bill

Effective July 1, 2004, the Massachusetts Business Corporation Law (Chapter 156B of the General Laws) (the "BCL") was largely replaced by a new Massachusetts Business Corporation Act (Chapter 156D) (the "MBCA"). The enacting legislation provided broadly "Any reference contained in the General Laws to chapter 156B or to any section of chapter 156B which has been superseded and replaced by this act shall be considered a reference to chapter 156D[1]." However, Chapter 156B was not repealed and Section 17.01(1) of the new MBCA states that Chapter 156D does not apply to various listed types of special corporations, including without limitation "corporations organized for the purpose of carrying on the business of a bank, savings bank, co-operative bank, trust company, credit union, surety or indemnity company, or safe deposit company . . . ." [2] Although not entirely clear, the Legislature seems to have left the old law in place for these kinds of special corporations.

House Bill No. 1000 is the product of a pro bono project undertaken by corporate and banking lawyers of Pierce Atwood LLP commencing in the summer of 2008. The project aims to change the statutory cross-references in Massachusetts banking statutes so that these entities will be able to enjoy the greater clarity and flexibility afforded by the new MBCA. For Massachusetts-chartered banks, the proposed legislation would modernize the specialized corporation laws providing for their organization, governance and structural transactions (e.g., mergers).

Massachusetts banks are organized and governed under three chapters of the General Laws: Chapter 168 governs savings banks; Chapter 170 governs co-operative banks; and Chapter 172 governs trust companies and certain aspects of savings banks and cooperative banks that convert from mutual to stock ownership. These three chapters of the General Laws provide in detail for the organization, capitalization, governance, merger, reorganization and dissolution of Massachusetts banks, and differ in certain respects from the laws governing business corporations generally. For example, they require approval of the Commissioner of Banks and specify regulatory approval criteria for virtually every category of structural change by a Massachusetts bank.

With respect to certain matters, the banking laws incorporate by reference specified provisions of the general corporation law. In these areas, the legislature evidently concluded that public policy did not require banks to follow different procedures from those applicable to business corporations generally. In General Laws Chapters 168, 170 and 172, there are 32 such provisions incorporating by reference provisions of Chapter 156B.

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1 Section 23 of Chapter 127 of the Acts of 2003.

2 The entire list of excluded special corporations is as follows: "corporations organized for the purpose of carrying on the business of a bank, savings bank, co-operative bank, trust company, credit union, surety or indemnity company, or safe deposit company, or for the purpose of carrying on within the commonwealth the business of an insurance company, railroad, electric railroad, street railway or trolley motor company, telegraph or telephone company, gas or electric light, heat or power company, canal, aqueduct or water company, cemetery or crematory company, any other corporations which on October 1, 1965 have or may thereafter have the right to take land within the commonwealth by eminent domain or to exercise franchises in public ways granted by the commonwealth or by any county, city or town, and corporations subject to chapter 157 and corporations subject to chapter 157A." For reasons of public policy, corporations engaged in these lines of business have long been chartered and regulated by expert government agencies administering their own specialized corporation laws. While these corporations are expressly excluded from the scope of the general business corporation laws, their specialized laws do incorporate by reference selected provisions of the general corporate law, particularly Chapter 156B.

These cross-references deal with the mechanics and effects of mergers and acquisitions, dissenters appraisal rights, special meetings of stockholders, and changes in authorized capital stock.
For these matters, a Massachusetts bank (or its corporate attorney) must consult Chapter 156B to determine how to proceed, even though the MBCA has replaced the BCL for corporations generally. The BCL thus retains relevance for banking lawyers long after it has been superseded for the general business corporations it originally was meant to govern. Since most banks are owned by holding companies organized as ordinary business corporations, a corporate lawyer planning a corporate transaction for a Massachusetts banking organization must refer to at least three chapters of the General Laws to determine how to proceed – the new MBCA to determine the law applicable to the holding company; Chapter 168, 170 or 172 depending on the category of bank involved; and the old BCL, to decipher cross-references in the banking law.

House Bill No. 1000 would remedy this anomalous and inefficient situation by replacing the BCL cross-references in the banking laws with updated references to the corresponding provisions of the MBCA. It would carry forward the legislative determination that with respect to certain matters, banks should follow the same corporate procedures that apply to business corporations generally.

The need for this legislative housekeeping was anticipated by the draftsmen of Chapter 156D, who wrote in their commentary to Section 17.01 in 2003: "On the effective date of the Act it is unlikely that any of its provisions will have been so incorporated, but it is expected that over time . . . the existing references to the BCL in other statutes will be changed to incorporate various sections of the Act."

Seven years later, House Bill No. 1000 does for the banking laws what the drafters of the MBCA envisioned.

While House Bill No. 1000 deals only with the banking laws, similar outdated cross-references are sprinkled throughout the Massachusetts laws governing insurance companies and public utilities. Updating those cross references may be an appropriate task for future pro bono corporate law projects.

Case Note

By Robert Bench

On December 14, 2009, the United States Court of Appeals for the 6th Circuit decided *Monroe Retail v. RBS Citizens, N.A., 589 F.3d 274* (6th Cir. 2009). At issue in the case was whether the trial court properly dismissed a conversion claim by the plaintiff-garnishors (the "Garnishors") against the defendant-banks (the "Banks") on grounds that the National Banking Act ("NBA") preempted the claims. The Garnishors claimed that Ohio's garnishment statute, ORC §§ 2716.13(B), 2716.21(D), which requires Banks to immediately freeze an account upon a garnishment order, is explicitly exempt from preemption. The 6th Circuit disagreed with the Garnishors and affirmed dismissal of their claim.

The Banks, joined by the Office of the Comptroller of the Currency ("OCC") via an interpretive letter, contended that the NBA expressly authorizes them to charge customers non-interest charges and fees, including deposit account service charges, even if the accounts are subject to garnishment. The Banks argued that any interpretation of the applicable Ohio garnishment laws that would allow the Garnishors' conversion claim to proceed would interfere with their ability to collect fees, as authorized by 12 CFR 7.4002(a), as well as their ability to determine the order in which the Banks manage their daily account balances.

Drawing upon U.S. Supreme Court cases such as the 2007 decision *Watters v. Wachovia* and the 1996 decision *Barnett Bank of Marion County v. Nelson*, the 6th Circuit held that states may not prevent or significantly interfere with a national bank's exercise of its powers. When state laws significantly impair the exercise of authority enumerated or incidental under the NBA, the state laws must give way. The court cited its own prior precedents for the proposition that the level of interference giving rise to preemption under the NBA is not very high. The court concluded that the Ohio statute requiring Banks to immediately freeze bank accounts upon the receipt of a garnishment order "significantly interferes" not only with the Banks' power to charge fees, but also with their authority to complete other transactions and balance their accounts. The court thus held that any interpretation of the Ohio garnishment statute that would allow the Garnishors' claim to proceed is preempted by the NBA's grant of authority to the Banks to collect fees without interference.

Featured Committee: Investment Companies & Advisers Committee

The Investment Companies & Advisers Committee is co-chaired by Joseph R. Fleming, Partner at Dechert LLP, and James E. Thomas, Partner at Ropes & Gray 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 include:

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

- A discussion with John C. Coates IV, John F. Cogan, Jr. Professor of Law and Economics at Harvard Law School, regarding potential reforms to the taxation and regulation of mutual funds to improve the treatment of middle class investments.

- A panel discussion, co-sponsored with the Securities Enforcement & Litigation Committee and the Securities Law Committee, of the Supreme Court's review of the Gartenberg standard in Jones v. Harris Associates. Panelists were: John C. Coates IV, John F. Cogan, Jr. Professor of Law and Economics at Harvard Law School, Eric D. Roiter, Lecturer in Law at Boston University, Robert A. Skinner of Ropes & Gray LLP, and Frances S. Cohen of Bingham McCutchen LLP.

- A presentation by Dr. Michael A. Goldstein, Professor of Finance and Natalie Taylor Senior Term Chair at Babson College, regarding trading issues, including naked access, fast trading, and other evolving trading venues and methods.

- A discussion by Matthew K. Kerfoot, Dechert LLP, regarding the arguments in favor of a more liquid, transparent market for OTC derivatives, and also the potential downside to the push towards the clearing and trading of OTC derivatives.

Recent Money Market Fund Reform

By James E. Thomas and Emma Cecilia Eriksson

When the Reserve Primary Fund's net asset value per share fell from $1.00 to 97 cents on September 16, 2008, "breaking the buck," it provoked a run on the Fund as investors sought to redeem their shares before the net asset value fell further. Money market fund investors generally reacted with consternation to this development; during the week of September 15, 2008, investors withdrew approximately $300 billion from money market funds. The prospect that the Reserve Primary Fund's troubles might result in runs on other money market funds had severe implications for not only the funds themselves, but for the economy more broadly. (Money market funds provide significant funding to U.S. government agencies, state and local governments, and financial and other institutions, by purchasing their short-term debt securities, and a significant loss of confidence in money market funds could have seriously affected capital raising.) In response, there were several government- and industry-proposed temporary remedial programs as well as new and enhanced rules governing money market funds.

On September 19, 2008, in the immediate aftermath of the run on the Reserve Primary Fund, the United States Department of the Treasury (Treasury Department) established a Temporary Guarantee Program for Money Market Funds that would guarantee money market fund shareholders a share price of $1.00 per share, capped at the amount shareholders held on September 19, 2008, for funds participating in the Program. The Program was extended on two occasions and expired on September 18, 2009. Although the Treasury Department was not called upon to make guarantee payments under the Program, it earned approximately $1.2 billion in participation fees and Treasury Secretary Geithner stated that the Program "served its purpose of adding stability to the money market mutual fund industry during market disruptions." Also in September 2008, the Federal Reserve Board established the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), which extended credit to U.S. depositary institutions and bank holding companies to assist them in purchasing high-quality asset-backed commercial paper from money market funds. The AMLF was intended to improve liquidity in the markets for these securities and to assist money market funds in raising funds to meet redemption requests. The AMLF expired, and stopped extending new loans, on February 1, 2010.

Problems in the money markets prompted additional commentary and proposals. The Investment Company Institute's (ICI) Money Market Working Group submitted a report to the Securities and Exchange Commission (SEC) in March of 2009 recommending several changes to tighten rules governing mutual funds and to increase oversight. President Obama's administration subsequently released a white paper on financial regulatory reform which, among other things, encouraged the SEC to impose additional restrictions on money market funds to reduce their credit and liquidity risk, and called for further consideration of whether money market funds should be permitted to use a stable net asset value of $1.00 per share and whether they should be required to obtain access to reliable emergency liquidity facilities from private sources. Others have called for money market funds to be regulated as banks.

The SEC announced new rule proposals in June 2009 designed to initiate money market reform. On January 27, 2010, the SEC announced the adoption of these rules, with some modifications, "to increase the resilience of money market funds to economic stresses and reduce the risks of runs on the funds." The new rules, released on February 23, 2010, become effective on May 5, 2010, with compliance dates staggered throughout 2010 and 2011.

Some of the new rules are designed to restrict credit and liquidity risks associated with money market fund investments by:

- Reducing the portion of a fund's total assets that may be invested in illiquid securities (defined as securities that cannot be disposed of at approximately carrying value within 7 days) from 10% to 5%, and establishing minimum daily and weekly liquidity requirements. In addition, money market funds must hold sufficient liquid securities to meet foreseeable redemptions and must develop procedures to identify investors whose redemption requests may pose risks for funds;

- Permitting money market funds to invest only up to 3% (rather than the 5% currently permitted) of their total assets in Second Tier securities ("Second Tier" is defined in the existing rules and refers to lower quality securities). In addition, a fund may not invest more than one half of one percent of its total assets in Second Tier securities of any one issuer and funds may not acquire any Second Tier Securities with remaining maturities exceeding 45 days;

- Restricting a money market fund's maximum "weighted average life" maturity (calculated without regard to portfolio securities' interest reset dates) to 120 days and shortening the maximum weighted average maturity (calculated using interest reset dates) of a money market fund's portfolio to 60 days (from 90 days);

- Augmenting current rules relating to the role of Nationally Recognized Statistical Ratings Organizations (NRSROs) by requiring funds to designate at least four NRSROs whose ratings are considered reliable by the fund's board and eliminating requirements that money market funds may only invest in asset-back securities that are NRSRO-rated. In addition, money market funds must identify the designated NRSROs in their statements of additional information;

- Requiring the board of directors of money market funds to establish written procedures that provide for periodic stress tests to assess a money market fund's ability to maintain a stable net asset value in the face of various stresses on a fund, such as large redemptions, interest rate changes, or potential defaults. The results of these stress tests must be regularly reported to the board; and,

- Permitting a money market fund to "look through" a repurchase agreement for purposes of money market fund diversification requirements only if the repurchase agreement is collateralized by cash items or government securities. In addition, money market funds must assess the creditworthiness of their repurchase agreement counterparties.

The SEC also adopted rules to enhance the disclosure of portfolio securities. Money market funds will be required to publicly post their portfolio holdings on their websites, and to provide more detailed portfolio schedules to the SEC, each on a monthly basis. The detailed information provided to the SEC will include the mark-to-market value of the money market fund's net assets ("shadow" NAV) and will be available to the public after a 60-day lag period (by which time the information will be largely stale, in light of the new weighted average life and weighted average maturity limits). The purpose of these enhanced and periodic disclosure requirements is to allow investors to assess risks and to gauge more frequently how a portfolio manager is achieving a money market fund's stable net asset value. Finally, the SEC adopted several new rules with the goal of improving money market fund operations. The board of directors of a money market fund may suspend redemptions if the fund risks breaking the buck and the board has decided to liquidate the fund. Additionally, money market funds and their administrators must develop the capability to process purchases and redemptions at a price other than $1.00 per share, and a money market fund's affiliate's ability to purchase distressed assets from a fund to protect the fund from investment losses is expanded.

The SEC and its Division of Investment Management stressed that these new rules were only the "first step" in reforming money market funds and promised to continue examining additional proposals, including the somewhat controversial proposal to establish floating share prices, abandoning the traditional $1.00 fixed net asset value price for money market funds. (Indeed, the new rules were not approved unanimously by the SEC's Commissioners, as Commissioner Kathleen Casey dissented, in part, because the rules did not go far enough.)

During the past two years, we have seen the worst turbulence in money market funds in their thirty years of operation, as well as the most significant regulatory reform affecting money market funds since the 1990s. While the new safeguards appear to have been reasonably well received by the industry, it seems likely that the cost of these safeguards will be further reductions in the already low yields of money market funds. This comes at a difficult time for many money market fund sponsors, who are currently waiving fund fees to ensure that the funds have a positive yield in this low interest rate environment. Further efforts to protect the safety and stability of money market funds should take into account the possibility that lower yields and additional changes, especially fundamental changes such as the introduction of a floating share price, may drive investors out of money market funds to seek investment alternatives in other, perhaps unregulated, products.

Private Fund Investment Advisers Registration Act of 2009

By Joseph R. Fleming

Proposed Legislation.

On December 11, 2009, the U.S. House of Representatives approved The Wall Street Reform and Consumer Protection Act of 2009 (the "Consumer Protection Act"), which includes the Private Fund Investment Advisers Registration Act of 2009 (the "Act"). The Act would amend Section 203(b) of the Investment Advisers Act of 1940 (the "Advisers Act"), which currently exempts an investment adviser from registration with the U.S. Securities and Exchange Commission (the "SEC") if during the preceding twelve months the adviser had fewer than fifteen clients and neither holds itself out generally to the public as an investment adviser nor acts as an investment adviser to any registered investment company or business development company (the "Private Adviser Exemption"). Investment advisers to hedge funds, private equity funds and venture capital funds generally rely on this exemption by treating each fund as the client rather than counting the individual investors in a fund.

Elimination of the Private Adviser Exemption.

Specifically, the Act would eliminate the Private Adviser Exemption and require registration of investment advisers to private funds. A private fund would include any fund that relies on Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 to be excepted from the definition of investment company. Hedge funds, private equity funds and venture capital funds generally rely on these sections to avoid regulation as investment companies.

Registration Exemptions for Certain Advisers.

The Act would amend Section 203, however, to provide exemptions from the registration requirements for the following advisers:

- an adviser to private funds if each of the private funds has assets under management in the United States of less than $150 million;
- an adviser to venture capital funds (which must be defined by the SEC);
- an adviser to small business investment companies; and
- a foreign private fund adviser, which is defined as an adviser who (i) has no place of business in the United States; (ii) during the preceding twelve months had fewer than fifteen clients in the United States and less than $25 million in assets under management attributable to clients in the United States; and (iii) neither holds itself out generally to the public in the United States as an investment adviser nor acts as an investment adviser to any registered investment company or business development company.

Advisers to private funds with assets under management of less than $150 million and advisers to venture capital funds would be subject to recordkeeping and reporting requirements determined by the SEC as necessary or appropriate in the public interest or for investor protection.

Systematic Risk Reporting and Recordkeeping Requirements.

The Act would require a registered adviser to private funds to (i) maintain records for such period or periods prescribed by the SEC and (ii) file with the SEC such reports as the SEC determines, in consultation with the Board of Governors of the Federal Reserve System (the "Board"), are necessary or appropriate for the public interest and investor protection or for the assessment of system risk. The Act would also authorize the SEC to provide the reports or records or the information contained therein to the Board and any other entity having systemic risk responsibility. This would effectively bring the SEC into a supportive and cooperative role of systemic risk regulation.

At a minimum such records and reports would be required to include, for each private fund, (i) the amount of assets under management; (ii) the use of leverage, including off-balance sheet leverage; (iii) counterparty credit risk exposures; (iv) trading and investment positions; (v) trading practices; and (vi) such other necessary information, as determined by the SEC in consultation with the Board. The Act would also permit the SEC to implement different reporting requirements for different classes of private fund advisers based on the particular types or sizes of private funds advised by the advisers. All records of a private fund maintained by the fund's adviser would be subject to SEC examination.

Reporting Requirements to Investors, Counterparties and Creditors.

Additionally, private fund advisers would be required to provide reports, records and other documents to investors, prospective investors, counterparties and creditors of any private fund advised by the adviser, as prescribed by the SEC.

Reporting Requirements About Clients.

The Act would also remove Section 210(c) of the Advisers Act, which limits the SEC's ability to obtain information about an adviser's clients unless the disclosure may be necessary or appropriate to a particular proceeding or investigation. This appears to broaden the SEC's power to require certain disclosure from advisers.

Registration and Examination Procedures for Mid-Sized Private Funds.

The SEC would also be required to consider the size, governance and investment strategy of mid-sized private funds and provide registration and examination procedures for advisers to such funds that reflect the level of system risk posed by the funds. The Act does not define mid-sized private funds.

Implications of Registration.

Once a private fund adviser is registered with the SEC, it would not only become subject to the requirements noted above, if the Act is adopted as proposed, but generally would also be subject to the other provisions of the Advisers Act and the rules thereunder. For example, private fund advisers would be subject to Section 205 of the Advisers Act, which, among other things, prohibits an adviser from structuring its fee as a performance fee. Rule 205-3 provides an exemption from this prohibition, but certain private fund advisers may not be able to satisfy the exemption's criteria (e.g., that the client at issue be a qualified client). Unless the SEC utilizes its rulemaking authority to, for example, permit "grandfathered" private fund advisers (i.e., those operating prior to the adoption of the Act) to continue relying on the Rule or amend the Rule itself in some fashion, then the performance fee structure may be at jeopardy for certain private fund advisers.

Legislative Status.

The Consumer Protection Act now passes to the U.S. Senate for consideration, where it has been referred to the Committee on Banking, Housing, and Urban Affairs, chaired by Senator Dodd (D-Connecticut).

Featured Committee: Energy and Telecommunications Committee

The Energy and Telecommunications Committee addresses regulatory and related issues affecting the natural gas, electric, and telecommunications industries in Massachusetts, on the federal level, and in other jurisdictions. Members typically practice before the Massachusetts Department of Public Utilities, the Massachusetts Department of Environmental Protection, the Federal Energy Regulatory Commission, the Federal Communications Commission, and state and federal courts.

To date this year, our committee has sponsored and co-sponsored a number of timely and interesting events, including brown bag lunches and a CLE with leaders and decision-makers in government, non-profits and private practice. Our events have included discussions of the prospect of federal climate change legislation, the goals and priorities of the Massachusetts Clean Energy Center, the goals and priorities of the Department of Telecommunications and Cable, the scope and implementation of the newly passed Massachusetts lobbying and ethics reform legislation, the Green Communities Act's benefits and programs for municipalities, and the MEPA Greenhouse Gas Policy. Our committee, along with the Environmental Law Section and Real Estate Section, also sponsored a CLE last October entitled "Renewable Energy in Massachusetts: Navigating the Opportunities and Challenges."

The month of March was a busy month for our committee. Below are some of the programs we hosted:

- March 1 – "Changes in the Air – EPA's Air Quality Agenda in 2010 and Beyond" (with Janet McCabe from EPA)
- March 12 – "Climate Change Update: Emerging Issues in Federal and State Climate Change Policy" (CLE)
- March 24 – "DPU 101: Practicing at the DPU"

The Energy and Telecommunications Steering Committee meets periodically throughout the year to plan events and discuss issues. Anyone interested in joining the Steering Committee should contact Jed Nosal (jed.nosal@state.ma.us) or Mike Koehler (mkoehler@keeganwerlin.com).

Review of Green Communities Act (GCA) Implementation

By Courtney Feeley Karp with contributions from Kevin Penders

On July 2, 2008 Governor Patrick signed into law the country's most sweeping energy reform piece of legislation, the Green Communities Act (GCA). The law addresses all aspects of clean energy, from incentivising new cleaner technologies, to requiring use of all cost effective efficiency measures. Most importantly, the law's overarching view is that clean energy is not only important to combat climate change, but also presents incredible economic development opportunities for the Commonwealth. In addition to establishing this clean energy framework, the GCA provides the tools to flesh out and implement all of its innovative initiatives. As the second anniversary of this law approaches, the progress of some of the major components of this legislation is outlined and described.

EEAC AND 3-YEAR ENERGY EFFICIENCY PLANS

Designed to promote enhanced energy efficiency throughout the Commonwealth, the GCA requires gas and electric distribution companies and municipal aggregators (together "Program Administrators" or PAs) to develop energy efficiency plans that will provide for the acquisition of all cost-effective energy efficiency and demand reduction resources. In connection with these energy efficiency plans, the GCA established a new advisory body, the Energy Efficiency Advisory Council (the "Council" or the "EEAC"), consisting of eleven voting members of diverse backgrounds and expertise, a non-voting member from the heating oil industry, a non-voting member from the energy efficiency business, and a non-voting member from each Program Administrator.

Pursuant to the GCA, the Program Administrators were required to provide statewide electric and gas efficiency investment plans that represented their collective efforts and objectives. On April 30, 2009, the Program Administrators, by unanimous consent, submitted a Plan for the Council's review and approval. Following that undertaking, the Program Administrators engaged in a collaborative process with the EEAC and its consultants, as well as other interested stakeholders, to further develop and refine the statewide plans.

After approval of the plans by the EEAC, they were submitted to the Department of Public Utilities (DPU) on October 31, 2009, in accordance with the GCA, together with the Council's approval or comments and a statement of any unresolved issues, to the Department of Public Utilities. G.L. c. 25, § 21(d). Consistent with the GCA, the plans sought to capture all available cost-effective energy efficiency for the three-year period beginning January 1, 2010, with consideration paid to the factors and concerns noted at the Council, including, but not limited to, bill impacts, environmental benefits, and the need for a reasonable ramp-up schedule. In total, the electric three-year plans will result in a cumulative savings on an overall statewide basis of 2,625,6000 megawatt hours ("MWH") over a three-year period, and 30,884,096 lifetime MWH savings. As a direct result of these savings, CO_2 emissions will be reduced by approximately 9,759,374 short tons over the life of those savings, comparable to the environmental benefits achieved by taking approximately 1,622,000 cars off the road, or by recycling 3.0 million tons of waste instead of sending it to a landfill. Cost effectiveness testing indicates that the electric plans are not only cost effective, but over the three year plan are expected to produce net economic benefits of over $3 billion.

Similarly, the gas company three-year plans will result in cumulative savings on an overall statewide basis of 57,402,198 therms over the three-year period, and 897,481,544 lifetime therm savings. As a result of these savings, CO_2 emissions will be reduced by approximately 5,269,604 short tons over the life of those savings, an achievement that is comparable to the environmental benefits achieved by taking approximately 876,000 cars off the road, or by recycling 1.65 million tons of waste. Cost effectiveness testing indicates that the gas plans are not only cost effective, but that over the three years of the plan are expected to produce net economic benefits of over $700 million.

Following full evidentiary hearings, the Department of Public Utilities reviewed and approved the electric and gas three-year plans on January 28, 2010. These three-year plans support the development of an enhanced energy services delivery infrastructure in Massachusetts, will provide thousands of jobs throughout the Commonwealth in the energy efficiency services sector, and enhance program designs in order to provide a seamless experience for customers seeking services from both gas and electric Program Administrators. Such coordination by the PAs should allow for the achievement of deeper and broader levels of savings at customer homes and facilities, all in a more cost-effective manner. In turn, these increased savings levels, over time, will help the PAs reduce their costs of providing services and provide economic and environmental benefits to all customers.

RPS/APS

Since the Restructuring Act of 1997, the Massachusetts Renewable Energy Trust (MRET) and the Renewable Energy Portfolio Standard (RPS) have been the major drivers in installing renewable energy units throughout the Commonwealth. The RPS program requires retail energy suppliers to purchase a certain percentage of their electricity from eligible renewable resources. Compliance with this requirement can be met through the purchase of Renewable Energy Credits (RECs), which are generated as a separate commodity from energy, with one REC for every MWh. The Department of Energy Resources (DOER) also sets an alternative compliance payment (ACP) that suppliers must make if they do not purchase enough RECs to meet their obligation, and this effectively operates as a market ceiling on the market prices of RECs.

The GCA accelerated the minimum percentage that suppliers must purchase from .5% growth each year to 1%, so that the requirement will be 15% by 2020. In addition, geothermal, certain hydroelectric, and hydrokinetic technologies were added as eligible technologies. The RPS was also expanded to include a Class II for vintage renewable facilities, or those that were in operation prior to 1998, to assist them in staying online.

In addition, the GCA included a "carve-out" for new onsite resources of 2 MW or less located in the Commonwealth, and required the DOER to establish an alternative compliance payment that would appropriately incentivize generation resources eligible for this carve-out. DOER has launched the Solar Carve-Out Program to meet this requirement, and also to serve as the successor to the Commonwealth Solar Rebate program administered by MRET.

In January 2008 Governor Patrick launched the Commonwealth Solar Rebate Program which as of its conclusion in October 2009 had awarded $68 million to install 25 MW of new solar installations. Since this program was operating with a set amount of money available, a longer term solution was always needed to maintain the solar industry that the Rebate Program helped create. As a result of the Commonwealth Solar, the number of installers has more than doubled.

Beginning in the summer of 2009, DOER sought significant input from stakeholders on how to implement the carve-out program and ultimately launched the Solar Carve-Out Program in January 2010. It is a market-based incentive program to support residential, commercial, public, and non-profit entities to develop 400 MW of solar energy across the Commonwealth.

Similar to the RPS program, projects that are eligible for this carve-out will generate RECs, but they will be specifically solar credits (SRECs) that will be necessary for suppliers to meet their separate carve-out obligation. In addition, since solar energy is generally more expensive on an installed cost basis than other renewable technologies, the ACP is set at a much higher rate than regular RPS Class I RECs. For Compliance Year 2010, the RPS Class I ACP rate is $60.93 and for the Solar Carve-Out Program it is set at $600.

Since this aimed to provide a financial incentive for new projects, building off the rebate program, projects that have received funding from programs administered by MRET prior to the start date of the Solar Carve-Out Program (January 1, 2010) and those that received substantial funding (over 67% of total installed cost) from the American Recovery and Reinvestment Act (ARRA) federal stimulus programs are not eligible.

While an emergency regulation was filed in January 2010, the formal regulatory process is currently ongoing by DOER with a public hearing held on March 2, 2010.

LTK

The GCA created a specific unique requirement that utility companies purchase three percent of their power through long term contracts of 10-15 years from new renewable generation sources in the Commonwealth. Especially in light of the current conditions of the financial markets, a long term contract such as this can be essential to some renewable projects receiving financing. The law requires utility companies to solicit proposals twice by 2014, and DOER and the utility companies worked together to develop a standard solicitation process that was submitted to and approved by the Department of Public Utilities. This first solicitation was issued on January 15 with responses due February 19. Contracts with successful renewable energy bidders are anticipated to be signed in June, after which the power purchase agreements of each individual utility company will be submitted to the Department of Public Utilities for review and approval.

Net metering

Net metering is an option that has been available to small (<60 kw) distributed generation units for some time, but only provided the average clearing prices for any power these units exported back to the grid. The GCA greatly expanded the availability of this tool by increasing the cap on the size of the facilities that are eligible, and increased the value of the credit.

The changes create three eligible classes for net metering, with Class I including the types of facilities previously eligible. Class II includes facilities from 60kw up to 1 MW but only solar, wind, and agricultural facilities are eligible. Class III also includes solar, wind, and agricultural facilities between one and two MW in size.

Customers may also choose to allocate their credits to other accounts or customers. There is also a cap for this program set at one percent of each utility company's historic peak load. Each company is tracking the number of applications received on its web site to monitor available space under this cap.

After an involved regulatory process, the Department of Public Utilities approved both regulations and tariffs for each of the companies and since December 1, 2009, the updated net metering program has been in place.

This incentive provides potentially significant financial benefits to individuals or businesses with small community scale solar and wind projects that would otherwise have difficulty achieving financing based solely on wholesale energy prices. This provision is maybe the most significant, but there are others throughout the GCA that acknowledge the importance of supporting these types of projects.

In addition, municipally owned projects receive special treatment, including applying the cap on a unit rather than on a facility basis. One of the unique themes running through a number of provisions in the GCA is to ensure that municipalities in addition to the private sector will be able to take advantage of the development opportunities in clean energy.

Green Communities Division

Part of the GCA reorganized the existing Division of Energy Resources into the Department of Energy Resources with three explicit divisions: energy efficiency, renewable and alternative energy, and green communities. While DOER has historically administered the Commonwealth's renewable energy and efficiency policies, the Green Communities Division (GCD) opened up a new opportunity for DOER. This first in the nation program highlights not only the state's commitment to clean energy but also its recognition of municipalities as important partners in this venture.

The GCD was designed to serve as the hub for all energy related matters for all 351 cities and townsin the Commonwealth. Although the GCD administers a variety of services for all cities and towns, the legislation also provides a statutory framework for a specific grant program known as the Green Communities Program. Cities and towns may apply to be designated as "Green Communities" if they meet the five criteria established by statute which are:

- adopt local zoning bylaw or ordinance that allows "as-of-right-siting" of renewable energy projects – siting that does not unreasonably regulate these uses;
- adopt an expedited permitting process related to the as-of-right facilities;
- establish a municipal energy use baseline and establish a program designed to reduce baseline use by 20 percent within five years;
- purchase only fuel-efficient vehicles for municipal use, whenever such vehicles are commercially available and practicable; and
- require all new residential construction over 3,000 square feet and all new commercial and industrial real estate construction to reduce lifecycle energy costs.

In addition to these criteria it is important to note that communities served by municipal light plants are only eligible to apply for this program if they have adopted the renewable energy surcharge that funds MRET. The legislation also provides up to $10 million annually in grants available to "green communities" for energy related programs. As the GCD began to develop the infrastructure and application process for this program, its staff conducted numerous workshops across the state to both educate cities and towns and to receive their feedback on the criteria. Additionally, the Division conducted a Request for Information (RFI) to assess how many of the criteria cities and towns might be able to meet and received over a hundred responses. One of the important results of the RFI was that not many cities and towns would likely achieve green community status at present. The GCD decided to offer technical assistance, hiring consultants to help municipalities assess their ability to meet the criteria and to develop a plan to achieve green community designation. The GCD was able to award this technical assistance to over a hundred municipal entities, including some regional applications. These awards were made at the end of the summer of 2009 and the consultants have been providing the GCD regular progress reports.

In January of 2010, the GCD was able to make two significant announcements. First, building on the success of its technical assistance, the Green Communities Program application was launched, allowing cities and towns to apply for designation through May 14, 2010. After receiving this status, these new green communities will be eligible to apply for funds from the $10 million allotment to continue their clean energy development.

The GCD also launched MassEnergyInsight, a web-based tool now available to all 351 cities and towns, which provides communities with customized electricity, natural gas, and oil usage information, enabling local officials to focus on places where their departments and buildings are wasting energy and, in the process, taxpayers' dollars. The system will help municipalities make informed, targeted decisions about energy efficiency investments. In addition, by providing municipalities with energy use benchmarking, MassEnergyInsight will help them meet the baseline criterion to become a green community.

The GCD also hired four Regional Coordinators who can work directly with cities and towns to assist them with energy related matters. Although this Division is less than two years old it has established the framework to provide a broad range of services to municipalities on all things energy.

Utility Owned Solar

One of the main purposes of the Act was to take utility companies out of the generation business and allow them to focus on the service of transmitting and distributing energy to their customers, and creating an open competitive generation market. Despite this, the GCA recognized that solar remains an expensive technology and offered an opportunity to utility companies to own solar generation, as an incentive to see larger scale solar projects built in the Commonwealth. These are projects that require an entity to have sufficient financial resources or capabilities, such as utility companies. As an incentive for utility companies to build these solar facilities, it allows the companies, after pre-approval from the DPU of the projects, to recover their costs through their rate-making process.

Two of the utility companies, Western Massachusetts Electric Company and National Grid, have received approval from DPU to install six and five MW facilities in various locations. This represents a unique experiment. The legislature realized this and set a reporting deadline to assess the costs and benefits of this program as well as a sunset date in 2012.

Energy and Emission Goals

One of the important aspects underlying all of the policies and incentives contained within the GCA is the recognition of the need to address climate change. The GCA includes a number of energy related goals and another statute, the Global Warming Solutions Act (GWSA), addressed the need for emission reductions and appropriate goals. Examples of these climate goals include:

- 20% of energy use from renewable and alternative resources;
- 25% of Commonwealth load from demand response resources; and
- 80% reduction of GHG by 2050 (from 1990 levels).

The GWSA also required the Secretary of Energy and Environmental Affairs to set interim benchmarks for emission reductions. The Secretary just announced that based on the clean energy policies Governor Patrick's administration put in place, as well as pre-existing programs, Massachusetts is on track to achieve greenhouse gas emission reductions by more than 18 percent below 1990 levels in the next decade.

Conclusion

The GCA provided an extensive framework for Massachusetts to become the nation's leader in clean energy in the 21st century. Nearly two years after its passage a significant amount of progress has been achieved. The Patrick administration continues to build on the foundation laid by this Act to ensure that clean energy is not only combating the effects of global warming but is also the cornerstone of job creation here in the Commonwealth. Massachusetts continues to show that although change may not happen overnight, it continues to work towards meeting and exceeding its energy and emission goals.

Cost Trackers and Decoupling: Recent Changes and Trends in Regulatory Ratemaking

By Jed Nosal, Jamie Tosches DeMello and Laura Bickel

Introduction

In 2009, the Massachusetts Department of Public Utilities ("Department") issued two rate orders that included new ratemaking methods for local gas and electric distribution companies. In addition to approving utility rate increases based on increased operating costs and capital investments, the Department approved new ratemaking mechanisms that will result in annual adjustments to rates. The Department extended the use of cost trackers to a new cost category -- capital expenditures on distribution system infrastructure -- which will allow utilities to receive annual rate increases to recover capital costs one year after they are incurred. The Department also adopted decoupled rates for one electric and one gas utility that will guarantee them the recovery of a target level of revenues through annual rate adjustments.

Regardless of the ratemaking method employed by the Department, ratemaking requires a careful balancing of customer and shareholder interests. By law, ratemaking must achieve "just and reasonable" rates that allow a utility an opportunity to recover its prudently incurred costs and earn a reasonable return. Utilities, in turn, must provide safe, reliable and least-cost service to customers.

While the Department intended for the cost trackers and revenue decoupling mechanisms to equally benefit utility customers and shareholders, the overall effect on rates, quality of service, deployment of energy efficiency, and rate of return are not yet known. In time, these recently adopted public policies will be tested and scrutinized by the Department, the Attorney General, and other stakeholders to ensure that they result in just and reasonable utility rates for Massachusetts customers while providing appropriate incentives to utilities.

Traditional Cost of Service Ratemaking

Under traditional cost of service ratemaking, base rates provide a utility with the primary mechanism to recoup its operating costs for providing distribution service and earn a reasonable rate of return on its capital investment. Base rates are representative of a utility's costs, are set using historic test year data, and *do not increase if costs increase or if revenue declines*. Under traditional ratemaking, a utility could act to decrease its operating costs or boost its sales to try and improve its earnings between base rate cases, and capital projects would typically be funded by revenue growth. The only way for a utility to increase its base rates or recover specific capital costs, however, was to file a base rate case.

Pursuant to G.L. c. 164, § 94, a base rate case involves a six month administrative proceeding and investigation into the propriety of the base rates proposed by a utility. The Department, the Attorney General, and other stakeholders review extensive documents such as expert testimony and accounting data to scrutinize all costs proposed for inclusion in the utility's base rates. By law, the Department may only approve rates for a utility if it finds that they are "just and reasonable" and in doing so, it must set the utility's return at a level that allows it a fair opportunity to earn a reasonable rate of return.

Cost Trackers

While the law requires the Department to ensure utility rates are just and reasonable, the Department has the discretion to consider alternative rate structures and mechanisms such as cost trackers. Contrary to fixed base rates, rates set using cost trackers allow a utility to recover costs as they are incurred. The type of cost trackers used today varies widely. Ken Costello of the National Regulatory Research Institute defines cost trackers as a mechanism that "allows a utility to recover its actual costs from customers for a specified function on a periodical basis outside of a rate case."[1] Most significantly, cost trackers are attractive to utilities because they avoid regulatory lag and allow dollar for dollar recovery of costs incurred, usually on an annual basis.

1 Ken Costello, How Should Regulators View Cost Trackers?" National Regulatory Research Institute (NRRI), Sept. 13, 2009, page 1, available at http://nrri.org/pubs/gas/NRRI_cost_trackers_sept09-13.pdf). ("This paper discusses the major issues regulators face in evaluating the costs and benefits of cost trackers.").

Cost trackers first appeared in the United States around the 1920s and their use was generally limited to taxes, fuel and gas. [2] Cost trackers are allowed to expedite the recovery of costs that were considered large, volatile, and beyond the utility's control. The primary purpose for the use of these cost-trackers was and still is to protect the utility's earnings, particularly during periods of economic inflation or times costs are volatile. Because cost trackers allow for expedited cost recovery, they generally lower a utility's risk profile. In some cases, the adoption of a cost tracker has been accompanied by the imposition of a lower rate of return. Even though cost trackers are used to recover costs outside of a base rate case, the Massachusetts Supreme Judicial Court recently explained that cost trackers must be adopted or modified in a G.L. c. 164, § 94 base rate case to allow for a thorough review of operating costs and the effect of a tracker on base rates and rate of return.[3]

When one utility seeks a cost tracker, other utilities are likely to follow suit. The use of cost trackers has increased in Massachusetts as a result of statutory mandates and Department proceedings. Massachusetts utilities have received Department approval to use cost trackers to recover numerous costs including: natural gas commodity and transportation, basic service electricity, pension and post retirement non-pension benefits, low-income discount programs, supply related bad debt, capital expenditures, initiatives stemming from Chapter 169 of the Acts of 2008, An Act Relative To Green Communities ("Green Communities Act") (energy efficiency, net metering, solar investment), storm repairs, rate case consultants, and environmental remediation. The increase in the use of cost trackers has increased the number and complexity of annual administrative proceedings.

Decoupling

Decoupled rates, unlike other adjustment mechanisms, reset total revenues or revenues per customer on a periodic basis to allow the utility to recover a target level of revenue from customers. In Massachusetts, the target level of revenues is established through a fully litigated base rate case involving a full review of the company's costs as described above. Once the target revenue level is established, under decoupled rates, a utility earns the target amount of revenue every year, regardless of increases or decreases in customer consumption. Rates get periodically reconciled for over- or under-collection of revenues. The Department must review the annual or semi-annual rate adjustments for each utility within an adjudicatory proceeding.

In 2008, a policy to allow revenue decoupling was adopted by the Department to further the goals of the Green Communities Act, which encouraged gas and electric companies to take a leading role in deploying a variety of measures known as demand resources. The Green Communities Act mandated that utilities deploy all cost effective energy efficiency and facilitate net metering, and it also encouraged utilities to procure and install renewable electricity. In a 2008 policy investigation, D.P.U. 07 50, the Department determined that because revenue decoupling severs the link between sales and revenue it would encourage utilities to pursue demand resources and still enable them to earn a fair rate of return. The Department found that once companies were made immune from changes in consumption, demand resources could be expected to flourish.

Recent Rate Orders Adopting Capital Trackers & Decoupling

In the spring of 2009, two Massachusetts distribution companies each filed a base rate case that requested an increase in base distribution rates, along with adoption of decoupled rates and cost trackers for infrastructure costs: Bay State Gas Company in D.P.U. 09-30; and Nantucket Electric Company and Massachusetts Electric Company d/b/a National Grid ("National Grid") in D.P.U. 09-39. Both proposals presented a number of new policy questions for the Department to resolve, including the future relationship between decoupled rates and infrastructure costs. At the conclusion of these fully-litigated proceedings, Bay State Gas Company and National Grid received the Department's approval to become the first two utilities in Massachusetts to implement revenue decoupling and cost trackers for infrastructure costs.

In their respective base rate cases, both utilities sought to justify their request for an infrastructure cost tracker using similar arguments. They claimed that their distribution systems used for local transport of gas or electricity to customers required considerable investments, and

2 See generally Trigg, Escalator Clauses in Public Utility Rate Schedules, 106 U. of Pa.L.Rev. 964 (1958); see also Consumers Organization for Fair Energy Equality, Inc., et al. v. Department of Public Utilities et al, 368 Mass. 599, 601-602 (1975).

3 Attorney General v. Department of Public Utilities, 453 Mass. 191, 197 202 (2009) (explaining G.L. c. 164, § 94).

they further claimed that under decoupled rates, they would need cost trackers to recover the costs of these investments. Both utilities characterized their distribution systems as in need of significant improvements to ensure that customers receive safe and reliable service and proposed cost trackers for their infrastructure costs. Bay State proposed a targeted infrastructure replacement factor ("TIRF") for replacing unprotected steel mains within its gas distribution system, and National Grid proposed a capital expenditure adjustment mechanism ("CapEx") to recover its current and future capital expenditures and its inflation-adjusted operations and maintenance expenses. The proposed TIRF and CapEx were designed to provide annual recovery of future infrastructure costs in excess of the costs already being recovered through base rates.

Ultimately, the Department granted both utilities' proposals for decoupled rates and cost trackers, but it also recognized the need to limit capital spending. Bay State's proposed TIRF included an annual cap equal to one percent of its annual revenue, with any excess costs to be deferred for recovery until future years. The Department determined that Bay State's proposed TIRF was limited in its scale and scope, and contained the protections needed to prevent the recovery of any investment deemed imprudent.

The Department modified National Grid's proposed CapEx mechanism, however, because it determined that the CapEx did not include a limit on costs, and thus did not strike an appropriate balance between: (1) providing National Grid with sufficient funds to ensure the safety and reliability of its electric service; and (2) protecting ratepayers against National Grid's incentive to overinvest in capital infrastructure and provide earnings to shareholders. The Department modified the CapEx by imposing an annual limit on the amount of annual incremental infrastructure costs to be recovered, and denying the inclusion of incremental operations and maintenance expenses. Also, the Department directed National Grid to work with stakeholders on the development of a comprehensive capital investment plan, including goals and metrics by which to measure and quantify the success of the proposed plan.

The utilities' respective requests to significantly increase rates were evaluated during the rate cases and substantially modified by the Department. Bay State's request to increase customers' gas distribution rates by approximately $34 million was reduced by 45 percent, and National Grid's request to increase electric distribution rates by approximately $111 million was reduced by 60 percent. These rate increases also included a specific rate of return for each utility. In each case, the Department determined that, all other things being equal, the approved revenue decoupling mechanisms will reduce the variability of revenue and, accordingly, reduce risk and investors' return requirement. [4] The Department reduced each utility's proposed rate of return based on revenue decoupling and a number of other factors, reducing Bay State's proposed return on equity by 1.05 percent for a total of 9.95 percent, and reducing National Grid's return on equity by 0.71 percent for a total of 10.35 percent.

Conclusion

In severing the link between sales and revenue, revenue decoupling guarantees target revenue for utilities, a change which inevitably shifts some financial risk from shareholders to ratepayers. However, because gas and electric companies have been tasked with a leading role in the expanded deployment of demand resources, decoupling now ranks among the Department's goals in ratemaking. In approving decoupled rates for two companies, the Department has approved cost trackers for the recovery of a limited amount of infrastructure investments between rate cases. As decoupled rates are implemented by utilities, it should become evident whether cost trackers are an effective element in the provision of balanced decoupling rate structures in Massachusetts.

With the increased use of cost trackers and the adoption of decoupled rates, the Department will set rates for each utility within more frequent and numerous adjudicatory proceedings. The increased number of proceedings will pose an administrative challenge to the Attorney General, Department and interested parties to thoroughly but efficiently review the reasonableness and prudence of rates. In addition, it will also be a challenge to keep customers informed about the numerous annual rate changes that result.

4 Massachusetts Electric Company and Nantucket Electric Company d/b/a National Grid, D.P.U. 09-39, at 395 (2009); Bay State Gas Company, D.P.U. 09-30, at 367-369 (2009).

Featured Committee: Insurance Law Committee

In 2009 the Co-Chairs of the Insurance Law Committee formed a steering group to provide a stronger leadership base. The composition of the steering group includes the current Co-Chairs, the immediate past Co-Chair as well as four additional members. The steering group will assist in growing the committee membership as well as provide a broader platform for members to introduce current issues and topics of interest.

In addition, the Insurance Law Committee held two brown bag luncheons over the past few months. The first luncheon included a presentation by reinsurance specialist Paul McGee that provided attendees the opportunity to hear a seasoned reinsurance professional discuss the fundamentals of the reinsurance industry. A second luncheon included a presentation co-sponsored with the Environmental Law Committee regarding the recent SJC ruling in *Boston Gas Company v. Century Indemnity Co.* The meeting format included a lively discussion between an insurer counsel and a policyholder counsel.

The upcoming winter and spring meetings include a variety of activities. The first meeting will include a presentation by BDO Consulting that will delve into the evidence necessary to substantiate proof of loss for insurance claims. Subsequent meetings include a presentation on the principles of life/disability insurance for business owners, executives, and professionals as well as a presentation on commercial risk management. Lastly, the Committee is considering the formulation of a MCLE program that would appeal to the business law section membership.

Property and Casualty Insurance Policies: A Permanent Keeper

By Michael Weinberg and Patrick Tracey

The efficacy of a record retention policy should be a consideration for all business entities. Businesses of every type make decisions concerning retention of records and documents on a frequent basis. Companies maintain varying types of records for differing periods of time, such as financial records, bank statements, contracts, inventory files, personnel files, pension documents and tax returns. Specific retention policies, however, diverge among companies based upon perceived need, statutory or otherwise. A strong record retention policy requires safeguarding all property and casualty (P&C) insurance policies regardless of the coverage periods. The importance of preserving insurance policies cannot be overstated.

Record Retention and Document Destruction Policies

A review of various record retention and document destruction policies reveals mixed positions concerning the length of time entities retain P&C insurance policies. One national association suggests that its members "permanently" retain P&C insurance policies as well as current accident reports and claims still in effect. Another organization recommends preserving P&C insurance policies permanently. As a minimum requirement, a third national counsel association recommends maintaining P&C insurance policies after a three year policy expiration. In addition, the review revealed two articles of interest regarding record retention policies. One article recommended a ten year minimum retention of P&C policies while a second article did not include P&C policies within its retention suggestions. Notably, setting a "minimum" retention period leaves open when to destroy any insurance policies rather than setting a permanent retention period.

Allocation of Multi-Year Losses

Insurance policies should be maintained on a permanent basis because of the potential negative financial impact of doing otherwise. A recent decision by the Massachusetts Supreme Judicial Court (SJC), *Boston Gas Company v. Century Indemnity Company*, 454 Mass. 337, 910 N.E. 2d 290 (2009) supports this position. The *Boston Gas* case involved a situation where Boston Gas, the insured, operated a manufactured gas plant (MGP) in Everett, Massachusetts that produced natural gas as a source of fuel. The process of creating usable gas fuel produced a variety of non-biodegradable carcinogenic byproducts. The byproducts contaminated the ground and water near the Everett MGP facility, causing significant environmental damage.

Century Indemnity Company (Century) provided insurance coverage for the operations at the Everett MGP facility. Century provided coverage for some, but not all, of the relevant period during which environmental damage occurred. These were occurrence based policies - meaning that Century would indemnify Boston Gas for its ultimate net loss for liabilities stemming from, among other things, property damage caused by an occurrence during the relevant policy period. The type of damage covered under the policies involved long-term environmental contamination over many years, including the period that Boston Gas operated the Everett MGP facility. Boston Gas located only a select few applicable P&C policies during its search for the pertinent policies. The retained policies accounted for some, but not all, of the relevant years during which the alleged environmental damage occurred.

Boston Gas and Century did not agree on the appropriate insurance coverage for the relevant years of the damage. In the resulting litigation, the Massachusetts Supreme Judicial Court considered the question of how to allocate liability for such contamination where a policyholder sues a P&C insurer that provided coverage for the risk for only a portion of the time during which the contamination took place. This allocation issue commonly arises in the context of insurance disputes involving so-called "long tail claims" for injuries caused by environmental damage and toxic exposure.

Long tail claims involve complex issues due to the latency and longevity of the associated injuries. The damage or injuries often occur continuously over many years, known as progressive injuries. Frequently, progressive injuries involve a liable party with insurance coverage falling under several different insurance policies often provided by a number of insurance companies. Additionally, coverage may not exist for some years because specific policies cannot be located by the insured or losses may be excluded. Boston Gas maintained the position that because of certain "all sums" language in the Century and other insurers' policies, the insurers remained jointly and severally liable to cover all damage if any injury occurred during a single insurer's policy period. Therefore, Boston Gas propounded that if it could identify one insurer with coverage for any damage during its policy period, such as Century, then Century would have to pay all indemnity concerning the entire environmental loss.

The SJC disagreed with the Boston Gas position and adopted the insurers' position of pro rata allocation. The Court sided with Century and adopted a pure "time on the risk" method of allocation. The Court ruled that in the absence of a more precise measure of actual damage per year, each insurer owes its years on the risk divided by the total loss and that the time-on-the-risk method of allocating losses is appropriate where the evidence will not permit a more accurate allocation of losses during each policy period. The SJC ruled that policy wordings and common sense require allocation on a pro rata basis. During years where no insurance existed, either because the policy holder did not locate or establish insurance coverage, or exclusions prevented coverage for certain losses, then the policyholder would need to pay for any loss during those uncovered years. No insured, such as Boston Gas, would expect to receive coverage for losses in years where it had no insurance.

Long Tail Claims Persist

Long tail claims exist in various forms. Asbestos claims constitute the longest-running mass tort litigation in the United States.[1] The initial wave of asbestos litigation involved cases against asbestos manufacturers, sellers and distributors. However, the current litigation has transformed to second and third tier defendants that include, among others, friction material manufacturers, equipment manufacturers, paper mills and construction materials producers that allegedly used asbestos as a product component. Long tail claims also have resulted from injuries due to lead, mold, and silica. It is not uncommon for long tail claims to involve damages which may have an insurance policy trigger dating back some thirty, forty or more years ago. For this reason, companies need to maintain P&C insurance policies on a permanent basis.

Reconstruction of Lost Policies

An insured making a claim under a policy has the burden of proving its existence and material terms should a business entity misplace or lose an insurance policy. *Employers' Liab. Assur. Corp. v. Hosechst Celanese Corp.*, 43 Mass.App.Ct. 465, 484, 684 N.E.2d 600, 612 (1997). Relevant evidence may include documents such as insurance binders, declarations pages, testimony from insurance agents and brokers, financial and accounting records, certificates of insurance, a company's custom and practice, testimony from policy reconstruction experts, and standard policy forms used by the insurer during the relevant period. In the absence of good records, the task of presenting secondary evidence is often challenging. Should an insured attempt to present testimonial evidence, Massachusetts law requires the use of a competent witness to authenticate appropriate secondary evidence. *Kleenit, Inc. v. Sentry Ins.* Co., 486 F.Supp.2nd at 127. Furthermore, "under Massachusetts law, the insured bears the initial burden of proving that an injury occurred within the coverage ambit of the insurance policy." *Id*. citing *U.S. Liability Ins. Co. v. Selman*, 70, F.3d 684, 688 (1st Cir. 1995) (citing Trustees of *Tufts Unvi. v. Commercial Union Ins. Co.*, 415 Mass. 844, 616 N.E.2d 68, 74 (1993)).

The standard of proof that an insured must meet to prove the existence of a missing policy varies by jurisdiction. The Federal Rules of Evidence allow for the admissibility of secondary evidence if the original insurance policy was lost or destroyed, other than in the course of bad faith by the insured. [2] However, courts in Massachusetts often apply varying standards of proof

1 Stephen J. Carroll, et al., Asbestos Litigation, 2005 RAND INST. FOR CIV. JUST.

2 John H. Mathias, Jr., et al., Insurance Coverage Disputes, 2009 Law Journal Press; Fed R. Evid. 1004.

to demonstrate the existence of a lost policy. Thus, in order to avoid reliance on secondary evidence, a well-designed record retention policy is imperative to track and retain policies regardless of coverage periods.

In some instances insurers used manuscript policies instead of standard form policies. These manuscript policies were drafted specifically for an insured and were unique in many respects. If lost, these policies would be extremely difficult to recreate years later wherein many witnesses and records may be lost. Insurance companies do not have a duty to maintain insurance policies on a permanent basis, but rather in accordance with state regulation. Further, a policyholder would need to establish a reasonable explanation for the missing policy as well as an explanation that no bad faith or fraud occurred regarding the loss or destruction of the policy. As with standard policies, a policyholder would need to demonstrate that it conducted a diligent but unsuccessful search for the applicable documents. Notably, an insurer would likely question the sufficiency of such secondary evidence, but such only goes to the weight, not admissibility of the evidence. Once the policyholder establishes the existence of a policy and the material terms, including the insuring agreement, it has met its objective. The burden of proving any exclusions from coverage, or conditions or limitations in coverage, generally rests with the insurer.

Conclusion

The time, effort and expense involved in attempting to establish the existence of missing P&C insurance policies can be enormous. Businesses should make every attempt to locate insurance policies, or risk being responsible for bearing losses for periods of time where no coverage can be established. Maintaining insurance policies on permanent file involves minimal cost to a business, particularly in the modern computer age where formerly large paper files can now be safely stored as electronic data. A well-formulated record retention program that emphasizes the preservation of all insurance policies is a necessity of good business practice and should be the goal of every company.

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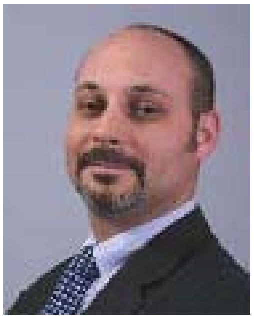

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