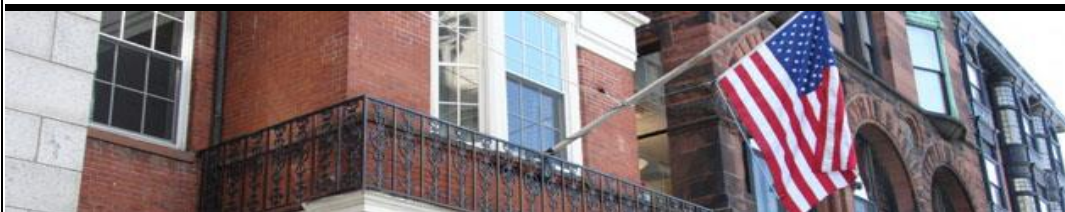


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Voice of the Judiciary



Near the top of the application for judgeships is an innocent-sounding question: “If appointed, will you accept assignments from time to time in other departments and other geographic divisions as the administrative needs of the Massachusetts Trial Court require?” With visions of Nantucket or the Berkshires in the summer, I cheerfully answered “yes.” Only later did I learn this was a reference to the Judicial Response System (“JRS”), unknown to me at the time and, I suspect, to most lawyers in the Commonwealth.

Courts never close. There is always a judge available if needed. From 4:30 p.m. to 8:30 a.m. weekdays, and all hours of the day and night on weekends and holidays, a judge is “on call.” Every trial court judge participates, without exception, serving for a week at a time every eight months or so (judges covering the Berkshires serve for a month), on a rotating basis, in one of the eight districts into which the state has been divided.

What kinds of matters does JRS address? JRS is not a continuation of ordinary court business. It is intended only for true emergencies needing immediate relief. These most often are abuse or harassment prevention orders (c. 209A and c. 258E), search warrants, and probable cause review of warrantless arrests, but also include orders for emergency medical care and treatment when judicial intervention is the only available recourse, psychiatric hospitalization of persons detained by the police, and civil commitment of mentally ill persons at substantial risk of physical harm to themselves or others. There are also other types of emergencies. For couples on their wedding day with their minister, guests, caterers, and band all waiting for the ceremony to begin, but who forgot to obtain the required three-day notice of intent to marry, JRS judges have the authority to waive that requirement, thus allowing the marriage to go forward. Sometimes the JRS judge must involve others, even in the middle of the night. In juvenile matters, often the Department of Children & Families must be contacted for assistance. With civil commitments and medical interventions, counsel for those affected must be obtained.

Orders issued by JRS judges are effective only until the next court day, when the applicants must appear in court to have them extended and those affected by *ex parte* relief can be there to tell their side of the story.

How does JRS work? Generally speaking, an applicant contacts the local police department, each of which has the district's "on call" judge's cell phone number at hand. The police then make the initial contact with the judge. Some matters can be handled over the telephone, typically abuse and harassment prevention orders. Others, such as search warrants, emergency medical care decisions, and civil commitments, require "in person" hearings. Recall that any of these matters can occur at any time of day or night, without warning, and because they are emergencies, the judge must be immediately available and ready to hear and decide them.

What is it like for the judge? The need to be constantly and immediately available means never being out of cell phone coverage, never being anyplace where you cannot be reached or interrupted, no out of state travel, and having a kind and understanding spouse who does not mind (or says they do not mind) a loudly-ringing 2:00 or 3:00 a.m. telephone call, ruining all prospect of remaining sleep. These are not vacation weeks for the judge, who must be in court the next day handling regular matters.

What makes JRS different from any other judicial duty is its range and immediacy. I am a Land Court judge, whose cases center on real property disputes. When I serve on JRS, I am also interdepartmentally assigned to the Juvenile Court, the Probate & Family Court, the Boston Municipal Court, the Superior Court, the Housing Court, and the District Court, with their full jurisdiction and powers, civil and criminal, "to the extent necessary." Every time I serve I gain a new appreciation and respect for the challenges faced by my colleagues in these courts. The immediacy of the matters is also striking — not the ordinary "look-back" of a trial, but as close to real time as a court can get.

I have had a late night telephone call, originating in a hospital emergency room, from a college-aged woman seeking a restraining order against her mother who had slashed her with a knife when she came home ten minutes past curfew. What past events, I wondered, had led to that? I wondered also what would happen in the future between the mother and the daughter, who needed her mother's help with tuition and lacked the money to live alone. There would never be a way for me to know. My order expired the next day, and the case was now in the hands of the local court.

Another was a late night call from a woman whose live-in boyfriend threatened to set fire to her house if she threw him out. She did, and he did, after which he ran into the woods. When I got the call, the fire trucks were still there, and there was a three-town search underway to find the boyfriend. Did they catch him? What happened afterward? Again, no way to know.

Some calls are unbearably sad. I had a young, foreign-born woman, not long in the US, whose husband had beaten her badly during an argument (he had recently lost his job). I issued the restraining order, after which she asked, "Does this mean he can't come to our daughter's first birthday party tomorrow?" It

did. “I can’t go home judge,” she continued. “Now that I am married my family will not take me back. I have no job of my own. My husband is unemployed. What do I do?” “Be sure to tell the court your situation when you’re there Monday morning,” was all I could say.

I am always glad when my week draws to a close and I return the JRS telephone to the Trial Court office. Life returns to normal. But I’m also grateful for the insight the week has given me into the world outside my court, and the chance to make even a small difference in people’s lives.

Judge Long has served on the Land Court since 2004. He was a partner at K&L Gates LLP before his appointment, and is a graduate of the University of Washington, Harvard Law School, and Oxford University.

The Scalpel or the Bludgeon? Twenty Years of Anti-SLAPP in Massachusetts

by David A. Kluff

Legal Analysis



This December will mark the twentieth anniversary of **Chapter 231, Section 59H** of the Massachusetts General Laws, commonly known as the Massachusetts anti-SLAPP statute. A SLAPP suit (SLAPP stands for “strategic litigation against public participation”) is often described as a “generally meritless suit[] brought by large private interests to deter from or punish common citizens for exercising their political or legal rights.”^[1] Section 59H allows a party to bring a “special motion to dismiss” such suits.

Governor William Weld, who argued that Section 59H was overbroad, once characterized it as “a bludgeon when a scalpel would do.” The first two decades of cases brought under the statute tell a story of tension and negotiation between the opposite impulses described by Governor Weld’s metaphor. While some decisions have expanded – or confirmed – broad access to the statute’s protections, other decisions have sharpened and narrowed the kind of activity it protects.

The Rise of the SLAPP

The petition clause of the First Amendment guarantees “the right of the people . . . to petition the government for a redress of grievances.” In the latter half of the twentieth century, activists and other individuals increased their petitioning activity in all three branches of government, from speaking out at town meetings to lobbying Congress. In the judicial arena, new legislation such as Section 304 of the 1970 Clean Air Act allowed private parties to sue to enforce public rights. Citizen petitioners were no longer “to be treated as nuisances or troublemakers but rather as welcomed participants in the vindication of” public interests.^[2]

However, beginning in the 1970's, those same petitioners increasingly found themselves targeted by retaliatory SLAPP suits. Landlords were suing tenants who reported building violations, businesses were suing customers who made consumer complaints, and public officials were suing their political critics. The classic scenario involved land use. For example, a neighbor opposed a new real estate development by testifying at a zoning hearing or asking a court for an injunction. The developer responded with a SLAPP suit against the neighbor, typically demanding ruinous damages on the grounds that the petitioning activity was defamatory or constituted an abuse of process.^[3]

SLAPP suits were rarely, if ever, successful, because the First Amendment guarantees a qualified immunity for petitioning activities.^[4] However, winning was not the point. Simply by filing the SLAPP suit, the plaintiff forced the petitioner to divert his focus away from the petitioning activity to deal with a costly legal battle against an opponent with greater resources. SLAPP suits were often difficult to dismiss at the pleading stage and, by the time the petitioners finally prevailed, they were financially exhausted, emotionally drained, and very possibly deterred from engaging in further petitioning.

The Origins of Anti-SLAPP

In 1984, the Supreme Court of Colorado developed a procedure that — while not preventing SLAPP suits altogether — sought to identify them at an early stage for quick disposition. ***Protect Our Mountain Environment, Inc. v. District Court***, 677 P.2d 1361 (Colo. 1984) was a classic SLAPP scenario, in which a developer sued a citizens group in retaliation for its public opposition to a building project. The Court announced that, henceforth, where a claim is based on petitioning activity and the petitioner files a motion to dismiss, the motion would be converted to one for summary judgment. To overcome that motion, the SLAPP plaintiff would have to show that the petitioning activities in question “were devoid of reasonable factual support.” This new procedure was a self-conscious attempt to balance, on the one hand, the danger that SLAPP suits may discourage legitimate petitioning and, on the other, the dangers of illegitimate “sham” petitioning.^[5] Over the next decade, states began enacting statutory mechanisms loosely modeled after the Colorado decision.^[6]

The Massachusetts Anti-SLAPP Statute

The Massachusetts anti-SLAPP statute traces its roots to a 1991 suit brought by a developer against residents of Rehoboth who had signed a petition to oppose a construction project. The suit was eventually dismissed, but only after nine months of litigation and over \$30,000 in attorneys' fees. This episode caused Massachusetts legislators to take note of a “disturbing increase in lawsuits brought primarily to chill the valid exercise of the constitutional rights of freedom of speech and petition for the redress of grievances.” ^[7]

Anti-SLAPP legislation modeled in part after Colorado's expedited summary judgment procedure was first introduced in the Massachusetts House of Representatives in 1993. The bill that was eventually codified as Section 59H provided that a "party may bring a special motion to dismiss" any claim which is "based on that party's exercise of its right to petition." The right to petition is defined broadly as:

[A]ny written or oral statement made before or submitted to a legislative, executive, or judicial body, or any other governmental proceeding; any written or oral statement made in connection with an issue under consideration or review by a legislative, executive, or judicial body, or any other governmental proceeding; any statement reasonably likely to encourage consideration or review of an issue by a legislative, executive, or judicial body or any other governmental proceeding; any statement reasonably likely to enlist public participation in an effort to effect such consideration; or any other statement falling within constitutional protection of the right to petition government.

The motion judge is required by Section 59H to hear a special motion as expeditiously as possible, and to grant it unless the SLAPP plaintiff can show that "(1) the [petitioner's] exercise of its right to petition was devoid of any reasonable factual support or any arguable basis in law and (2) the [petitioner's] acts caused actual injury to the responding party." All discovery is stayed until the motion is decided, except that the court may order specified discovery pertinent to the anti-SLAPP motion "for good cause shown." In the event the motion is granted, the trial court "shall award the [petitioner] costs and reasonable attorneys' fees."

Governor Weld vetoed the bill and endorsed a more limited mechanism aimed at the dismissal of improper lawsuits brought by real estate developers. However, on December 29, 1994, the Massachusetts House and Senate overrode the veto and Section 59H became effective.

Setting the Standard

The first Section 59H case to reach the Massachusetts Supreme Judicial Court ("SJC") was not a typical SLAPP scenario. ***Duracraft Corp. v. Holmes Prods. Corp.***, 427 Mass. 156 (1997) involved a former executive of a company who allegedly violated a nondisclosure agreement while preparing for and testifying at a deposition. The company sued for breach of contract, and the defendant filed a Section 59H motion, arguing that the breach of contract claim was "based on" his participation in the judicial process, which constituted petitioning activity. The motion was denied.

On appeal, the SJC announced two important interpretations of Section 59H, one which expanded access to the statute's protections and the other which significantly narrowed its scope. First, the Court confirmed that the anti-SLAPP law was not limited to issues of "public concern," as it was in some other states, but also protected petitioning activity with respect to private matters, such as the underlying contract dispute in *Duracraft*.

Second, a major issue for critics of Section 59H had been the breadth of the phrase “based on.” If any claim “based on” petitioning activity was a SLAPP suit, that could lead to early and unfair dismissal of perfectly legitimate claims or counterclaims merely because they were somehow connected to petitioning activity. The breach of contract claim in *Duracraft* was but one example. To protect one kind of petitioning (responding to a notice of deposition), the statute was arguably punishing another kind (bringing a legitimate contract claim). The Court addressed this issue by narrowly construing the statutory text and adopting a burden-shifting mechanism for future application of the statute:

- The petitioner bringing the anti-SLAPP motion must make a threshold showing through pleadings and affidavits that the claims against it are not just loosely “based on” petitioning, but “based on the petitioning *alone* and have no substantial basis other than or in addition to the petitioning activities.”
- Then, the burden shifts to the nonmoving party to show actual injury, and to demonstrate that the petitioning was “devoid of any reasonable factual support or any arguable basis in law.”

By establishing this procedure, *Duracraft* effectively rescued the statute from the potentially unconstitutional breadth of its own literal text and ensured that it would be applied in a manner consistent with the federal right to petition. Thus, petitioning activity had immunity, but it was a qualified immunity, one that potentially could be overcome by a party with a legitimate grievance. [8]

Is Abuse of Process Dead?

An issue left undecided by early SJC cases was the statute’s effect on the tort of abuse of process. This tort is, by definition, based on petitioning activity. However, it concerns not so much the act of petitioning as the “ulterior or illegitimate purpose” for that petitioning. In *Fabre v. Walton*, 436 Mass. 517 (2002), the defendant had obtained a domestic violence restraining order against her ex-boyfriend. In retaliation, the ex-boyfriend sued the defendant for abuse of process, alleging an improper motive for obtaining the restraining order (harming his career). The defendant filed a Section 59H motion. She argued that asking for a restraining order was protected petitioning activity, but the motion was denied.

On appeal, the ex-boyfriend argued that his abuse of process claim was based not on the defendant’s restraining order *per se* (the petitioning activity), but on the defendant’s alleged “ulterior motive” for obtaining the restraining order. The SJC refused to recognize such a fine distinction. Irrespective of the defendant’s alleged motive, the only *conduct* complained of was her petition for the restraining order. The alleged motive for the petitioning was irrelevant, and the Section 59H motion should have been granted. [9]

Did Section 59H and cases like *Fabre* effectively eliminate common law claims for abuse of process and malicious prosecution? The SJC confirmed the continued existence of these torts in *McLarnon v.*

Jokisch, 431 Mass. 343 (2000). Nevertheless, such claims are undeniably risky since the statute's passage, and the risk was perhaps increased after **Wenger v. Aceto**, 451 Mass. 1 (2008), in which the SJC held that, of course, unsuccessful petitioning activity was protected by Section 59H. According to the Court, the "critical determination is not whether the petitioning activity in question [was] successful, but whether it contain[ed] any reasonable factual or legal merit at all."**[10]**

Who Is a Petitioner?

Perhaps the most contentious issue in Massachusetts anti-SLAPP jurisprudence has concerned who gets to call themselves a "petitioner." In **Kobrin v. Gastfriend**, 443 Mass. 327 (2005), a psychiatrist acting as a government expert witness in a malpractice proceeding was sued over the content of his testimony. The psychiatrist's Section 59H motion was initially allowed.

On appeal, however, the SJC reversed. The statute describes an anti-SLAPP motion as one "based on [the moving] party's exercise of *its right* to petition" (emphasis added). As an expert testifying *for the government*, the psychiatrist was not exercising *his right* to petition. Therefore, the Court held, Section 59H did not apply.**[11]** A vigorous dissent, authored by Justice Martha Sosman, argued that the psychiatrist's testimony was within the statute's definition of petitioning, which included "any written or oral statement made before or submitted to a" government body.

But while *Kobrin* signified an important limit on what constituted petitioning under Section 59H, a parallel line of cases has expanded access to the statute for agents and affiliates of petitioners. This includes parents reporting crimes on behalf of children, **McLarnon v. Jokisch**, 431 Mass. 343, 349 (2000), and attorneys engaged in petitioning activity on behalf of clients. **Plante v. Wylie**, 63 Mass. App. Ct. 151, 156-157, *rev. denied*, 444 Mass. 1103 (2005). Most recently, in **Town of Hanover v. New Eng. Reg'l Council of Carpenters**, 467 Mass. 587 (2014), a municipality brought an abuse of process action against a union that allegedly had worked behind the scenes to enlist, and then to provide organizational and legal support for, a group of citizens seeking judicial review of a controversial expenditure of town funds. In a decision that will no doubt provide greater protection for all kinds of advocacy groups, the SJC held that the union was engaged in petitioning activity under Section 59H because, unlike the psychiatrist in *Kobrin*, it was advancing a cause in which it believed and, presumably, shared an interest.

The Line Between Petitioning and Other Speech

Although grounded in the First Amendment's petition clause, Section 59H's definition of petitioning arguably protects a wide range of speech not aimed directly at the government but nevertheless "in connection with" petitioning activity. The line between petitioning and other speech was explored by the SJC in **Cadle Co. v. Schlichtmann**, 447 Mass. 242 (2006). In that case, an attorney made allegedly defamatory statements on a website and to newspapers about a debt collection agency with which he

had an ongoing legal dispute. The agency sued for defamation, and the attorney filed a Section 59H special motion to dismiss, which the motion judge denied.

On appeal, the SJC, citing *Wynne v. Creigle*, 63 Mass. App. Ct. 246, *rev. denied*, 444 Mass. 1105 (2005), acknowledged that statements by petitioners to the press, where they essentially mirror the petitioner's statements to government bodies are protected by Section 59H. However, that didn't mean that every statement concerning any issue under government review was protected. For example, in *Global NAPS, Inc. v. Verizon New England, Inc.*, 63 Mass App. Ct. 600 (2005), a company's statements about a government investigation of its competitor were not protected, because the company was not petitioning on its own behalf. This distinction is further echoed in cases like *Ayasli v. Armstrong*, 56 Mass. App. Ct. 740 (2002), *rev. denied*, 439 Mass. 1101 (2003), in which the Appeals Court separated protected petitioning activity (contacting municipal authorities to stop a building project) from related tortious behavior (engaging in physically intimidating acts in order to stop the project).

Similarly, in *Cadle*, the SJC held that the attorney's statements to the press and on his website were not protected because they exceeded the scope of the petitioning activity, and instead they were designed to attract new clients and gain other tactical advantages. [\[12\]](#)

Making a Federal Case

Before 2010, a Section 59H motion could not be filed in federal court because it was regarded as a procedural mechanism — not a substantive right — which conflicted with the standards governing dispositive motions pursuant to Rule 12(b)(6) and Rule 56. *Baker v. Coxe*, 940 F. Supp. 409, 417 (D. Mass. 1996). However, in *Godin v. Schencks*, 629 F.3d 79, 92 (1st Cir. 2010), the First Circuit held that Maine's anti-SLAPP statute was sufficiently substantive in nature such that failure to apply it in federal court diversity actions would frustrate the goals of *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938): the discouragement of forum shopping and the equitable administration of the law. Three years later, the court in *Bargantine v. Mechs. Coop. Bank*, 2013 U.S. Dist. LEXIS 169284 (D. Mass. 2013) recognized that, because the Massachusetts anti-SLAPP statute was identical to the Maine statute, Section 59H should apply in diversity actions in the District of Massachusetts.

The Bludgeon And the Scalpel

After twenty years of case law, it would be unfair to characterize the Massachusetts anti-SLAPP statute as a bludgeon or a scalpel. Section 59H's application by courts has aspects of both metaphors, sometimes within the same case. On the one hand, the decision in *Duracraft* maintained access to the statute for matters of private concern but, on the other hand, it substantively narrowed the statutory text to ensure that the statutory protection is limited to petitioning activity "alone." Subsequent cases further reflect these dialectic impulses of expanded access and limited definitions of "petitioning." On the one

hand, cases like *Wenger, Town of Hanover* and the introduction of Section 59H into federal court further expand access to the statute for different types of litigants. On the other hand, *Kobrin* and *Cadle* significantly limit the kinds of activity that are identified as petitioning in the first place. It seems likely that — as the courts strive to balance the rights of the parties in a manner that is fair and consistent with the First Amendment right to petition — these opposite impulses will continue to shape the law over the next twenty years.

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Footnotes

[1] *Kobrin v. Gastfriend*, 443 Mass. 327, 337 (2005), quoting *Wilcox v. Superior Court*, 27 Cal. App. 4th 809, 816 (1994). The term “SLAPP” was coined by two professors at the University of Colorado. See George Pring, *SLAPPs: Strategic Lawsuits Against Public Participation*, 7 Pace Envtl. L. Rev. 3 (1989).

[2] *Friends of Earth v. Carey*, 535 F. 2d 165, 172 (2d Cir. 1976).

[3] See Joseph Brecher, *The Public Interest and Intimidation Suits: A New Approach*, 28 Santa Clara L. Rev. 105, 114 (1988).

[4] First Amendment petitioning immunity is qualified, not absolute, and can be overcome by a showing of “actual malice.” See *McDonald v. Smith*, 472 U.S. 479, 481 (1985) (letter to President regarding executive appointment not absolutely privileged), citing *New York Times v. Sullivan*, 376 U.S. 254 (1964).

[5] This language derives from the **Noerr-Pennington doctrine**, pursuant to which petitioning activity is immune from antitrust liability unless it is a “mere sham to cover what is actually nothing more than attempt to interfere directly with the business relationships of a competitor.” See *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961); *United Mine Workers v. Pennington*, 381 U.S. 657 (1965).

[6] See 10 Del. C. § 8138 (1992); Cal. Civ. Proc. Code § 425.16 (1993); N.Y. Civ. Rights Law §§ 70a (1993); R.I. Gen. Laws §§ 9-33-1 — 9-33-4 (1993); Minn. Stat. Ann. §§ 554.01 *et seq.* (1994); Neb. Rev. Stat. §§ 25-21,241 *et seq.* (1994).

[7] The legislative history set forth in this section is derived from *Duracraft Corp. v. Holmes Prods. Corp.*, 427 Mass. 156 (1998); *Kobrin v. Gastfriend*, 443 Mass. 327 (2005), *Scanlon v. McHugh*, 4 Mass. L. Rep. 334 (Mass. Super. Ct. 1995); and sources cited therein.

[8] Later important refinements to Section 59H procedure included *Baker v. Parsons*, 434 Mass. 543 (2001) (nonmoving party must meet burden by “preponderance of the evidence”); *McLarnon v. Jokisch*, 431 Mass. 343 (2000) (judge has no discretion to deny award of attorneys’ fees to prevailing

anti-SLAPP movant); and **Fabre v. Walton**, 436 Mass. 517 (2002) (permitting interlocutory appeal to Appeals Court after denial of Section 59H motion). Most recently, *Polay v. McMahon*, SJC-11460 (2014), the SJC held that a prevailing petitioner was entitled to attorneys' fees notwithstanding the fact that a liability insurer had paid for his defense.

[9] See also **Office One, Inc. v. Lopez**, 437 Mass. 113 (2002) (ulterior motive irrelevant); **N. Am. Exp. Co. Ltd. P'ship v. Corcoran**, 452 Mass. 852, 863 (2009) (commercial motive irrelevant).

[10] The Boston Bar Journal previously published an analysis of this issue by Richard J. Yurko and Shannon Choy, entitled **Reconciling The Anti-SLAPP Statute with Abuse of Process and Other Litigation-Based Torts**, 51 B.B.J. 15 (2007). Richard also provided valuable input to this author.

[11] Later decisions concerning this issue include **Moriarty v. Mayor of Holyoke**, 71 Mass. App. Ct. 442, *rev. denied*, 451 Mass. 1107 (2008) (Section 59H not available to government agents acting in official capacity); **Fustolo v. Hollander**, 455 Mass. 861 (2010) (Section 59H did not protect journalist writing on issues about which others had petitioned).

[12] The attorney also cited **MacDonald v. Paton**, 57 Mass. App. Ct. 290 (2003), in which the Appeals Court had concluded that a website run by a politician was an interactive public forum in which citizens discussed local governance, and therefore was a protected petitioning activity. The Supreme Judicial Court distinguished that case on the grounds that, while the website in *MacDonald* had been interactive and non-commercial, the attorney's website in *Cadle* solicited clients and did not provide a space for public discussion.

When Is Hacking A Crime? Potential Revisions to the CFAA

by Allison D. Burroughs, Benjamin L. Mack, and Heather B. Repicky

Viewpoint



In the wake of the much-publicized federal criminal prosecution and suicide of Aaron Swartz, the Computer Fraud and Abuse Act (“CFAA”) (codified at 18 USC §1030) has drawn deserved criticism from legal commentators and lawmakers. Indeed, the CFAA is an outdated, patchwork statute, in need of revision.

Swartz, a computer programmer, entrepreneur, and activist, was accused of accessing restricted portions of MIT’s computer network in order to download millions of journal articles from a digital library. He faced as much as 35 years in prison and a \$1 million fine under the CFAA and related statutes.

Prominent critics, like Congresswoman Zoe Lofgren (D-CA), contend that the CFAA imposes substantial criminal liability and punishment for relatively innocuous conduct. In 2011, in the wake of the Swartz case, Congresswoman Lofgren introduced “Aaron’s Law” to prevent arguably disproportionate penalties for certain CFAA violations. However, the proposed statute would also seemingly insulate “authorized users” of computers from prosecution, regardless of the nature of their conduct or the harm it causes. Congress should not seek to fix the CFAA by opening unnecessary gaps in the statute. Instead, a more careful revision would ensure that violations of, for example, terms of service agreements would not trigger criminal liability for users, while also giving law enforcement means to punish malicious, damaging conduct by even “authorized” computer users.

The Computer Fraud and Abuse Act

The CFAA criminalizes many activities done after “knowingly access[ing] a computer without authorization or exceeding authorized access.” Generally speaking, the seven provisions of the CFAA punish: (1) obtaining national security information; (2) obtaining information of a government agency or of a confidential nature (e.g., financial information); (3) trespassing in a government computer; (4) accessing a computer to commit a fraud; (5) damaging a computer (e.g., by worm, virus, or denial of service attack); (6) trafficking in computer passwords; and (7) threatening to damage a computer.

The CFAA punishes computer access “without authorization” or “exceeding authorized access.” Penalties under the CFAA range from a misdemeanor (imprisonment for not more than one year) to 20 years incarceration, with the majority of offenses carrying a penalty of five years incarceration for a first offense and ten years for a second. There is a jurisdictional requirement of \$5,000 worth of damage which is, in effect, a technicality since that amount can be satisfied by investigative and administrative costs related to understanding and assessing an intrusion.

Aaron Swartz

Late in 2010, Swartz entered a restricted network wiring closet in the basement of an MIT building. He then rigged a laptop and external hard drive to retrieve 4.8 million articles from JSTOR, a not-for-profit digital library that offered paid subscribers access to 2,000 academic journals. Swartz was apprehended and arrested on January 6, 2011, as he sought to retrieve the laptop and hard drive, while obscuring his identity with a bicycle helmet.

The operative 13 count indictment was returned against Swartz on September 12, 2012 and included five counts charging violations of §1030(a)(4) (computer fraud, 5 year maximum penalty), five counts charging violations of §1030(a)(2) (unlawfully obtaining information from a protected computer, 5 year maximum penalty), one count charging a violation of §1030(a)(5) (recklessly damaging a protected computer, misdemeanor), and two wire fraud counts.

The original CFAA counts against Swartz were premised on Swartz accessing protected computers without authorization *and* in excess of authorized access. In the superseding indictment, the United States alleged only that Swartz accessed protected computers without authorization.

Circuit Split

The Courts have long debated the meaning of both “without authorization” and “exceed[ing] authorized access” under the CFAA. There have been *inter* and even *intra* circuit splits on this issue for some time. The Fifth, Seventh and Eleventh Circuits all have held that the CFAA broadly covers violations of corporate computer use restrictions. See *U.S. v. Rodriguez*, 628 F.3d 1258 (11th Cir. 2010); *U.S. v. John*, 597 F.3d 263 (5th Cir. 2010); and *Int'l Airport Ctrs. LLC v. Citrin*, 440 F.3d 418 (7th Cir. 2006).

In contrast, more recently the Ninth and Fourth Circuits have narrowly interpreted “exceeds authorized access” as not to include mere violations of corporate computer restrictions. In the leading case, *United States v. Nosal*, 676 F.3d 854 (9th Cir. 2012), the Ninth Circuit *en banc* dismissed the indictment of David Nosal, a former employee of a search firm, who convinced his former colleagues to download and provide him with confidential firm information. The CFAA counts against Nosal were grounded in a theory that he aided and abetted his former colleagues to “exceed [their] authorized access” with intent to defraud. In other words, he was alleged to have violated the CFAA by persuading his former co-workers to use a company computer in a way prohibited by company policy. The court expressed great concern over the government’s attempt to “transform the CFAA from an anti-hacking statute into an expansive misappropriation statute.” It ultimately held that there was no liability under the CFAA because it covers only the “unauthorized procurement or alteration of information, not its misuse or misappropriation.” Thus, violating company policy regarding computer use is not an actionable offense, according to the Ninth Circuit, under the CFAA. See also *WEC Carolina Energy Solutions LLC v. Miller*, 687 F.3d 199, 202, 207 (4th Cir. 2012) (affirming the dismissal of a complaint for failure to state a claim under the CFAA).

It is clear that the meanings of “without authorization” and “exceeding authorized access” are subject to varying interpretations. The trend among courts, however, appears to be narrowing the scope of the CFAA rather than broadening it.

Aaron’s Law

The latest version of Aaron’s Law dates to June 20, 2013 and has been stalled in the House Subcommittee on Crime, Terrorism, Homeland Security, and Investigations since July 2013.

Aaron’s Law would make changes to both the CFAA and the wire fraud statute (18 U.S.C. §1343). In substance, the proposal would eliminate the “exceeds authorized access” language. It would further define “access without authorization” to include only obtaining “information on a protected computer,” that the “accesser lacks authorization to obtain,” by “knowingly circumventing one or more technological or physical measures that are designed to exclude or prevent unauthorized individuals from obtaining or altering that information.”

With the prohibition on “exceed[ing] authorized access” abolished, Aaron’s Law would decriminalize violations of an agreement, policy, duty, or contractual obligation regarding Internet or computer use, such as an acceptable use policy or a terms of service agreement. No longer would use of a computer service by a 16-year-old arguably create criminal liability where the operative service agreement provides that the user must be over 18. This change would bring the statute in line with the cases like *Nosal* that have construed the CFAA narrowly.

By limiting the applicability of the CFAA to outside computer hacking, Aaron’s Law would re-write the CFAA such that even malicious, destructive conduct by a person with legitimate access to information on

a computer would not seem to be prohibited. By eliminating “exceeding authorized access” as a basis for criminal liability, Aaron’s Law might be going too far in its efforts to limit criminal liability only to hackers.

Although *Nosal* and some other cases focus on whether violations of terms of service agreements should be a basis for criminal liability, “exceeding authorized access” covers a much broader swath of conduct, including users with authorized access who steal or destroy valuable information. Under Aaron’s Law there would arguably be no liability for even the most serious misconduct undertaken by legitimate users like subscribers or employees.

The CFAA should, instead, differentiate authorized users who access immaterial, non-sensitive information from authorized users who exceed their access rights in a malicious and destructive way. A more comprehensive amendment to the CFAA would (i) define what types of information are worthy of greater protection and (2) ensure that benign activities such as violations of terms of service agreements would not risk criminal liability. The CFAA must still allow prosecution both of true hackers, regardless of content accessed, and authorized users who access or compromise a defined subset of sensitive or valuable information and thereby cause meaningful harm.

Finally, even had they been in place in 2010, the amendments proposed by Aaron’s Law may not have shielded Swartz from prosecution. After all, the superseding indictment charged Swartz with “unauthorized access” of the MIT network and he allegedly circumvented both technological and physical measures to obtain JSTOR information. Such conduct is very likely prohibited by the current version of CFAA and would have been explicitly prohibited by Aaron’s Law.

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Foreclosure in the Aftermath of Securitization

by Thomas O. Moriarty

Legal Analysis



The creation and subsequent collapse of mortgage-backed securities had far reaching impacts on both the housing and stock markets. Not coincidentally, as reflected in numerous appellate decisions over the past three years, attempts to exercise the statutory right of sale with regard to such securitized loans have been complicated and led to fundamental changes in the mortgage foreclosure process in the Commonwealth. Experience has revealed that the assignment of securitized loans has been poorly documented and carried out with little concern for who maintained the interest in the underlying mortgage note secured by the mortgage. Prior to these cases, it had been accepted practice for foreclosing mortgagees to receive post-foreclosure assignments and to foreclose without a documented interest in the mortgage note. The Supreme Judicial Court (“SJC”) has now held that, to foreclose under G.L. c. 244 and G.L. c. 183, a foreclosing mortgagee must – at the time of notice and foreclosure – hold both the mortgage and the underlying note or act on behalf of the note holder. The foreclosure of many securitized mortgages failed to meet such requirements. While recent decisions of the SJC and Appeals Court have placed some outside limits on this rule, many titles have been clouded and remain clouded by these developments.

In *U.S. Bank National Association v. Ibanez*, the SJC held that, under the plain language of G.L. c. 183, § 21 and G.L. c. 244, § 14, a purported assignee of a mortgage could exercise the power of sale contained in the mortgage only if it possessed the mortgage at both the time of the notice of sale and the subsequent foreclosure sale. 458 Mass. 637, 648 (2011). U.S. Bank brought a quiet title action in Land Court pursuant to G.L. c. 240, § 6, seeking a declaration that it held title to certain land it bought back at its own foreclosure sale, alleging that it had become the holder of the subject mortgages by way of an assignment made after the foreclosure sale. *Id.* at 638-639.^[1] The Land Court entered judgment against U.S. Bank finding that a post-notice and post-foreclosure assignment resulted in an invalid foreclosure. *Id.* at 639.

The SJC affirmed and found that a mortgage that contains a power of sale permitting foreclosure refers to and incorporates the statutory requirements of G.L. c. 183, § 21 and G.L. c. 244, §§ 11-17C. The SJC concluded that a foreclosing mortgage holder must strictly follow the requirements of these statutes or any resulting sale will be “wholly void.”

The SJC held that post-notice, post-foreclosure mortgage assignments failed the strict adherence standard on two counts. First, pursuant to G.L. c. 183A, § 21 and G.L. c. 244, § 14, as relevant to the facts presented, the statutory power of sale can only be exercised by the mortgagee. Second, G.L. c. 244, § 14 provides that a statutory sale is ineffectual unless notice has been provided to the mortgagor and also published. *Id.* at 647. The SJC reasoned that because only the “present holder of the mortgage is authorized to foreclose” and “because the mortgagor is entitled to know who is foreclosing,” a notice lacking such accurate information is defective, and a foreclosure sale relying on such deficient notice is void. *Id.* at 648. Importantly, the SJC held that strict adherence to the statute does not require that an assignment be in recordable form at the time of the notice of sale or the foreclosure sale. *Id.* at 651.^[2]

The SJC rejected plaintiffs’ request to apply the decision prospectively, noting that prospective application is warranted only where a “significant change in the common law” is made. *Ibanez*, 458 Mass. at 654. *Ibanez* observed that the law had not changed as a result of the decision, rather “[a]ll that has changed is the plaintiffs’ apparent failure to abide by those principles and requirements in the rush to sell mortgage-backed securities.” *Id.* at 655.

In *Bevilacqua v. Rodriguez*, the SJC was presented with the question of whether a plaintiff has standing to maintain a try title action under G.L. c. 240, §§ 1-5 when he is in physical possession of property but his foreclosure deed is a nullity under the SJC’s holding in *Ibanez*. 460 Mass. 763 (2011). A try title action is fundamentally different from other civil actions involving disputed title. It allows a plaintiff – upon the satisfaction of jurisdictional prerequisites – to compel an adverse party either to abandon a claim to the plaintiff’s property or to bring an action to assert the claim in question. *Id.* at 766. Before an adverse party can be summoned and compelled to either disclaim or try its title, the plaintiff must establish two jurisdictional facts: (1) that it is a person in possession, and (2) that it holds a record title to the land in question. *Id.* at 766-767 (citing *Blanchard v. Lowell*, 177 Mass. 501, 504 (1901); *Arnold v. Reed*, 162 Mass. 438, 440-441 (1894)). Unlike a quiet title action, which requires a plaintiff to prove a sufficient title to succeed, a plaintiff in a try title action may defeat an adverse claim by default or by showing its title is superior to that of the respondents. *Id.* at 767 n.5.

Bevilacqua argued that the mortgage, which was purportedly foreclosed, constituted a cloud on the title he claimed to possess as the result of a void foreclosure sale. *Id.* at 765-766. The SJC held that *Bevilacqua* did not have standing to advance a try title action. *Id.* at 780. While the SJC accepted that *Bevilacqua* was “a person in possession,” it rejected his claim that a foreclosure deed from a defective foreclosure gave him the record title required by G.L. c. 240, § 1. *Id.* at 770.

The decision in *Eaton v. Federal National Mortgage Association*, which as discussed further below was given prospective application, addressed a question that was not presented in *Bevilacqua*: whether a mortgage holder may foreclose the equity of redemption without also holding the mortgage note or acting on behalf of the note holder. 462 Mass. 569 (2012). Eaton concluded that under G.L. c. 183, § 21 and G.L. c. 244, § 14, to be a “mortgagee authorized to foreclose pursuant to a power of sale, one must hold the mortgage and also hold the note or act on behalf of the note holder.” *Id.* at 571.

Eaton filed a complaint in Superior Court to enjoin a summary process eviction. *Id.* at 570-571. The trial court granted the plaintiff a preliminary injunction. *Id.* at 571. After a single justice of the Appeals Court denied a petition by the defendant and reported same to a full panel, the SJC transferred the case on its own motion.

The SJC observed that a real estate mortgage has two distinct but related aspects: (1) it is a transfer of title, and (2) it serves as security for an underlying obligation (and is defeasible when the debt is paid). *Id.* at 575. While the Court recognized that a mortgage and an underlying note can be separated or “split,” it found that in such circumstances the mortgage is a mere technical interest. *Id.* at 576. Relying upon its analysis in *Ibanez*, Eaton found that under Massachusetts common law, when a mortgage is split from the underlying note, “the holder of the mortgage holds the mortgage in trust for the purchaser of the note,” which purchaser has an equitable right to an assignment of the mortgage. *Id.* at 576-577 (quoting *U.S. Bank Nat’l Ass’n v. Ibanez*, 458 Mass. 637, 652 (2011)). Eaton thus held that at common law, “a mortgagee possessing only the mortgage was without authority to foreclose” *Id.* at 577-578.

The defendant’s statutory arguments fared no better. Eaton held that a foreclosure sale conducted pursuant to a power of sale in a mortgage must comply with all applicable statutory provisions, including G.L. c. 183, § 21 and G.L. c. 244, § 14. *Id.* at 571, 579-581. G.L. c. 244, § 14 provides, in relevant part:

The mortgagee or person having his estate in the land mortgaged, or a person authorized by the power of sale, . . . may, upon breach of condition and without action, do all the acts authorized or required by the power.

Id. at 581 (emphasis in original). The SJC held that the term “mortgagee” in § 14 was ambiguous and concluded that the Legislature intended that a “mortgagee” must also hold the mortgage note.^[3] *Id.* at 581-582, 584. However, *Eaton* made clear that a foreclosing mortgagee need not have physical possession of the mortgage note to validly foreclose. Recognizing the application of general agency principles in this context, the SJC interpreted the statutes to permit “the authorized agent of the note holder, to stand ‘in the shoes’ of the ‘mortgagee’ as the term is used in these provisions.” *Id.* at 586.

In giving *Eaton* prospective application, the SJC considered several factors including the fact that the term “mortgagee” in the statute was ambiguous. *Id.* at 587. The Court also noted that *Eaton*’s ruling differed from prior interpretations which, if retroactive, could create difficulties in ascertaining the validity of certain titles. *Id.* at 588.

The scope of *Eaton*’s prospective application was recently clarified in *Galiastro v. Mortgage Electronic Registration Systems, Inc.*, 467 Mass. 160 (2014). On direct appellate review to the SJC, the *Galiastro*s argued that, because their appeal of the same issue was stayed pending the decision in *Eaton*, the *Eaton* decision should apply to their claims. *Id.* at 167. The SJC agreed, holding that the *Eaton* decision would apply to cases that were on appeal at the time *Eaton* was decided (June 22, 2012) and in which a party claimed a foreclosure sale was invalid because the holder of the mortgage did not hold the note.

As many post-foreclosure challenges to the validity of the foreclosure process arise in connection with summary process proceedings (*Eaton* among them), it is not surprising that the Housing Court has been confronted with these issues. But, as a court of limited jurisdiction, a preliminary issue was presented as to the scope of the Housing Court’s authority. In *Bank of America, N.A. v. Rosa*, the SJC held, *inter alia*, that the Housing Court has jurisdiction to consider defenses and counterclaims challenging a bank’s right to possession and title, including those premised upon the validity of a prior foreclosure sale. 466 Mass. 613, 615 (2013). The case did not, however, extend Housing Court authority to original actions to set aside a foreclosure. *Id.* at 624 n.10.

The SJC’s recent decision in *U.S. Bank National Association v. Schumacher* limits the Court’s broad holding in *Eaton*. 467 Mass. 421 (2014). *Schumacher* held that a mortgagee’s failure to provide notice of a ninety-day right to cure, as required by G.L. c. 244, § 35A, did not affect the validity of a foreclosure sale because § 35A is not part of the foreclosure process and, therefore, strict compliance was not required to validly foreclose.^[4] *Id.* at 422. The SJC rejected *Schumacher*’s attempt “to engraft” the requirements of § 35A onto the power of sale because it properly viewed § 35A as a mechanism that gives a mortgagor an opportunity to cure a payment default before the foreclosure process is commenced. *Id.* at 431. As the § 35A notice procedure was viewed as a “preforeclosure undertaking,” it is not one of the statutory requirements with which a mortgagee must strictly comply in exercising its statutory power of sale.

In a concurring opinion in *Schumacher*, Justice Gants provided guidance to homeowners facing foreclosure. Justice Gants opined that when a mortgage holder fails to provide notice pursuant to § 35A, a homeowner may file an equitable action in the Superior Court seeking to enjoin the foreclosure. In a post-foreclosure proceeding, Justice Gants suggested that while a violation of § 35A may not alone be relied upon to defeat an eviction, if a defendant can prove that the violation “rendered the foreclosure so fundamentally unfair,” it may be sufficient to set aside a foreclosure sale “for reasons other than failure to

comply strictly with the power of sale provided in the mortgage.” *Id.* at 433 (Gants, J., concurring) (quoting *Rosa*, 466 Mass. at 624).

In the recent case of *Sullivan v. Kondaur Capital Corporation*, the Appeals Court had an opportunity to address two questions of first impression in this arena – one on standing and one regarding registered land – and a chance to rein in efforts to extend *Ibanez* and its progeny. 85 Mass. App. Ct. 202 (2014). The Sullivans owned registered land and executed a mortgage conveying legal title to MERS, which mortgage was thereafter filed for registration with the Land Court. The mortgage was assigned to Kondaur Capital, which also filed for Land Court registration. Kondaur Capital thereafter foreclosed and filed a summary process action in the District Court. The case for possession settled with the Sullivans reserving rights to challenge Kondaur Capital’s title, which they did by subsequently filing an action in the Superior Court based upon *Ibanez*. Because the dispute involved registered land, the case was transferred to the Land Court, which has exclusive jurisdiction of such claims. *Id.* at 204.

The Appeals Court first addressed Kondaur Capital’s argument that the Sullivans had no standing to challenge defects in the assignments to which they were not a party. While acknowledging that a party who does not benefit from a contract could not enforce it, the Court concluded that the plaintiffs were not attempting to enforce rights under the contract. Rather, the Court found the Sullivans were challenging Kondaur Capital’s claim that it owned the subject property which, but for the foreclosure, the Sullivans would still own. The Appeals Court held that, to protect its ownership interest, a property owner has standing to challenge the bank’s authority premised upon the validity of the assignment. *Id.* at 205-206.

Kondaur Capital also claimed that the plaintiffs were precluded from challenging the validity of its title because the mortgage had been registered with the Land Court, and a transfer certificate of title had issued in its name prior to the filing of plaintiffs’ action. The Court rejected the contention, noting that there are numerous exceptions to the conclusiveness of registration. The Appeals Court concluded that Kondaur Capital was not an innocent third-party purchaser but a mortgagee required to establish its title by reference to various instruments of assignment following the plaintiffs’ mortgage to MERS. The Court held that Kondaur Capital was “fairly charged” with knowledge of the deficiencies in its chain of title, and its certificate of title could be challenged based upon any break in that chain. *Id.* at 208.

The Appeals Court also rejected the argument that because MERS had no ownership interest in the underlying note, it could not assign the mortgage unless authorized by the debt’s owner. The Court noted that the *Eaton* decision was prospective and not available to the plaintiffs and, in any case, did not require that a mortgagee hold legal and equitable title at the time of an assignment of the mortgage. *Id.* at 208-210. The Court correctly observed that “nothing in Massachusetts law requires a foreclosing mortgagee to demonstrate that prior holders of the record legal interest in the mortgage also held the note at the time each assigned its interest in the mortgage” *Id.* at 210. In fact, as the Court noted, *Eaton* confirmed that a mortgage could be separated from the debt it secured and, even at the time of foreclosure, the

mortgage holder simply needs to demonstrate it holds the note or acts as the note holder's authorized agent. *Sullivan*, 85 Mass. App. Ct. at 210.

The Appeals Court ultimately found that the Sullivans' challenge to the signature on the assignment to Kondaur Capital should have survived the motion to dismiss and remanded the case. The Court ruefully observed that the circumstance presented a further illustration of "the utter carelessness with which the [foreclosing lenders] documented the titles to their assets" described in the *Ibanez* concurrence. *Id.* (quoting *U.S. Bank Nat'l Ass'n v. Ibanez*, 458 Mass. 637, 655 (2011) (Cordy, J., concurring)).

These cases have had a profound and immediate impact on the foreclosure process in the Commonwealth. Fortunately, the cases have provided direction with regard to how a mortgagee can both comply with the applicable statutes and demonstrate its compliance in the face of subsequent challenge. Unresolved at this stage, however, is how titles clouded by deficiencies in earlier foreclosures will be cleared – a remedy which now appears to be left to the Legislature. Unless and until some curative legislation is signed into law, the carelessness with which securitized mortgages were documented and tracked over the last decade will deprive thousands of innocent purchasers at foreclosure of good, clear and marketable titles to their homes and properties.

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Footnotes

[1] The *Ibanez* mortgage, like many securitized mortgages, followed a complex and tortuous path of assignments ultimately reaching U.S. Bank. *Ibanez*, 458 Mass. at 641.

[2] Justice Cordy, in a concurring opinion, noted "that what is surprising about these cases" is not the statements of law "but rather the utter carelessness with which the plaintiff banks documented the titles to their assets." *Ibanez*, 458 Mass. at 655 (Cordy, J., concurring).

[3] The Eaton Court analyzed G.L. c. 244, §§ 17B, 19, 20 & 23 in detail in reaching its holding regarding the meaning of the term "mortgagee" in § 14, noting the terms "holder of mortgage note" and "mortgagee" are used interchangeably. *Eaton*, 462 Mass. at 582. Additionally, the Court points to the same conflation of meanings in G.L. c. 183, §§ 20-21. *Id.* at 584 n.23.

[4] At all times relevant in *Schumacher*, G.L. c. 244, § 35A gave a mortgagor of residential real estate a ninety-day right to cure a payment default prior to the commencement of foreclosure and required a foreclosing mortgagee to provide notice of such right to the mortgagor. *Schumacher*, 467 Mass. at 430.

Striving for Clarity in Purchase Price Adjustment Dispute Resolution

by Alexander J. Aber and Matthew E. Miller

Heads Up



The marketplace for acquisitions of Massachusetts-based, privately-owned companies is active. Many such transactions will be executed through acquisition agreements that contain a purchase-price-adjustment provision keyed to the level of the target company's "working capital." This article briefly explains some common features of working-capital-adjustment provisions and addresses one component that could lead to uncertainty and frustration of the purchase-price-adjustment mechanism.

Generally speaking, "working capital" is the difference between a company's current assets (e.g., cash and accounts receivable) and current liabilities (e.g., accounts payable). Businesses generally require a certain level of positive working capital to operate, and a buyer of a privately held company will often require that a target company have a specified level of positive working capital at closing. If a target company's working capital is less than the amount necessary to operate the business going forward, the additional capital required to make up the shortfall effectively increases the buyer's purchase price. Conversely, the buyer will enjoy a windfall if the target's working capital is in excess of the minimum mandated by the buyer.

To avoid either result, many private-company acquisition agreements include a mechanism to adjust the purchase price if the seller's working capital as of the closing differs from a previously negotiated amount. Typically, the seller is required to deliver to the buyer in advance of the closing an estimate of working capital at the closing based on an estimated balance sheet prepared by the seller. The purchase price is often adjusted at the closing on the basis of the seller's estimate of working capital in the event that such estimate differs from the amount of working capital as specified in the acquisition agreement. After the closing, the buyer often has a limited window (e.g., between 60 and 90 days) to audit the target's records

and, with the benefit of hindsight, calculate the target's closing working capital and verify the accuracy of the seller's closing estimates.

If the buyer's post-closing calculation indicates a working capital deficit not reported by the seller (or one larger than that reported by the seller), the buyer will attempt to recoup an equivalent amount of its consideration. Acquisition agreements often provide for a mandatory dispute-resolution process in the event that the parties cannot reconcile their respective calculations, and a common formulation requires that the parties submit their dispute to an arbitrator (often an independent accounting firm) for a binding determination of the target's working capital as of the closing.

Of course, acquisition agreements also invariably include representations regarding the target company's financial statements. Oftentimes sellers are required to append their most recent annual and interim financial statements to the agreement and represent that such statements fairly present in all material respects the financial condition of the target company as of and for the periods covered by such statements, and that such statements have been prepared in accordance with generally accepted accounting principles ("GAAP").

Private-company acquisition agreements also often have indemnity provisions defining the buyer's rights upon a breach of the seller's representations, which typically are the buyer's exclusive remedy for such a breach. Such indemnity provisions tend to specify dispute resolution procedures, often litigation in an exclusive judicial forum, time periods for making indemnification claims, as well as limits on the amount that can be recovered.

Overlap between the working capital dispute mechanisms and the indemnity provisions can lead to confusion and disputes regarding whether parties are able to proceed through arbitration, or whether they must litigate for breach of representation. If the acquisition agreement is ambiguous, a buyer may attempt to make essentially the same claim against the seller under either the working capital adjustment mechanism or the indemnity provisions – and the difference in outcome as to which provisions govern can be significant. For instance, typically there are no limits on the amount by which the purchase price can be adjusted through the working capital adjustment mechanism. Indemnity provisions, however, often place specified limits on the amount a buyer can recover for a seller's breach of representations and warranties. In addition, indemnity provisions frequently have claim deductibles or "baskets" — meaning the buyer must incur a certain amount of damages before having the right to seek redress.

Courts have addressed such disputes with varying results. In one recent case, the purchase agreement required the seller to prepare a closing balance sheet as of March 30, 2011, and calculate "Estimated Working Capital" as of that date, "in accordance with GAAP consistently applied and following the . . . methods employed in preparing the Company's balance sheet as of December 31, 2010 included in the Financial Statements." *Severstal US Holdings, LLC v. RG Steel, LLC*, 865 F. Supp. 2d 430, 433 (S.D.N.Y. 2012). Disputes over working capital were to be referred to an independent accountant in arbitration. The

purchase agreement also contained a representation by the seller that its December 31, 2010 financials were prepared in accordance with GAAP, and indemnification through litigation was the exclusive remedy for any alleged breach of representation in the agreement.

As it turned out, the parties were far apart on the calculation of working capital. The buyer maintained the seller's estimation of working capital was overstated due to a failure to follow the required working capital calculation methodology by properly applying GAAP in the March 30, 2011 closing balance sheet, and sought an \$83 million purchase price reduction through arbitration pursuant to the working capital dispute provisions. *Id.* at 435. The seller contended that any assertion that it failed to prepare its financial statements in accordance with GAAP was a claim for breach of representation, for which indemnification was the sole remedy. *Id.* at 439. Important to the court's ultimate decision was that the seller made no representation with respect to the March 30, 2011 closing balance sheet's compliance with GAAP, but only that its historical financials as of December 31, 2010 complied with GAAP. Thus, the Court held the dispute was not covered by the indemnity provisions in the purchase agreement and the parties were ordered to proceed to arbitration. *Id.* at 440-41.

Courts in other cases have paid less attention to the actual reach of the seller's representations. Some courts have emphasized that purchase agreements typically require a seller to prepare the estimated closing balance sheet in compliance with GAAP and in a manner consistent with its historical financial statements. These courts have concluded that an assertion that the estimated closing balance sheet fails to comply with GAAP is equivalent to asserting that the historical financials fail to comply with GAAP, which is covered by the seller's representations and thus the indemnity provision of the purchase agreement. See, e.g., *Westmoreland Coal Co. v. Entech, Inc.*, 794 N.E.2d 667, 669-71 (N.Y. 2003); *OSI Systems, Inc. v. Instrumentarium Corp.*, 892 A.2d 1086, 1092 (Del. Ch. 2006).

So far, no Massachusetts court has published an opinion in a case concerning the way in which working capital adjustment disputes should be resolved. Nevertheless, parties in acquisitions should strive for clarity in delineating how such disputes should be addressed.

One method for achieving such clarity is to exclude from the indemnity provision any difference over working capital calculations that may be addressed through the purchase-price-adjustment provision. See, e.g., *Violin Entm't Acquisition Co. v. Virgin Entm't Holdings, Inc.*, 59 A.D.3d 171, 172 (N.Y. App. Div. 2009). Alternatively, the parties could provide that the estimated closing balance sheet upon which the closing working capital calculations are based need only be prepared in accordance with the seller's historic accounting practices (without the seller making any representations as to the estimated closing balance sheet's compliance with GAAP), and the parties could expressly limit the working-capital-dispute provisions to resolving differences between the seller's closing estimates and the buyer's post-closing calculations using the same accounting practices. Whatever the method used, addressing this issue

head-on in the language of the acquisition agreement will provide the clarity necessary to allow all parties to rely on the deal they bargained for.

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