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SEC/CORPORATE

SEC's Division of Corporation Finance to Review Foreign Private Issuer Reporting Requirements

On March 8, Meredith Cross, the Director of the Securities and Exchange Commission's Division of Corporation Finance, delivered a speech at a conference in London in which she stated that the SEC would review its approach to regulating foreign private issuers.

Ms. Cross noted that in the past, foreign private issuers tended to consist of large companies that were listed on stock exchanges in their home countries and had only a secondary listing on an exchange in the United States. Under the current reporting regime, a foreign private issuer is required to file a Form 20-F with the SEC within 120 days of the end of its fiscal year and file on Form 6-K any material information that is required to be disclosed under the issuer's home country regulation. This regulatory regime was created under the theory that the United States, as an issuer's secondary trading market, should not drive that issuer's disclosure obligations. The SEC has noticed, however, that in recent years a "large percentage" of foreign private issuers that registered with the SEC were not listed in their home countries, and used either the New York Stock Exchange or NASDAQ as their only trading market. Yet these issuers are required to make only minimal disclosures under the current regulatory regime.

Accordingly, Ms. Cross stated that the focus of the SEC's review would be the following:

- Whether the current Form 6-K reporting regime is the appropriate model for issuers that are not listed in their home countries, or for all foreign private issuers generally;
- Whether an issuer that is (i) only listed in the United States, (ii) has a significant stockholder base in the United States and (iii) is not subject to its home country's reporting requirements should have disclosure requirements that are different from United States issuers, or should such issuers be required to file with the SEC quarterly reports on Form 10-Q and current reports on Form 8-K; and
- Whether these potentially revamped regulations should also apply to foreign private issuers that are listed, and subject to regulation, in their home countries.

Ms. Cross did not provide a specific time frame for the SEC's review, but did note that the review would be sensitive to the potential negative consequences associated with creating an overlapping disclosure regime for foreign private issuers that are already subject to reporting requirements in their home countries.

For more information, click here.

LITIGATION

Court Applies Alter Ego Doctrine to Deny Motion to Dismiss For Lack of Personal Jurisdiction

An Arizona district court recently relied on the alter ego doctrine to deny a motion to dismiss for lack of personal jurisdiction in a case involving breach of a partnership agreement and trademark infringement.

The plaintiff, Activator Methods International, Ltd. (Activator) and the defendant, Future Health Inc., an Iowa corporation (FHI), entered into a Shared Revenue Partnership Agreement (SRPA) allowing FHI to market Activator's software program, develop Activator's software application and use Activator's trademarks. FHI allegedly failed to pay the fees required under the SRPA and, as a result, Activator terminated the SRPA. Shortly thereafter, FHI ceased doing business and an identically named company incorporated in Delaware (FHD) was formed and became the successor in interest to FHI. The plaintiff brought an action against FHI, FHD, and Steven and Jane Doe Kraus, husband and wife. Steven Kraus was the chief executive officer (CEO) and majority shareholder of FHI and FHD and negotiated and signed the SRPA in Arizona. The Krauses moved to dismiss for lack of personal jurisdiction.

The Krauses conceded that the court had personal jurisdiction over FHI and FHD. The court determined that it had jurisdiction over the Krauses because the plaintiff pled facts sufficient to show that the Krauses were the alter ego of the FHI and FHD entities. To prevail under an alter ego theory, plaintiff must show (1) unity of control and (2) that observance of the corporate form would sanction a fraud or injustice. The court held that the plaintiff sufficiently alleged unity of control through the allegations that Steven Kraus owned or operated FHD and FHI and that the Krauses usurped funds of the corporation. In doing so, the court rejected the Krauses' argument that a party must be the sole shareholder to have unity of control over a corporation. Instead, the court held that there is unity of control when a "Defendant CEO 'disregards[s] corporate formalities'[,] … use[s] corporate funds for his own … personal purposes" and makes all "important management decisions," including those at issue.

Activator Methods International, Ltd. v. Future Health, Inc., 2012 WL 715629 (D. Ariz. March 6, 2012).

Missouri Court Holds That Economic Loss Doctrine Bars Plaintiff's Tort Claims

A Missouri district court recently ruled that a negligent misrepresentation claim was barred by the economic loss doctrine in a case involving a merchant-to-merchant sale of allegedly defective products.

The plaintiff, Bruce Martin Construction, Inc. (Martin), a dealer and installer of grain bin unloading systems sued the defendant CTB, Inc. (CTB), a farm equipment manager and marketer, for breach of express warranty and negligent misrepresentation. Martin alleged that it had to replace malfunctioning CTB systems at significant expense and that CTB's systems have exposed Martin's customers to risks of danger and increased labor costs due to the systems' failure to perform as warranted.

CTB argued that the negligent misrepresentation claim should be dismissed under Missouri's economic loss doctrine, which precludes tort claims arising solely from the sale of defective products where there is no personal injury or property damage. The court determined that application of the economic loss doctrine was appropriate in this case, rejecting Martin's argument that its negligent misrepresentation claim should be allowed because it was covered by the public duty exception to the doctrine. The court was not convinced, however, and found that there was no allegation that the failure to disclose in this case violated any duty other than those arising out of the parties' contract. In particular, the court held that the public duty exception was not applicable because the alleged harm to the public only came into play if the end users chose to disregard the machine's operating instructions.

Bruce Martin Construction, Inc. v. CTB, Inc., 2012 WL 718624 (E.D. Mo. March 6, 2012).

BANKING

Federal Reserve Announces Stress Test Results

On March 13, the Federal Reserve announced summary results of the latest round of bank stress tests, which show that the majority of the 19 largest U.S. banks would continue to meet supervisory expectations for capital adequacy despite large projected losses in an extremely adverse hypothetical economic scenario.

The stress scenario--which includes a peak unemployment rate of 13 percent, a 50 percent drop in equity prices, and a 21 percent decline in housing prices-- "shows that losses at the 19 bank holding companies are estimated to total $534 billion during the nine quarters of the hypothetical stress scenario. The aggregate tier 1 common capital ratio, which compares high-quality capital to risk-weighted assets, falls from 10.1 percent in the third quarter of 2011 to 6.3 percent in the fourth quarter of 2013 in the hypothetical stress scenario. That number incorporates the firms' proposals for planned capital actions such as dividends, share buybacks, and share issuance."

"Despite the significant projected capital declines, 15 of the 19 bank holding companies were estimated to maintain capital ratios above all four of the regulatory minimum levels under the hypothetical stress scenario, even after considering the proposed capital actions, such as dividend increases or share buybacks."

For more information, click here.

Federal Reserve Announces Mobile Banking Survey Results

According to the Federal Reserve, "one out of five American consumers used their mobile phone to access their bank account, credit card, or other financial account in the 12 months ending in January 2012 and an additional one out of five indicated they would likely use mobile banking at some point in the future." The "findings suggest that the use of mobile banking is poised to expand further over the next year, with usage possibly increasing to one out of three mobile phone users by 2013. However, the survey indicates that many consumers remain skeptical of the benefit of mobile banking and the level of security associated with the technology."

The use of mobile banking is highly correlated with age, according to the survey results. "People between 18 and 29 account for approximately 44 percent of mobile banking users, relative to 22 percent of all mobile phone users. Conversely, people age 60 and over account for only 6 percent of all mobile banking users, but 24 percent of mobile phone users. The survey showed a significantly higher level of mobile banking uptake among African Americans (16 percent) and Hispanics (17 percent), relative to 11 percent and 13 percent of mobile phone users, respectively."

For more information, click here.

EXECUTIVE COMPENSATION AND ERISA

Audits May Soon Require Even Greater Scrutiny of Executive Compensation

Citing a concern about increased risk of fraud and material misstatement, on February 28, the Public Company Accounting Oversight Board (the PCAOB) issued Release No. 2012-001 (the Proposal). The Proposal would amend public company auditing standards to require increased review and analysis of executive compensation programs because such programs can put pressure on management to meet financial performance targets to ensure larger compensation payments. The PCAOB believes that such pressure may result in a material misstatement of the company's financial position.

Existing standards already require the auditor to have a thorough understanding of the company's executive compensation programs. If adopted, the Proposal would amend Auditing Standard No. 12, Identifying and Assessing Risks of Material Misstatement, to require the auditor to undertake certain procedures to ensure that he or she has a thorough understanding of the company's executive compensation programs and whether the related

performance metrics may increase the likelihood of misstated financial results to enlarge payments to executives. The Proposal would require the auditor to adopt specific procedures designed to identify risks of material misstatement. The Proposal provides that "such procedures should include, but are not limited to, (i) reading employment and compensation contracts and (ii) reading proxy statements and other relevant company filings with the Securities and Exchange Commission and other regulatory agencies that relate to the company's financial relationships and transactions with its executive officers."

The release of the Proposal is another in a long line of recent indicators that legislators, regulators and investors are still paying close attention to the amount and forms of compensation paid to executive officers, and the risk that intentional misstatements may occur to ensure that such compensation is increased. If the Proposal is adopted, public companies will want to work with their auditors to ensure that they have access to the required information so that audits can be completed in a timely and orderly fashion.

Public comment on the Proposal are invited and must be submitted to the PCAOB no later than May 15.

The Proposal can be found here.

UK DEVELOPMENTS

FSA Censures Bank of Scotland for Serious Systems Failures

On March 9, the UK Financial Services Authority (FSA) announced a public censure of Bank of Scotland plc in respect of failings of the bank's corporate division relating to sub-investment grade lending.

The FSA found that between January 2006 and December 2008, the bank had failed to comply with Principle 3 of the FSA's Principles for Businesses (adequate risk management systems). The bank's systems and controls were not appropriate to the high level of risk that its corporate division was taking as it pursued an aggressive growth strategy, focusing on high-risk sub-investment grade lending. The corporate division continued to pursue this strategy despite the worsening of market conditions in 2007. Rather than re-evaluating its business as conditions worsened, the division set out to increase its market share as other lenders began pulling out of the relevant market. The FSA found the following specific deficiencies:

- The bank's control framework provided insufficient challenge to the corporate division's strategy.
- The framework for managing credit risk across the relevant loan portfolio was deficient.
- The distribution framework did not operate effectively in reducing the risks in the portfolio.
- The process for the identification and management of transactions that showed signs of stress did not function effectively.

No financial penalty was imposed as there were exceptional circumstances – the fact that substantial taxpayer funds have been provided to the bank. The FSA stated that imposing a fine would mean that "the taxpayer would effectively pay twice for the same actions committed" by the bank. Accordingly, the FSA issued a public censure to ensure that details of the bank's "misconduct can be viewed by all and act as a lesson in risk management fallings."

In an accompanying press release, the FSA stated that it remains committed to producing a public report into the causes of the bank's overall failure. However, it considered that working on such a report at present could prejudice the outcome of ongoing enforcement actions against the bank. Accordingly, the FSA will commence its review and analysis work for the report only when relevant enforcement proceedings have been concluded.

For more information, click here.

HM Treasury Discussion Paper on Policy Options for Implementing AIFMD

On March 14, HM Treasury published a discussion paper on high level policy options for implementing the EU Alternative Investment Fund Managers Directive (2011/61/EU) (AIFMD). The comment period lasts until May 4.

The areas covered by the policy paper are:

- Whether the UK should continue to apply its current private placement marketing regime to alternative investment funds (AIFs). (Currently the UK government is not minded to impose additional requirements on third country managers and third country funds).
- The extent to which the UK should permit AIFs to be marketed to UK retail investors. (This applies in particular to certain types of fund which are within the scope of AIFMD and which may currently be marketed to retail investors.)
- Whether (and if so how) to apply a lighter regulatory regime to alternative investment fund managers (AIFMs) managing AIFs with assets under management below certain thresholds.
- Application of the Financial Services Authority's approved persons regime to individuals within AIFMs that are newly subject to regulation.
- Interaction of the AIFMD with the proposed EU Regulations on European Venture Capital Funds and European Social Entrepreneurship Funds.

The FSA published a discussion paper covering operational issues on implementing the AIFM Directive in January, as reported in the January 27, 2012 edition of *Corporate and Financial Weekly Digest*.

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