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## UK Hits Same Snags As SEC With Reverse-Merger Rules

By **Max Stendahl**

Law360, New York (October 03, 2012, 6:33 PM ET) -- U.K. financial regulators said Tuesday they would place new barriers on foreign companies that use reverse mergers to list on London exchanges, but experts say the anti-fraud rules will suffer the same issues that have plagued a U.S. crackdown.

The new measures by the Financial Services Authority are designed to raise barriers for private, foreign companies seeking to go public on a domestic exchange by merging with an already-listed shell firm. They echo similar measures established last year by the U.S. [Securities and Exchange Commission](#) to protect investors from reverse-takeover firms suspected of accounting fraud.

The FSA's proposal has been in the works since at least January, when the watchdog released a consultation paper saying new listing restrictions could help protect investors from scams. Tuesday's announcement comes just days after Bumi PLC, a London-listed affiliate of an Indonesian mining company and the product of a reverse merger, commenced a probe of more than \$500 million in possible accounting issues.

The rules would strip away exemptions for companies that try to obtain a coveted spot on London exchanges through reverse takeovers. Such companies would instead need to reapply individually for a listing, and would also face higher standards for financial reporting and corporate governance.

The SEC put in place similar measures in November amid fraud scandals involving Chinese reverse-merger firms. But the agency has seen its crackdown hampered by Chinese secrecy laws, which generally bar China-based auditors from turning over information about their clients.

While the FSA's new rules offer important investor protections, they are likely to suffer from the same transparency issues that have dogged the SEC, according to [BakerHostetler](#) partner Randy Katz.

"The lack of permission to go look, investigate, uncover and re-audit is going to be the same," he said. "If we are handicapped here, our friends in the U.K. will face the same challenges."

At the heart of the regulatory push on reverse mergers has been a series of scandals in which little-known Chinese firms with questionable accounting practices have gained access to the exposure and liquidity that only a major U.S. exchange can provide.

The SEC has delisted a slew of such companies, but it has struggled to litigate enforcement actions without the necessary documents. The agency's frustration reached a boiling point in May, when it sued the Shanghai arm of [Deloitte & Touche LLP](#) for refusing to turn over an audit of [Longtop Financial Technologies Ltd.](#), a Chinese company accused of duping U.S. investors.

Despite the best efforts of the SEC and FSA, the roadblock presented by China's stringent secrecy laws cannot be resolved through simple rule-making, according to Michael T. Campoli, an attorney and securities law compliance expert at [Pryor Cashman LLP](#).

"I would assume that the U.K. would run into the same problems that you find with the SEC, because those problems are primarily related to China or to the host country itself," he said.

In addition, while U.K. regulators will have no trouble delisting firms it suspects of fraud and bringing enforcement actions, they will inevitably run into problems during the crucial discovery phase of litigation, Campoli said.

As they experience similar discovery roadblocks, U.S. and U.K. authorities are likely to bring Chinese officials to the negotiating table to resolve the issue, Campoli added.

"I would hope there's incentive on both sides to find the right way to do this," he said.

To be sure, Tuesday's rules go well beyond a crackdown on reverse-merger companies. The FSA said it would also tighten regulation of listed companies that have a dominant shareholder. Those companies will now need to have a majority of independent directors on their boards and must introduce a dual-voting procedure to give independent shareholders a greater say in the appointment of the directors.

More broadly, the FSA's rules also underscore a welcome level of cooperation between British and U.S. regulators, which have both stepped up efforts to protect equity investors and rid their exchanges of fraud, according to Katz.

But it's also likely that fraudulent reverse-merger companies will now simply set their sights on exchanges in other developed countries to escape oversight, he said.

"Once they determine it's more difficult to run those schemes in one geographic location, people of that mentality are pretty smart, and they'll go somewhere else," Katz said. "Then it falls to the next public regulator to say, 'Not so fast. You're not doing that to our public markets.'"

--Editing by Sarah Golin and Lindsay Naylor.  
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