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U P D A T E

News of Developments in the Financial Sector and Related Areas

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Choice of Law Provision in Contracts

In *Heating & Air Specialists, Inc. v. Jones*, 180 F.3d 923 (8th Cir. 1999), the United States Court of Appeals for the Eighth Circuit was called upon to interpret a choice of law provision contained in a contract as to whether the parties chose the law of Texas to govern their rights and obligations. The facts in the case involved, among other things, Heating & Air Specialists, Inc. ("A/C") having brought suit against Lennox Industries, Inc. ("Lennox") alleging violation of the Arkansas Franchise Practices Act for terminating A/C's franchise with Lennox. The Arkansas Franchise Practices Act prohibits a franchiser from canceling a franchise without good cause. A/C is a corporation engaged in marketing heating and air conditioning products and in 1994 began negotiating with Lennox to become a dealer of Lennox equipment and supplies. Representatives of Lennox met with representatives of A/C at its office in Arkansas, and the bulk of the parties' negotiations took place in Arkansas. The parties signed a "dealer agreement" that either party could terminate the agreement without cause upon 30 days' notice. On August 9, 1996, Lennox sent A/C a letter terminating its franchise. The agreement contained a choice of law provision stating that "the laws of the State of Texas shall govern its interpretation." The parties thereafter signed virtually identical contracts for the period 1994-1997. The Court held that the language Lennox used in its dealer agreement, when read according to its plain meaning, did not effectively displace the Arkansas protective legislation, but merely provided that Texas rules of contract construction should apply. The connection to Arkansas was qualitatively more significant than the parties' relationship to Texas in that A/C executed the agreement in Arkansas, Lennox shipped its goods to A/C in Arkansas, the dealer agreements themselves indicated that the franchise would operate in Arkansas, and the bulk of the parties' negotiations took place in Arkansas. Because of the significant contacts with Arkansas, the Court held that the substantive laws of Arkansas generally govern the parties' rights and responsibility under the agreement, while the substantive laws of Texas provide the applicable rules of contract construction. Accordingly, the Court held that the Arkansas Franchise Practices Act did apply and the choice of law language as to Texas did not provide A/C with fair warning that in signing the dealer agreement it would forfeit its right to protection under the Act. However, the Court went on to find that Lennox had good cause to cancel the franchise because of A/C's failure to make past due payments to Lennox.

Ban on Pooling of Interests of Accounting

The Financial Accounting Standards Board ("FASB") has formally issued its proposal to ban the pooling of interests method of accounting for mergers. In pooling of interests, the assets of the two merging companies are combined and the financial results are reported as if the two companies had previously been one company. The values of the assets of each company are not repriced. In purchase accounting, the price paid above the acquired company's net worth is accounted for as goodwill, which must be amortized or subtracted from the combined company's reported earnings over a period of time. The FASB will take comments on its proposal through December 7, 1999. A copy of the proposal is available on the FASB's website at www.fasb.org. Recently, the FASB said it would defer abolishing the immediate write-off for purchased research and development costs picked up in connection with an acquisition.

Sale of Insurance by Banks

The Texas Legislature earlier this year approved legislation which would allow state-chartered banks to sell general insurance through branches anywhere in Texas. The legislation would have eliminated the requirement that banks do insurance business through offices in towns of less than 5,000 in population. However, the Texas governor vetoed the legislation.

Commodity Trading Advisors

In *Taucher v. Born*, No. CIV A97-1711 (D.D.C. June 21, 1999) the United States District Court for the District of Columbia declared unconstitutional the Commodity Futures Trading Commission's ("CFTC") requirement that persons who provide general advice on futures markets register with the CFTC as Commodity Trading Advisors ("CTA"), finding that the CFTC's authority to regulate the CTA profession was a prior restraint on speech that violated the First Amendment of the United States Constitution. The Court noted that the CFTC had authority to regulate trading activity and speech incidental to such activity. However, the Court observed that CTAs had no personal contacts with clients, did not make individual trading recommendations, and did not execute trades, but offered only general trading advice.

Y2K Operational Requirements for Broker-Dealers

The Securities and Exchange Commission ("SEC") has adopted rules requiring broker-dealers and non-bank transfer agents to be Year 2000 compliant by August 31, 1999. A Year 2000 problem will be presumed to exist if, at any time on or after August 31, 1999, a firm:

- does not have written procedures reasonably designed to identify, assess and remediate Year 2000 problems in mission critical systems under its control;
- has not verified Year 2000 remediation efforts through reasonable internal testing of its mission critical systems;
- has not complied with any applicable Year 2000 testing requirements imposed by a self-regulatory agency to which it is subject; or
- has not remediated all exceptions related to its mission critical systems contained in any public independent accountant's report prepared on its behalf.

Year 2000 Operational Capability Requirements for Registered Broker-Dealers and Transfer Agents, SEC Release No. 34-41661 (July 27, 1999).