

# ohio securities bulletin

State of Ohio  
John J. Gilligan, Governor

Department of Commerce  
Dennis Shaul, Director

Division of Securities  
William L. Case III, Commissioner

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## INTRODUCTION

It is with a strong feeling of optimism that we at the Division of Securities inaugurate, with this first issue, the *Ohio Securities Bulletin* as the official publication of the Division. The publication of this monthly bulletin represents an integral part of the new administrative program, described in greater detail below, which is being undertaken by the Division this year.

One of the most frequent criticisms of the Division which has been related to me during the past five months is that with virtually no written regulatory standards and no regular and continuous method of communicating its policies to persons who are subject to its regulation, the Division puts a particularly onerous burden upon those who genuinely seek full compliance with such policies. It is in recognition of the legitimacy of such criticism and of the fact that this lack of communication has compounded the difficulty for the Division of exercising its regulatory functions, that this *Ohio Securities Bulletin* has been created.

Unlike the securities newsletters of many other states, this bulletin will concentrate primarily upon matters of substance involving regulatory policy. Although a summary of basic statistics with respect to the filing and disposition of applications to the Division for registration and licensing and the announcement of unfavorable or extraordinary orders of the Division will be included as a regular feature of this bulletin, it is not our present intention to include the kind of exhaustive listings of applications and dispositions thereof which constitute the bulk of many other securities newsletters.

Probably the most significant feature of this bulletin will be the material published regularly under the heading "*Regulatory Standards*". This Publication will be the prin-

cipal outlet, and therefore, the principal source of reference, for Division Rules, Statements of Policy, Forms, and Written Policy Guidelines (please see *Statement of Policy 1973-1* below for a definition of these terms), both adopted and proposed, which will collectively represent the expressed regulatory standards of the Division as they are formulated, in perhaps the most significant new undertaking of the Division, during the months to come.

Additional regular features involving matters of policy will include: "*Interpretive Opinions*," the Chief Counsel's expression of his interpretation of statutory terms and the provisions of Rules, Statements of Policy, and Written Policy Guidelines; "*Illustrative Rulings*," setting forth examples chosen by the Supervisors of the various Sections of the Division of the application of regulatory standards to actual applications for registration or licensing approved, denied, or requested to be withdrawn or to other regulatory determinations of the Division; and "*Policy Developments*," expressing the views of the Commissioner on subjects of new or changing policy.

Other items of particular interest regarding the activities of specific Sections of the Division, will be presented as they arise under the heading "*The Sections*" by the Supervisors of the Registration, Enforcement, Broker-Dealer, Foreign Real Estate, Audit, Consumer Finance, and Credit Union Sections of the Division.

Each month, the bulletin will also include: under the heading "*Senate Bill 338*", descriptions by the Counsel for Policy Development of specific provisions of the proposed new Ohio Securities Act recently introduced into the Ohio General Assembly; under the heading "*Other Developments*", announcements regarding new Division personnel and other matters of general interest; and finally, under the heading "*Comments of the Commissioner*", general comments regarding Division objectives, programs, and other administrative matters.

Through the combined efforts of over a dozen policy-level personnel of the Division, the *Ohio Securities Bulletin* will establish the potential for an extremely valuable exchange of communications between the Division and the subscribers to this publication. The realization of this potential will depend in part upon your willingness to forward to the Division your reaction to the contents of specific items contained in this bulletin and to the scope and content of the bulletin in general. I urge you to do so in order that we may be able to thereby improve in one additional way the regulatory operations of the Division.

William L. Case, III

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### COMMENTS OF THE COMMISSIONER The Division's Program for 1973

The Division of Securities is undertaking during 1973 an ambitious program designed to improve all aspects of its operations and thereby create, for the benefit of both public investors and persons subject to its regulation, a more effective, equitable, and practicable system of securities regulation for the State of Ohio. This program is composed primarily of two fundamental elements — the completion and enactment of the proposed new Ohio Securities Act and a comprehensive plan of reorganization of the administrative operations of the Division itself. The successful implementation of both of these elements is essential to the achievement of the Division's expressed objectives.

#### I. Ohio Securities Act

The proposed new Ohio Securities Act was introduced into the 110th General Assembly on April 18, 1973. It has been designated Senate Bill 338, is sponsored by Anthony Novak (D-Cleveland), and has been assigned to the Commerce and Labor Committee chaired by Howard Cook (R-Toledo).

This bill is largely a product of intensive efforts over the past two years on the part of the Securities Advisory Board, the Division of Securities, and the Corporation Law Committee of the Ohio State Bar Association.

The following general summary of this proposed legislation, contained in the transmittal letter submitted to the Governor by the Director of Commerce and myself on April 15, 1973, expresses the ramifications of this new law as seen by the Division.

"Several significant characteristics of this new legislation represent corrections of fundamental deficiencies in the existing securities laws of Ohio. Three of these are particularly deserving of your attention.

First, this bill provides for a more efficient utilization of the resources available to the Division of Securities by concentrating regulatory activity into those areas where it is most greatly needed through a revised statutory pattern of exemptions and provisions for notification registrations. New exemptions are added for sales of securities to ten or

fewer purchasers in Ohio, for sales not involving a public offering, and for sales exclusively to sophisticated or institutional investors, and a new provision for short-form registration by notification is added for nearly all sales limited to twenty-five or fewer Ohio purchasers. In each of these instances, due to a particularly close relationship to the issuer of the securities or due to a capability to understand the character and bear the risk of the investment decision, the purchaser is in a much better position to protect himself than is the unsophisticated public investor. The statutory recognition of this fact allows resources of the Division to be freed for more intensive application to areas where similar opportunities for self-protection are absent. As a result, this bill provides for a significant increase in the quality of governmental consumer protection for investors and at the same time opens avenues for accelerated capital formation in Ohio with a minimum of regulatory interference in areas where governmental protection is not so necessary. It also eases the burden of the general legal practitioner in consummating the simplest of transactions on behalf of closely held business entities.

Second, this bill adds to the administrative system the essential element of flexibility by providing the Division of Securities with broad rulemaking authority to enable it to meet the requirements of constantly changing patterns of business practices and regulatory problems. It gives the Division the authority to define statutory terms, to modify or further condition exemptions and provisions for notification registrations and to establish, modify, and revoke rules governing all aspects of regulatory policy and procedure consistent with the expressed intent of the legislature. These powers provide the administrative agency with the tools necessary to construct a system of rules which will allow it to bring its considerable and complex regulatory responsibilities into manageable proportions. This legislation retains the existing characteristics of active securities regulation inherent in the application of substantive fairness principles to registered securities transactions, and rule-making is essential to the successful implementation of this regulatory principle.

Finally, this bill effectuates an administrative reorganization of the structure and operations of the Division of Securities by injecting a variety of disciplinary mechanisms designed to assure a more prompt and equitable disposition of matters pending before this agency. It commands the Division to implement the bulk of its policy requirements by means of prior promulgated rules and to act upon registration and license applications within prescribed periods of time. It creates a nine-man Securities Board of Review to be appointed by you from persons knowledgeable or experienced in securities-related matters. This board will have the authority in its own discretion to review and, by a two-thirds vote, to overrule official actions of the Commissioner of Securities with respect to both rules and adjudication orders. The Securities Board of Review provides a useful check and balance upon and sounding board for a Division of Securities that must necessarily exercise considerable discretion in its rules and orders where the possibilities of obtaining prompt and meaningful judicial review are remote. Your retained power to remove with or without cause any or all members of this board will be adequate to

deal with the unlikely contingency of any obstructionism on their part.

This comprehensive legislation contains many additional regulatory innovations each designed to improve in one manner or another the system of securities regulation to be applied in Ohio. All of the various components of this bill taken together represent what we consider to be a vastly improved statutory blueprint for governmental effectiveness.

This legislation contemplates a modern, efficient and professional Division of Securities. Programs are currently being implemented to more closely approach the realization of this objective in anticipation of the enactment of this bill. The Division has initiated certain administrative procedures moving as far as possible under the present statute toward the achievement of desirable regulatory results prescribed by the proposed legislation. The present statute, however, imposes significant limits upon our ability to move in that direction. Ohio is in great need of this legislation for the sake of both better investor protection and the promotion of commerce in this state.

It is our expectation that this bill will generate broad support from all sectors of Ohio society, public and private. Although certain special interests will undoubtedly prefer modifications to certain specific provisions, we are confident that only the most recalcitrant will refuse to acknowledge that retaining the present statute is an unacceptable alternative to the enactment of this legislation during the current legislative session."

I believe that the proposed new Ohio Securities Act deserves the support of all members of the Bar, members of the accounting profession, representatives of the securities industry, leading business organizations, and other persons and entities with a particular interest in securities regulation in Ohio. The Division will appreciate the assistance of any and all interested persons in its efforts to secure the enactment of this legislation before the end of the year.

## II. Plan of Administrative Reorganization

Of perhaps even greater importance than the enactment of the proposed new Ohio Securities Act is the execution of that part of the Division's program represented by the plan of administrative reorganization set forth below. Within whatever statutory framework this administrative agency is operating, its likelihood of success in achieving meaningful regulatory results is dependent upon its ability to develop and implement sound regulatory policies. The administrative failures of the Division in the past are as much responsible for its historic ineffectiveness as are the shortcomings of the existing Ohio Securities Act. Just as the proposed new Ohio Securities Act is designed, in great measure, to correct fundamental deficiencies in the existing securities laws of Ohio, the plan of administrative reorganization of the Division is designed to correct past deficiencies in the development and implementation of regulatory policies.

The primary objective of the Division's administrative plan is to create regulation which is more effective, more equitable, and more practicable than that which has pre-

vailed in the past. Insofar as the operations of the Division are concerned, this means (1) the conduct of regulatory activities in a manner which is more vigorous and which offsets any inherent tendency to become too closely related to those who are being regulated, (2) the development of regulatory standards which are more relevant to the purposes for regulation and which reflect a better recognition of the realities of current financial and commercial principles and practices, and (3) the application of those standards in a manner which results in greater consistency and continuity and which, nevertheless, gives greater consideration to the particular circumstances under which the persons subject to its regulation are operating. Considerable improvement in each of these facets of regulation is needed in all areas of Division activity.

Achievement of the foregoing objectives is dependent upon the successful implementation of two equally essential operational components of the administrative plan. One of these involves the development and implementation of a whole new pattern of substantive and procedural policies relating to all areas of Division operations — in essence, a reordering of regulatory priorities of the Division. The second involves the establishment within the Division of an effective capability to develop and implement these policies — in essence, a reallocation of the administrative resources of the Division.

(A) **REALLOCATION OF ADMINISTRATIVE RESOURCES:** This component of the plan is the one which deserves the earliest attention, and is the one which, in fact, has been the object of the greatest amount of effort over the past five months. A great deal of progress has already been achieved toward the successful implementation of this component of the plan. As a result, the Division has now reached a point where the bulk of its energies can be turned toward the implementation of the other more substantive component. The reallocation of Division resources which have been made or are being made in order to establish the capacity to develop and implement policy include the following.

(1) A new Deputy Commissioner was appointed in January to assist the Commissioner in the general administration of the Division, to take responsibility for many decisions arising from the operations of all Sections of the Division, and to thereby enable the Commissioner to concentrate more fully upon further planning and organization requirements of the administrative plan.

(2) The seven Section chiefs of the Division have, since January, been given as great a degree of autonomy with respect to the operations of their respective sections as is consistent with the implementation of the substantive elements of the plan.

(3) An administrative staff has been created for the purpose of assigning specific responsibility for the most essential elements of the plan to persons whose undivided attention can be applied to their implementation. Four positions have been established, separate from the seven operational Sections of the Division, with the following areas of responsibility: (a) *Chief Counsel* — the application of proper prin-

ciples and procedures of administrative law to all specific adjudications and other regulatory activities of the Division; (b) *Counsel for Policy Development* — the development of new regulatory standards for application by the Division in all areas of its operations; (c) *Policy Coordinator* — the assembling and summarizing of information concerning new developments in securities regulation for use by Division personnel, the conduct of training and continuing education programs, and the dissemination of Division policies to persons subject to regulation; and (d) *Staff Attorney for Administration* — assistance in the implementation of certain substantive elements of the administrative plan, and the handling of special regulatory problems by assignment of the Commissioner. All four of these staff positions have been filled during the past three months and since April 20, all four have been functioning on a full-time basis.

(4) A position of Office Manager has been established to provide supervision for all of the clerical and fiscal functions of the Division.

(5) The Registration Section of the Division has been restructured to increase the efficiency of and improve the degree of control over the registration process. A team concept was implemented during March for review of interstate corporate, intrastate corporate, and non-corporate applications for the purpose of maximizing consistency and continuity in the application of regulatory standards. Four new financial analysts have been recruited and trained to replace the attorney-examiners assigned to administrative staff positions. A system for directing, recording and comparing the application of specific regulatory standards to registration applications was devised and implemented during April. Procedures for expediting applications, where appropriate, and for hearing appeals, where requested, were similarly implemented. A Statement of Policy setting forth the operation of these new registration features is currently being prepared and will be published in the June issue of the *Ohio Securities Bulletin*. As a result of these measures, the tremendous backlog in the review of applications has been eliminated and a reputation for reasonableness and competence is being restored to the Registration Section.

(6) The Enforcement Section of the Division has likewise been restructured to better facilitate the realization of meaningful enforcement operations. In order to gain control over a great variety of enforcement activities conducted throughout all Sections of the Division, the Enforcement Section has been identified as the single focal point for initiative in all enforcement matters. Accordingly, the Enforcement Section is now responsible for receiving and investigating all complaints, consulting with other sections involved with respect to the merits of particular cases, making final decisions regarding the propriety of administrative or criminal actions by the Division, making arrangements for administrative proceedings, coordinating activities with the office of the Attorney General of Ohio, the Counsel to the Director of Commerce, and county prosecutors, and carrying enforcement activities through to their ultimate conclusions. As of the end of April, the Enforcement Section has acquired a new Attorney-Inspector, three attorneys and four investigators.

(7) With this first issue, the *Ohio Securities Bulletin* has been established to facilitate the dissemination of all new or modified regulatory standards and other policies of the Division and to promote a meaningful exchange of communications with the Bar and with those persons and industries subject to regulation by the Division.

(8) Finally, and perhaps most importantly, a very significant intangible which is basic to the success of any organization has been carefully nourished to a relatively advanced stage of fruition. The central administrative core of the Division has developed a new sense of teamwork and common purpose, founded upon an attitude of optimism, confidence, and mutual respect. If this resurgence of morale can be maintained and transmitted to all personnel of the Division, the likelihood of success in implementing the remainder of the administrative plan should be very high.

Resource reallocations of the Division are at this point nearly complete, and the capacity to undertake a massive program of substantive and procedural policy development and implementation has been established to the extent which the existing level of resources will allow. Unless the qualitative and quantitative resources of the Division are increased significantly, completion of the plan will not be attainable within the near future since present resource needs will be compounded with the enactment of the new law. Therefore, the Division will attempt, later in the year, to secure additional appropriations, a reclassification of various civil service positions within the Division, and an upward revision of pay scales attributable to those positions.

**(B) REORDERING OF REGULATORY PRIORITIES:** The development and implementation of necessary new policies across the entire spectrum of Division regulatory activities, which constitutes the first component of the administrative plan, is currently being undertaken but is, for the most part, yet to be accomplished. This will be the primary object to which the Division will address its energies during the months to come. The reordering of Division priorities which is being made and will continue to be made in the near future includes the following:

(1) Significant work on the development and publication of regulatory standards for all sections of the Division has only recently begun. An earlier attempt to accomplish this task, initiated during 1971 but apparently abandoned thereafter, produced some valuable material which can be utilized in this effort. Manpower available to devote to this type of activity has been largely directed, during the past four months, to work on the completion of the proposed new Ohio Securities Act and other legislative matters relating to the Division. During the next year, more work will be required to develop an initial system of special rules required for the implementation of the new securities law upon its enactment. However, a great deal of progress can be expected during the same period in the development and publication of many new regulatory standards for registration of securities, registration of foreign real estate, and licensing and regulation of broker-dealers and salesmen, in accordance with the program described in *Statement of Policy 1973-1* set forth in detail in the bulletin below.

A summary of the most frequently applied regulatory standards of the Registration Section of the Division has been compiled during the past month and will be published in the form of Written Policy Guidelines of the Division in the June and July issues of the bulletin. A series of additional Statements of Policy and Written Policy Guidelines for registration of securities governing Offering Price, Commissions, Securities Advertising, Real Estate Limited Partnerships, Cattle Feeding Funds, Oil and Gas Programs, Mergers, Fairness Hearings, and Penalty Filings are currently being prepared in greater depth and will be published beginning in August. Similarly a new set of credit union rules has been prepared and, with the completion of a few recently-developed provisions, these rules will be ready for promulgation.

Development and implementation of regulatory standards will probably be in the long run the most significant activity which the Division will be undertaking this year. We hope to be able to directly involve a number of members of the Bar in this program with the help of the Corporation Law Committee of the Ohio State Bar Association or some other advisory body which might be established by the Division. The new *Ohio Securities Bulletin* will be a particularly valuable instrument for the dissemination of regulatory standards as they are developed.

(2) Also of considerable significance is the effort to bring all Division regulatory activities into conformity with the best of administrative practices and procedures, including strict adherence where applicable to requirements of the Administrative Procedures Act in connection with official Division proceedings. Extra-legal procedures such as delaying action upon registration applications indefinitely, applying pressure to sponsors to effect withdrawals of license applications, conducting programs of remedial activities informally in cases of violations, or referring complaints to registrants or licensees for quiet settlement are being eliminated and superceded by appropriate denial, suspension, and revocation orders and other proceedings which invoke the protections and the discipline afforded by administration hearings. A great deal of progress has already been made in reforming hearing procedures and other administrative practices.

(3) Specific policy changes designed to result in more meaningful regulation will be implemented in the order of highest priority on a section by section basis, as the resources of the Division allow, during the remainder of the year. A few of the more significant innovations now being implemented or contemplated in the near future include the following:

(a) *Registration Section*: Beginning on July 1, 1973, a significant readjustment of priorities will be officially initiated in the Registration Section. With the effectiveness of *Statement of Policy 1973-2*, set forth in detail in the bulletin below, the examination process will be modified to take into consideration the capacity of the members of a distinct class of purchasers to whom an offering will be directed to protect themselves due to a particularly close relationship to the issuer, a special capability to understand the character and bear the risk of the investment decision, or the parallel regulatory activities of another governmental

agency. Accordingly, a cursory review procedure will be implemented for registration applications in areas which are to be exempted as a matter of policy under the proposed new Ohio Securities Act in order that a more thorough examination can be given to applications involving more widespread public offerings where similar opportunities for self-protection are absent.

(b) *Enforcement Section*: A considerable degree of refinement will be required in the process by which priorities are set for acting upon the extremely large number of enforcement situations arising in the course of Division operations. A more meaningful rationale must be developed for selecting the cases which will receive the most exhaustive investigations, and better criteria for determining the appropriate administrative action to be taken on such matters must be established, so that increased initiative in pursuing enforcement matters will produce more in the way of positive regulatory results. Constructing and implementing this framework for decision-making will be the most significant undertaking of the Enforcement Section during 1973.

(c) *Foreign Real Estate Section*: It is apparent that fraudulent and unethical land sales practices are continuing despite the increasing difficulties which sponsors of out-of-state land developments have been having with some of their favorite marketing techniques. In order to effectively put an end to these practices, the Division will, from this point forward, hold the developers of foreign real estate projects directly responsible for the acts of their sales representatives, whether or not they have shielded themselves with intermediaries in the form of foreign real estate broker-dealers. Wherever a pattern of violations is discovered in connection with a particular land development registered with the Division, the registration of that development will be suspended, whether the fault lies with complicity of the sponsors in the violation or with the failure to properly supervise their sales representatives. More comprehensive regulatory standards, including requirements for more meaningful disclosure, will be developed for foreign land sales activities in Ohio in the near future, and more vigorous regulation will be pursued as the top priority of the Foreign Real Estate Section.

(d) *Credit Union Section*: Significant new policies have been in the process of implementation in the Credit Union Section of the Division since the early part of March. The failure to maintain adequate reserves or to prevent any other occurrence which results in an impairment of the share capital of a credit union or a similar risk of loss to credit union members, or the failure to make adequate disclosure of such impairment or risk of loss, are considered by the Division to constitute unsafe and unsound practices warranting the suspension of all operations of a credit union until a plan of corrective action can be implemented. New credit union rules to be promulgated in the near future will incorporate this concept which is designed to improve management practices of unstable credit unions and to protect the investments of credit union members. A series of credit union suspensions was initiated during March and April as a result of the implementation of this policy. Additional suspensions will be conducted until undisclosed and uncontrolled risks have been eliminated for the better-

ment of the entire credit union industry. New legislation was recently introduced by the Division to provide for the creation of a corporation to furnish share deposit insurance to state regulated credit unions and to provide greater administrative flexibility in connection with credit union suspensions. In addition, credit union examination procedures will soon be revised to incorporate more meaningful indicators of potential management and financial problems.

(e) *Consumer Finance Section:* A new standard format for offering circulars to be used in connection with sales of securities of consumer finance companies has recently been developed by the Consumer Finance Section of the Division in cooperation with the Registration Section. By requiring the use of an offering circular in connection with such offerings, and by encouraging the use of the suggested format, it is expected that a much greater degree of disclosure can be provided for the benefit of investors in these securities. Perhaps even more significant is the policy which is now being implemented of requiring consumer finance companies to amend their registrations by description or to reregister their securities at least annually in order to assure the accuracy and timeliness of the relevant information made available to the Division and to prospective investors. Advertising practices and inducements offered to investors in connection with the sale of securities is another area of regulation which will be receiving additional attention from the Consumer Finance Section of the Division during the year.

The foregoing are highlights of the new regulatory priorities which have been set for the Division so far this year. These priorities will continue to be subject to change and additional priorities will be developed in response to new regulatory problems which arise during the remainder of the year. With new capabilities established to develop and implement policies dealing with the entire scope of regulatory problems facing the Division, it can be expected that very meaningful gains will be made toward realization of the Division's objectives in the form of more effective, more equitable, and more practicable securities regulation. If this is accomplished and if the proposed new Ohio Securities Act is enacted before the end of the year, the Division's program for 1973 will have been a successful one.

William L. Case, III

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## SECURITIES INVESTIGATION

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The recent statewide publicity surrounding investigation of an alleged bribe solicitation relating to registration of securities by the Division has been unfortunate at a time when Division morale has been on the upswing, but current efforts by the Division to provide better securities regulation will continue undiminished.

Based upon the best information available at this time, it appears almost certain that no employee of the Division has been involved in any wrongdoing. The application in question was dealt with in good faith by the Division and entirely upon its merits at all times. The Division is con-

tinuing to cooperate fully with investigative authorities in an effort to bring to light all facts relating to this matter and is confident that the results of this investigation will confirm the propriety of all Division activities in connection with this case.

No special recognition is given to state employees for suffering through this kind of public ordeal. They continue with their work conscientiously and with composure. It is at this time particularly that the employees of the Division of Securities deserve the appreciation and continued support of all persons interested in good government.

William L. Case, III

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## POLICY DEVELOPMENTS

The Rules for the Offer and Sale of Real Estate Programs of the Midwest Securities Commissioners Association were adopted at the Association's spring conference in San Francisco on February 28. Final modifications have been incorporated as of April 26, and the rules in final form have been sent to Commerce Clearing House for publication. The Division of Securities has been applying earlier drafts of these rules to real estate programs filed for registration since the early part of this year. Confirmation of their adoption as Written Policy Guidelines of the Division will be set forth in the June issue of this bulletin. Four areas of application of these real estate guidelines are currently of particular concern to the Division.

First, the Division considers Section IV, dealing with fees, compensation and expenses, to be so restrictive that application of the rules would be impractical. The presumptive limitation of compensation for acquisition services to 18% of the gross proceeds of the offering appears to prohibit a 6% real estate commission where leveraging of greater than 2 to 1 is involved. Most real estate programs take advantage of high leveraging ratios as part of the basic economics of the venture. In addition, no allowance is made for higher levels of compensation in the form of development fees and contractors profits for development and construction services provided by the sponsor. Ohio has been the source of many syndications sponsored by vertically-integrated real estate companies which have made useful contributions to the economy of the state and have in the process provided appealing investments for Ohio residents. The Division will continue to allow reasonable compensation to sponsors of real estate programs without considering itself bound by the restrictions contained in the Midwest Rules.

Second, Section VII(B) deals with the requirement of voting rights for limited partners. The voting rights question is complicated by the fact that requirement of certain rights may have the effect of either (1) subjecting limited partners to unlimited liability because of the control elements of such rights or (2) subjecting the limited partnership to taxation as an association due to the establishment of "continuity of life" or the violation of other federal tax criteria. The State of California has amended its Uniform

Limited Partnership Act to allow a variety of voting rights for limited partners and has solved the first of the above two problems. House Bill 68, now pending before the Ohio General Assembly, proposes to accomplish the same result. However, the California Act has precipitated a number of challenges by the IRS, directed in particular to the right of the limited partners to remove and replace the general partner. Although the IRS has not yet challenged Ohio limited partnerships containing such voting rights, the Division of Securities will not require that limited partners be given the right to remove and replace the general partner. The remaining rights suggested by the Midwest Rules, including the right to amend the limited partnership agreement, the right to dissolve the program, and the right to approve or disapprove the sale of substantially all of the assets of the program, will be required by the Division where not otherwise violating the continuity of life test for all real estate limited partnerships in which the limited partners are substantially protected from any potential personal liability by non-recourse financing and by casualty and liability insurance. For partnerships in which the risk of personal liability for limited partners is particularly high, the Division will consider waiving the requirement of such rights where an opinion of counsel is presented indicating that such rights are likely to destroy the status of the investor as a limited partner.

Third, the Division considers the treatment of non-specified property programs in Section VI to be not sufficiently restrictive to give adequate protection against the increased risks inherent in the investor's lack of information concerning the specific properties to be included in the program. In addition to the requirements outlined in that section, the Division will apply an escrow requirement related to the size and scope of the offering, a more stringent suitability requirement, a diversification requirement, and a requirement that the general partner not only be experienced but also have a sufficient economic interest and financial capacity to assure his continuation with the partnership and his incentive to seek optimum performance. In connection with this latter requirement, the satisfaction of net worth and capital contribution criteria will be accepted as a "safe-harbor".

Finally, the Division will apply the guidelines to real estate programs in all forms — limited partnership, general partnership, or corporate — as provided in Section I(A), to the extent that the specific provisions of the guidelines are applicable to the form of organization under consideration. Where the real estate guidelines are applied to a corporate program, the satisfaction of inconsistent standards of the Division relating to corporations generally will not be required. The application of real estate guidelines to a program in the corporate form was successfully completed very recently to the satisfaction of the applicant and of the Division.

Refinements of the regulatory standards of the Division to be applied to these four areas will be published in this bulletin as Written Policy Guidelines in the near future. Hopefully other areas of departure by the Division from the provisions of the Midwest Rules will be highlighted at the same time. — William L. Case, III

## INTERPRETIVE OPINIONS

### Commercial Paper Exemption

As a matter of practice, the Division realizes that most law firms involved in the business planning aspects of closely held corporations prefer to "thin" the corporation as much as possible. Typically, an attorney will advise a client to issue and register a set number of shares, and then issue promissory notes or other debt securities to the same shareholders who purchased the initial issuance. These latter issues are made without the benefit of registration, in reliance upon a claimed exemption pursuant to Section 1707.02(G) of the Ohio Revised Code. In the past, there has been a great deal of confusion concerning the definition of "nonpublic offering" for purposes of Section 1707.02(G). That section provides: "Commercial paper and promissory notes are exempt when they are not offered directly or indirectly for sale to the public."

The Division has often taken the position that a nonpublic offering pursuant to the above section means an offering to only the officers and perhaps, the directors, of the corporation. We feel that this interpretation is too restrictive and should be broadened to include the same analysis applied to private placement offerings made pursuant to Section 4(2) of the 1933 Securities Act. We feel that the only difference between Section 1707.02(G) of the Ohio Securities Act and Section 4(2) of the 1933 Act is qualitative and refers only to the kind of securities exempted. While the federal act exempts nonpublic offerings of any type of securities, the Ohio act exempts only offerings of commercial paper and promissory notes. The difference is not meaningful enough to militate against applying similar standards under Section 2(G) that are applied under 4(2). Therefore, we will analyze claims of exemption under Section 2(G) utilizing the same standards adopted by the Securities and Exchange Commission in analyzing Section 4(2).

We feel that the most important of the standards is the nature of the relationship between the offeror and the offerees, with particular emphasis on the sufficiency of knowledge of the offerees of the business of the offeror and the sophistication of the offerees in the type of securities offered. We feel the offerees should be in a position of having naturally acquired knowledge of the issue, and we will not recognize a claim of exemption if the issue has "blitzed" the offerees with knowledge of its operations in hopes of obtaining an exemption.

As proposed Rule 146 is developed and finally adopted by the Securities and Exchange Commission, the Division will reassess the above stated position on Section 2(G) and it will probably be reevaluated in terms of the SEC ruling.

Finally, several caveats regarding the Division's policy should be noted. Section 1707.02(G) will only exempt commercial paper and promissory notes; it will not exempt other kinds of debt securities such as debentures. Furthermore, a claim of exemption under this section will **not** relieve the issuer of any dealer licensing requirements that may be involved since Section 2(G) is not a transactional exemption. — Robert DeLambo

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**REGULATORY STANDARDS**


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**Statement of Policy 1973-1**  
**Policy Development and Implementation**

In connection with the new administrative program of the Division of Securities, the following system of policy development and implementation, designed to effectuate the necessary transition from the historic Division practice of applying regulatory policy largely on the basis of unwritten standards and criteria to the sounder, more equitable, and more effective practice of applying regulatory policy by means of specifically defined and published standards and criteria, shall take effect on June 1, 1973, and shall thereafter remain in effect until further notice:

**I. Classification of Regulatory Standards**

A. For purposes of identification, all of the regulatory standards of the Division of Securities shall, until such time as the proposed new Ohio Securities Act is enacted into law and becomes effective, be divided into the five separate classifications described in paragraphs (B) through (F) below, and each shall be implemented in accordance with the specific requirements of its respective classification.

B. **Rules** of the Division of Securities are regulatory standards adopted and promulgated under the authority of Chapter 1707 and in compliance with the procedure prescribed in Sections 119.01 to 119.13, inclusive, of the Ohio Revised Code.

Those standards identified as "Regulations" in the current untitled publication of the Division containing Regulations and Administrative Rulings shall, to the extent they are not hereafter rescinded in compliance with such procedure, be considered effective Rules of the Division.

Rules shall be considered the highest level of policy applied by the Division and strict adherence shall be required, to the extent not inconsistent with the statement contained in paragraph (B) of Section III. below, in the disposition of matters pending before the Division and in the exercise of its regulatory functions.

C. **Statements of Policy** of the Division of Securities are regulatory standards having a general operation adopted for the purpose of implementing the authority of the Division under Chapter 1707 of the Ohio Revised Code and published by the Division in *Ohio Bar*, *CCH Blue Sky Reporter*, the *Ohio Securities Bulletin*, or such other publication as the Commissioner shall designate.

Those standards identified as "Administrative Rulings" in the current untitled publication of the Division containing Regulations and Administrative Rulings shall, to the extent they have not already been or are not hereafter rescinded by publication of a subsequent Statement of Policy, be considered effective Statements of Policy of the Division.

Statements of Policy or modifications thereto may be implemented after the expiration of a period of thirty days

following publication, and thereafter shall be given general application by the Division. For purposes of publication, Statements of Policy may incorporate by reference all or any part of the written standards of other regulatory agencies or associations, the full texts of which have been widely circulated and are generally available to interested persons.

D. **Forms** of the Division of Securities are regulatory standards adopted for the purpose of implementing the authority of the Division under Chapter 1707 of the Ohio Revised Code which prescribe initial basic requirements for completing applications to the Division for registration or licensing. Those standards identified in the table of forms of the current publication of the Division entitled "*Ohio Securities Act*" shall, to the extent not hereafter modified, be considered effective Forms of the Division. Forms or modifications thereto may be implemented by the Division after the expiration of a period of thirty days following publication in the *Ohio Securities Bulletin* and shall thereafter govern the requirements for completing the particular applications to the Division to which they are directed.

E. **Written Policy Guidelines** of the Division of Securities are regulatory standards having a general operation adopted for the purpose of implementing the authority of the Division under Chapter 1707 of the Ohio Revised Code other than Rules, Statements of Policy, and Forms, which have been reduced to writing for application by the Division. Written Policy Guidelines represent those standards which are newly developed, only recently reduced to writing, in the process of being modified, or otherwise considered by the Division to be not yet suitable for publication as Statements of Policy or for promulgation as Rules.

Due to the continuing regulatory responsibilities of the Division requiring the application of regulatory standards, in the exercise of substantive judgments in connection with specific adjudications, whether or not newly developed, recently reduced to writing, or in the process of modification, Written Policy Guidelines may be implemented at any time without publication or other notice and shall immediately thereafter be applied by the Division.

The Division will make available upon request, to persons preparing an application or for whom an application is pending before it, copies of any existing Written Policy Guidelines which are relevant to the consideration of such application and which have not previously been set forth in the form in which they are to be applied in the *Ohio Securities Bulletin*. The Division will endeavor to set forth periodically in the *Ohio Securities Bulletin* the full text of Written Policy Guidelines which are newly adopted and the full text or modified portions of those which have undergone substantial modification.

F. **Unwritten Policies** of the Division of Securities are those regulatory standards which have been formulated and adopted for the purpose of implementing the authority of the Division under Chapter 1707 of the Ohio Revised Code during the course of the exercise of a continuous series of substantive judgments in connection with specific adju-

dications required of the Division by the Ohio Securities Act and which have not been reduced to writing. In the execution of its continuing regulatory responsibilities under the statute, the Division will continue, where necessary, the adoption and application of Unwritten Policies in areas of regulation for which those policy standards of a more definitive nature described in paragraphs (B) through (E) above have not yet been prepared.

## II. Development of Regulatory Standards

The Division of Securities will endeavor to identify, refine and reduce to writing, as rapidly and to as great an extent as the manpower resources of the Division will allow, the regulatory standards applied by the Division in connection with the exercise of its regulatory functions. Wherever possible, in connection with the development of new standards, the Division will set forth in the *Ohio Securities Bulletin* interim drafts of the proposed standards prior to implementation for the purpose of providing advance notice and generating comments and suggestions for modification. The Division intends to request the assistance of a number of members of the Bar and members of the securities industry in developing and refining proposed policy standards.

The primary objectives of the Division in this process shall be to supplant all Unwritten Policies of the Division with Written Policy Guidelines and during the course of this process, to revise the regulatory standards applied by the Division to better reflect the realities of current financial, commercial and regulatory principles and practices. The promulgation of additional Rules of the Division is considered to be of secondary priority and will be accomplished only to the extent that resources of the Division allow.

## III. Application of Regulatory Standards

A. It is the interpretation of the Division of Securities of Chapters 1707 and 119 of the Ohio Revised Code that regulatory standards of the Division may be adopted for application in the exercise of substantive judgments in connection with specific adjudications required by the Ohio Securities Act without compliance with the procedure prescribed in Sections 119.01 to 119.13, inclusive. Therefore, Statements of Policy, Forms, Written Policy Guidelines, and Unwritten Policies of the Division will be considered to be in all respects equivalent to Rules of the Division and will be applied accordingly.

B. No registrant or licensee of the Division will be subject to administrative actions by the Division for violation of regulatory standards of which such registrant or licensee did not at the time of such violation have actual or constructive notice. Publication of regulatory standards of the Division in *Ohio Bar*, *CCH Blue Sky Reporter*, the *Ohio Securities Bulletin*, or such other publication as the Commissioner shall designate shall constitute constructive notice of such regulatory standards. Violations of regulatory standards continuing after the receipt of actual or constructive notice of such regulatory standards shall constitute sufficient grounds for administrative action by the Division.

C. All regulatory standards of the Division of Securities, whether in the form of Rules, Statements of Policy, Forms, Written Policy Guidelines, or Unwritten Policies, shall be applied collectively, to the extent relevant, in connection with specific adjudications made by the Division in the course of its regulatory functions. The Division will make its determination on the basis of all of the specific characteristics and circumstances of the individual adjudications under consideration and in the light of the basic statutory purposes for regulation in the particular area.

Because regulatory standards cannot adequately anticipate all potential application requirements, the failure to satisfy all regulatory standards of the Division will not necessarily foreclose the possibility of a favorable disposition of a matter pending before the Division, and, similarly, the satisfaction of all such regulatory standards will not necessarily preclude an unfavorable disposition if the specific characteristics and circumstances so warrant. For this reason, the nature of the disposition of any particular matter pending before the Division is not necessarily of meaningful precedential value and the Division shall not be bound by the precedent of any previous adjudication in the subsequent disposition of any other matter pending before it.

It is anticipated, however, and it shall be the objective of the Division that the great bulk of adjudications by the Division will be consistent with the currently applicable general regulatory standards of the Division and, in the absence of an intervening modification of such standards, with the results of previous adjudications by the Division to which they are equivalent.

D. Statements made and opinions expressed orally or in writing by personnel of the Division of Securities in response to inquiries or otherwise, and not specifically identified (and published where applicable) as Rules, Statements of Policy, Forms, Written Policy Guidelines, or Unwritten Policies applied to specific adjudications of matters pending before the Division, shall not be considered regulatory standards of the Division and shall not be considered binding upon the Division in connection with specific adjudications undertaken by the Division thereafter.

The Division shall endeavor to render as great a degree of assistance as possible to applicants and other persons making inquiry concerning Division policy, and by means of the *Ohio Securities Bulletin*, the Division shall undertake specifically to set forth in the form of Interpretive Opinions, Illustrative Rulings, and Statements of Recent Policy Development, general indicators of the current status of Division policy formulation in various areas to guide and assist the securities practitioner. These statements and opinions, however, should not be given the same degree of reliance as may be given to specific regulatory standards of the Division described in paragraphs (B) through (F) above.

Similarly, the degree of reliance which is given to regulatory standards of the Division described in paragraphs (B) through (F) above during the preparation of and prior to the submission of an application, should be related to the relative degree of definitiveness, the stage of development,

and the notice requirements for modification inherent in each such classification.

### Statement of Policy 1973-2 Interim Registration Procedures

In connection with the implementation of the new administrative program of the Division of Securities, the following procedures designed to maximize the utilization of resources of the Division and increase the efficiency of the registration process shall take effect on July 1, 1973 and shall remain in effect thereafter until further notice:

#### I. Registration by Description

A. In order to accelerate the consummation of registrations by description and to bring regulatory procedures for dealing with such registrations into compliance with the limitations of statutory authority, a registration by description pursuant to Ohio Revised Code sections 1707.05 and 1707.06 will be considered completed and transactions in such securities may be consummated when the application, together with the fee prescribed by Section 1707.08, is delivered or mailed by registered mail to the Division of Securities.

The applicant will be responsible for ascertaining that the offering is eligible for registration by description under the applicable section, that all statutory requirements have been satisfied, and that the application is accurate and complete.

A certificate of acknowledgment will be issued within ten days following receipt of the application by the Division unless a suspension of the registration is being considered.

B. A registration by description completed pursuant to Section 1707.08 for one of the securities or transactions specified in Section 1707.05 or 1707.06 will be suspended by the Division in accordance with the provisions of Section 1707.13 if the Division finds that the securities are being disposed of on grossly unfair terms or in such manner as to deceive or defraud purchasers or in disregard of any lawful rule, regulation, or requirement of the Division.

C. In order to provide for adequate protection of investors in cases of potentially widespread public offerings of securities being registered by description, a registration by description completed pursuant to Section 1707.06(A)(1) will be subject to immediate suspension in accordance with the provisions of Section 1707.13 pending the procurement of additional relevant or material information and the completion of a review of the application by the Division of Securities if the application is not accompanied by either (1) an undertaking, signed by a duly authorized representative of the applicant, that the applicant will not commence sales activities until the Division has reviewed the application and notified the applicant that the registration has been approved or (2) a signed statement of the applicant indicating that the following terms and conditions of the offering have been satisfied:

(a) **CLASS:** The offering is limited to a single class of equity securities and no other class of equity securities of the issuer is outstanding at the time of filing;

(b) **FINANCIAL STATEMENT:** The application is accompanied by a financial statement containing a balance sheet and a statement of income and expense for the most recently completed fiscal year of the issuer, and by supplementary financial statements for each quarter completed thereafter prior to the date of filing;

(c) **OFFERING PRICE:** Where no significant market for the securities exists, the offering price of the securities is not higher than the greater of twenty-five (25) times the average annualized net earnings per share of the issuer after taxes during the period composed of the most recently completed fiscal year and all quarters completed thereafter prior to the date of filing, or five (5) times the net tangible book value per share of the issuer as of the end of the most recently completed quarter;

(d) **LOSSES:** Total net losses of the issuer during the period composed of the most recently completed fiscal year and all quarters completed thereafter prior to the date of filing are not greater than ten per cent (10%) of the lesser of the net tangible book value of the issuer at the end of the most recently completed quarter or the amount of proceeds of the offering subject to escrow pursuant to a duly executed escrow agreement, and the issuer is not at the time of filing insolvent;

(e) **ESCROW:** Where the securities being registered are to be sold by the issuer or in a best-efforts underwriting and the offering is not limited to proceeds of \$50,000 or less, an escrow agreement has been executed which provides for an escrow of not less than seventy-five per cent (75%) of the maximum proceeds of the offering and which requires written approval by the Division of the release of proceeds of the offering to the issuer;

(f) **DILUTION:** The net tangible book value per share of the issuer immediately following the release to the issuer of the amount of proceeds of the offering subject to the escrow agreement and the release to the purchasers of the corresponding number of shares of the issuer will not be less than sixty per cent (60%) of the offering price of the securities being registered;

(g) **CHEAP STOCK:** The offering price of the securities being registered is not higher than five (5) times the price per share paid by promoters or affiliates of the issuer within a period of two (2) years preceding the date of filing for securities of the issuer similar to those being registered;

(h) **INTANGIBLES:** At least sixty per cent (60%) of the total consideration paid or given for all of the securities being offered or proposed to be offered plus all other securities issued by the issuer within a period of two (2) years preceding the date of filing of the application is cash or tangible property, as that term is defined in Section 1707.01(L);

(i) **SUBORDINATION:** In case promoters or affiliates of the issuer have received, within a period of two (2) years preceding the date of filing securities of the issuer similar to those being registered in exchange for other than tangible property or for consideration valued at less than the offering price of the securities being registered, arrange-

ments have been made to escrow such securities and to subordinate the rights of such securities to dividends and distributions in liquidation in favor of similar rights of the securities being registered until the issuer has produced net earnings per share after taxes for two (2) consecutive fiscal years of not less than six per cent (6%) of the offering price of the securities being registered, with the requirement of written approval by the Division of the release of such securities from the escrow and subordination arrangements.

(j) **OFFERING CIRCULAR:** Where the offering is not limited to twenty-five (25) or fewer persons or to proceeds of \$50,000 or less and the applicant does not file with the application an opinion of counsel to the effect that the sale of securities being registered will not involve a public offering within the meaning of Section 4(2) of the Securities Act of 1933, the application is accompanied by an offering circular which substantially complies with the requirements for offering circulars employed in connection with Regulation A offerings filed with the Securities and Exchange Commission pursuant to Section 3(b) of the Securities Act of 1933.

Whenever an undertaking of the type described above accompanies an application for registration by description received by the Division of Securities, the Division will endeavor to reply to the applicant in writing or by telephone with its comments within five (5) full business days following receipt of the application.

D. The terms and conditions set forth in paragraph (C) above are utilized to distinguish between those applications for registration of securities pursuant to Section 1707.06(A)(1) which are deemed appropriate for accelerated treatment by the Division of Securities and those applications which, due to the need for more intensive examination and analysis, are not deemed appropriate for such treatment.

The failure to satisfy all of such terms and conditions does not foreclose the possibility of approval of the offering by the Division of Securities in the form submitted subsequent to a complete review of the application and of any supplementary documentation submitted by the applicant to justify material departures from such terms and conditions. A determination will be made on the basis of all of the characteristics and circumstances of the offering taken as a whole.

Similarly, the satisfaction of all of such terms and conditions will not necessarily preclude a subsequent suspension of registration if the Division finds that the nature and circumstances of the offering are such that the provisions of paragraph (B) above are applicable. In particular, where an offering circular is employed in connection with an offering of securities pursuant to Section 1707.06(A)(1), it is advisable that the undertaking referred to in paragraph (C) above is submitted to the Division with the application in order to avoid the increased likelihood of suspension due to a deficiency in the offering circular itself.

E. The Division of Securities may from time to time designate additional classifications of registrations by

description which it deems inappropriate for accelerated treatment without the satisfaction of terms and conditions similar to those specified in paragraph (C) above for registrations by description completed pursuant to Section 1707.06(A)(1).

## II. Sales of Securities Not Involving a Public Offering or Limited to Sophisticated Investors

A. For the purpose of giving greater recognition, in the allocation of resources of the Division of Securities, to the greater ability of persons with a particularly close relationship to an issuer to protect themselves in connection with the purchase of securities of such issuer, an application for registration of securities by description or by qualification will be handled by the Division of Securities on the basis of a cursory review if the offering is limited to not more than ten persons in this state and the seller has no reason to believe that any such person is purchasing with an intent to distribute the security in this state OR if the application is accompanied by a description of the plan of distribution to be followed by the applicant and an opinion of counsel to the effect that the plan of distribution, if followed, will not involve a public offering within the meaning of Section 4(2) of the Securities Act of 1933.

B. Similarly, in recognition of the greater ability of persons with financial knowledge and experience and significant financial resources to protect themselves in connection with the purchase of securities, an application for registration of securities by description or by qualification will be handled by the Division on the basis of a cursory review if the application is accompanied by a statement signed by a duly authorized representative of the applicant indicating that the offering will be limited to persons for whom the purchase of such security is suitable because each of such persons meets the following qualifications:

(1) Because of his knowledge and experience in financial and business matters or because of effective representation by an investment adviser or other representative who has knowledge and experience in financial and business matters, he is capable of evaluating the risks of the purchase and of making an informed investment decision with respect to such purchase;

(2) Because of his or his investment representative's relationship to or communications with the issuer of the security, he or his investment representative has access to, or is furnished with, the kind of information about the issuer that would be disclosed in an application filed pursuant to Section 1707.09 of the Revised Code and to any additional information necessary to verify the accuracy thereof, and

(3) Because his net worth and financial resources are substantial in relation to the amount of the securities to be purchased, he is able to bear the economic risks of the purchase.

The financial resources requirement set forth above will be considered satisfied if the minimum initial cash investment per person will be \$10,000 or more and if each purchaser

has a tangible net worth excluding home, home furnishings and automobiles of \$50,000 or an annual net income before federal, state and local income taxes of \$30,000 for every \$10,000 to be invested by him in such securities.

C. The application will be examined in terms of the most basic relevant policy criteria. It is anticipated that an offering satisfying the requirements outlined in paragraphs (A) or (B) above will not be deemed grossly unfair by the Division unless the offering contains special risks or characteristics which would tend to work a fraud or would be unconscionable.

As a condition of approval of such application, the Division may require that the applicant distribute to offerees a short-form disclosure document pointing out specific risks or terms of the offering which the Division considers essential to an informed investment decision. The Division may also require that each purchaser sign a statement indicating that he meets the requirements for qualification set forth above.

D. The Division will endeavor to notify the applicant within ten days following receipt of the application of its approval of such application (subject to SEC effectiveness where applicable) or its request that such application be modified or withdrawn.

### III. Offerings Registered With the Securities and Exchange Commission

In order to give greater recognition, in the allocation of resources of the Division of Securities, to the investment protection afforded with respect to matters of disclosure by the review of the Securities and Exchange Commission, and to avoid the dissipation of resources inherent in an open-ended and unfocused review of applications by the Division, an application for registration by description or by qualification of securities for which a registration statement has been filed pursuant to Section 6 of the Securities Act of 1933 will be handled by the Division on the basis of a limited examination.

The application will be examined primarily in terms of a limited number of identified relevant policy criteria and will be approved if all of these criteria are satisfied by the terms of the offering and the offering is not found to be unsatisfactory in any other respect.

The Division will endeavor to reply to the applicant with its findings within ten days following receipt by the Division of such application and to notify the applicant of its approval of such application (subject to SEC effectiveness) or request that such application be modified or withdrawn, within thirty days following receipt of the application.

### IV. Applications for Restricted Dealers Licenses

The Division of Securities will continue to endeavor to expedite the processing of applications for restricted dealers licenses pursuant to Section 1707.15 in connection with specific applications for registration of securities.

The Division of Securities respectfully requests the cooperation of all applicants and their attorneys in furthering implementation of these procedures. Failure of the Division to meet the timing objectives outlined above without cause in connection with any particular application should be brought to the attention of the Supervisor of the Registration Section of the Division. The Supervisor of the Registration Section should likewise be contacted for interpretations of the various requirements outlined above.

It is anticipated that these procedures will be superceded by more comprehensive provisions upon the development of new rules and regulations governing policy and procedure later in the year. In the interim, the Division will modify, suspend or revoke the operation of these procedures in whole or in part if it finds that such procedures are ineffective, are subjected to abuse, or otherwise result in a reduction in protection for public investors in Ohio.

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### SENATE BILL 338 General Introduction

This is intended to be the first in a series of articles designed to acquaint *Bulletin* subscribers with some of the more important features of the proposed new "Ohio Securities Act", which was recently introduced into the General Assembly under the designation "Senate Bill 338". For the most part, these articles will merely identify and summarize the central provisions of the act so that the *Bulletin* readers who were not involved in the development of S. B. 338 will have some idea of its origin and content. However, on occasion, an attempt will be made to review the reasoning which led to the incorporation of certain key provisions into the act in order to provide readers with some additional insight into the policies being promoted by S. B. 338.

As Commissioner Case has noted in his *Comments* on the proposed new act, S. B. 338 is the product of the efforts of many knowledgeable individuals and organizations who have made significant contributions to its development over the past two years. Although the concept of a new securities law, particularly one modeled after the Uniform Securities Act, had been discussed throughout the latter part of the 1960's, the project did not begin in earnest until March 1971 when Governor Gilligan appointed a Securities Advisory Board to undertake this task. During the next year, the Advisory Board met frequently and extensively reviewed the status of the current law and a broad range of policy matters relating to the direction which the new law should take. The Board's work included an elaborate comparative analysis of the existing Ohio statutes and "practice", the original Uniform Securities Act language, and the federal approaches to securities regulation. By mid-August, 1972 the Board had prepared a draft of a bill which, although patterned largely after the uniform act and federal law, did retain many of the substantive elements of existing Ohio law.

In September, 1972 the Advisory Board's initial draft was presented to the Corporation Law Committee of the Ohio State Bar Association for review and comment and, during the following six months, it again underwent a thorough analysis by various members of that Committee. In February of this year, another draft of the bill, usually referred to as the "exposure" or "February" draft, was circulated amongst various broker-dealers, accountants, attorneys, law professors, trade associations, and others, i.e., a representative cross-section of those persons and organizations who were known to have a particular interest in securities regulation in this state. This exposure draft, which was a modified version of the Advisory Board's August 1972 draft and which incorporated a number of the changes that had been suggested by the Corporation Law Committee, was further discussed in a series of public meetings held in five major Ohio cities during the latter part of February, 1973. These meetings, conducted by representatives of the Division of Securities and the Advisory Board, were held for the dual purpose of explaining the policy choices reflected in various provisions of the draft and eliciting constructive comments and recommendations for future revision from as many sources as possible prior to the bill's introduction into the Legislature. As a result of this exposure process, a number of helpful suggestions were received from the public and many of them now appear in S.B. 338.

From this admittedly brief sketch of the high-water marks in the evolution of S. B. 338, it should be apparent that the proposed new act is primarily an amalgam of many familiar sources of securities law and practice. Much of its language has been lifted verbatim out of the Uniform Securities Act, which, in turn, is itself based largely upon the federal securities laws. In addition, a substantial number of the act's provisions have either been taken from, or are a direct reflection of, the present Ohio law and the experience of those who have worked most closely with it over the years. Thus, most of the provisions and policies of the new act should not be all that surprising or unfamiliar to the reader, for S. B. 338 is not intended to radically alter the basic character of securities regulation in this state, but rather to refine and improve it, and to coordinate it with recent developments in federal and state law.

#### Organization of the proposed new Ohio Securities Act

Although not formally a part of S. B. 338, a table of contents of suggested titles for each section of the proposed new act has been prepared for use by legal publishers and a copy thereof has been reproduced in this issue of the *Bulletin* as an appendix to this article. An inspection of this table of contents will give the reader a fairly good idea of how the proposed new Ohio Securities Act ("OSA") is organized.

Part I (OSA §§1707.01 to 1707.16) deals with the registration of securities that are to be sold in the state (e.g., §§1707.08 to 1707.16) and with the exemptions from the registration requirement (e.g., §§1707.02 to 1707.07). Definitions which are generally applicable throughout the act are found in OSA §1707.01.

Part II (OSA §§1707.21 to 1707.28) covers the registration and regulation of broker-dealers, agents and investment advisers who transact business in the state. It also deals with the licensing of dealers and salesmen of foreign real estate and warehouse receipts for intoxicating liquor.

Part III (OSA §§1707.31 to 1707.49 and 1707.99) contains general provisions relating to fraudulent and prohibited practices and to the enforcement and administration of the act.

It will be observed that several section numbers in Parts I and II have been left "vacant." This was done for the purpose of facilitating amendments to the act while at the same time maintaining the integrity of the present numbering system. That is, the "open" numbers will permit the addition of new sections to Parts I and II without necessitating the use of three digit numbers and without affecting the present section number assignment system, which is to reserve the series 1707.01 through 1707.19 for statutes relating to the registration of securities, 1707.21 through 1707.29 for statutes relating to the regulation of broker-dealers, agents and investment advisers, and so on. Hopefully, this format will make it easier for those who will become subject to the new act to locate and learn the sections applicable to their particular circumstances.

#### Introduction to the Description of Part I

As is the case with most all modern state Blue Sky laws, the proposed new OSA provides for the registration of securities prior to their sale as well as the licensing of the broker-dealers and agents (or salesmen) who sell them. It also prohibits fraudulent and other types of activities in connection with such transactions.

OSA §1707.02 is the statutory provision which contains the general prohibition against the sale of unregistered securities and which thus sets forth the basic requirement for registering securities. It declares that it is unlawful for any person to offer or sell any security in this state unless it is registered under Chapter 1707. of the Revised Code, or unless the security itself, or the transaction in which it is offered and sold, is exempted by statute. OSA §§1707.03 (exempt securities) and 1707.04 (exempt transactions) list the exemptions which are generally available for most common types of securities and transactions, and OSA §§1707.15(H) and 1707.16(K) contain several limited exemptions from the special registration requirements for the sale of interests in foreign real estate and warehouse receipts for intoxicating liquor, respectively. In addition, the exclusion of certain securities and transactions from the definitions of the term "security" and "sale" amounts to what is in effect a blanket exemption from all of the provisions of the act for those particular securities and transactions.

Although more will be said about the exemptions in subsequent issues of the *Bulletin*, it is worth mentioning at this time that several other provisions of the OSA will have a direct bearing on the availability and use of the exemptions enumerated in §§1707.03 and 1707.04. Section 1707.05, for example, imposes upon persons who sell

securities in reliance upon any of the private offering exemptions the obligation to file **post hoc** reports concerning such transactions and to pay a reduced filing fee. This is somewhat comparable to the Form 3-O filing (notification of a claim of exemption) required under current law [existing § 1707.03(O)]. OSA §1707.06 contains another example of this type of provision. It authorizes the Commissioner to adopt rules which modify or further condition all of the transaction exemptions specified in §1707.04 and certain selected securities exemptions specified in §1707.03 whenever he determines that such rules are necessary to protect investors or the public interest by reason of continuing acts or practices in the use of these exemptions which have been found to be dishonest, unconscionable or fraudulent. Section 1707.43(E) also gives the Commissioner the general power to exempt, by rule, any class of securities, persons, or matters from any of the provisions of the OSA, including the registration provisions, if the exemption is appropriate in the public interest and consistent with the purposes fairly intended by the policies and provisions of the act. And OSA §1707.07 codifies the traditional rule that the burden of proving the applicability or availability of an exemption or an exception from a definition is on the person claiming it. As a consequence of these statutes, a person who desires to effect transactions pursuant to and in reliance upon one or more of the general or special exemptions will want to consult the Commissioner's rule-book before doing so.

In the next issue, some of these exemptions, particularly those contained in the definitions of the terms "security" and "sale", will be reviewed.

Kenneth M. Royalty

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## OHIO SECURITIES ACT

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**OTHER DEVELOPMENTS****Personnel Changes**

A new look has been brought to the Division of Securities this year with the creation of new positions of responsibility and the hiring of additional personnel. William P. Boardman, formerly an associate with Wright, Harlor, Morris & Arnold, has been appointed to the position of Deputy Commissioner.

Appointments to newly created positions on the Commissioner's staff have resulted in the promotion of three former Division Attorney-Examiners and the hiring of an additional experienced attorney. Robert J. DeLambo is now Chief Counsel to the Commissioner. Kenneth M. Royalty, formerly of the law firm of Vorys, Sater, Seymour & Pease, has been hired as Counsel for Policy Development. Fred Elefant is now Policy Coordinator for the Division. The final position on the Commissioner's staff, Staff Attorney for Administration, has been filled by Gregory D. Seeley.

The Registration Section of the Division has undergone significant personnel changes. Bernard G. Boiston has been promoted to Supervisor of the section. Warren J. Williams, an Attorney-Examiner and Lee A. Passell, a Financial Analyst, have been respectively placed in charge of all interstate corporate and noncorporate offerings received by the Division. Four Financial Analysts have been hired in recent months to handle registration filings: R. Michael Jones, Joseph Bellino, H. Michael Sewell and Thomas Simon. In addition, two third-year students at Case-Western Reserve Law School, Alan P. Baden and Nelson Genshaft have been hired as Attorney-Examiners. They will be joining the Division this summer.

The Enforcement Section has added three attorneys to its staff. Veronica M. Dever, a former Assistant Police Prosecutor for the City of Cleveland, joined the Division earlier this year as Assistant Attorney-Inspector. Miss Dever was recently promoted to Attorney-Inspector. Sidney J. Silvian, formerly of the Legal Aid Society of Cincinnati, has been hired as an Assistant Attorney-Inspector. Alexander Martin has moved from the Real Estate Commission to the Enforcement Section as an Assistant Attorney-Inspector.

Fred Elefant

**ORGANIZATION OF THE DIVISION**

**Commissioner of Securities** — William L. Case, III

**Deputy Commissioner** — William P. Boardman

**Commissioner's Staff**

Chief Counsel — Robert J. DeLambo

Counsel for Policy Development — Kenneth M. Royalty

Policy Coordinator — Fred Elefant

Staff Attorney for Administration — Gregory D. Seeley

**Supervisors of Division Sections**

Registration — Bernard Boiston

Enforcement — Veronica M. Dever

Broker-Dealer — Elbridge Lewis

Foreign Real Estate — George A. Ward

Audit — James Hurd

Consumer Finance — Robert Fickell

Credit Union — John Gouch

**THE SECTIONS****BROKER-DEALER****Industry Income Down****Brokers Cautioned on Excess Subordination**

With commission income down, broker-dealer principals would be well advised to look carefully at their net capital.

Net capital should not include more than 25% equity capital and no more than 50% subordinated capital. When partners' personal accounts are considered in the total, no margin action should be attempted.

Subordination agreements should be dated, signed and witnessed. Copies should be on file at the Division.

Whatever is subordinated should be identified, so that a market value can be placed on it. Rest assured all regulatory agencies will consider these points of interest.

**Options Exchange Opens**

With rosy first quarter financial reports, industry generally faces the future optimistically. Not so for the stock trading industry; lay-offs have been planned, and principals have cast about for more subordination or a merger with a stronger firm. The small investor has picked up his money, and deserted the market-place taking his commission generating capacity with him.

A new exchange has been formed to deal in puts and calls. The Chicago Board of Options Exchange has been registered and approved in most of the states, including Ohio. The Exchange was required to register in Ohio since the Division could not recognize it as an exchange for purposes of the exemption provided by Section 1707.02 (E). The Division will closely scrutinize the operations of the Exchange, to insure that Ohio investors have sufficient information upon which to make informed investment decisions. The suitability requirements that appear in the Articles of the Exchange must be strictly adhered to.

The initial registration of the Exchange in Ohio is for a period of one year, and includes \$500,000 worth of option contracts. During that year and thereafter, additional requirements may be set forth by the Division to safeguard the investors.

Gordon Stott

**CONSUMER FINANCE****General Activities**

On January 3, 1973, the National Commission on Consumer Finance released its final report to the President and Congress of the United States. It contains the empirical data, information and analysis of some three years of research and study, together with 85 recommendations with regard to "Consumer Credit in the United States".

In addition to recommendations as to specific transactions in almost all phases and classes of consumer credit, it concludes that "free and fair competition is the ultimate and most effective protector of consumers" and that "we also favored making federally chartered financial institutions subject to state as well as Federal examination for compliance with state laws governing the terms and conditions of consumer credit extensions." There are many recommendations aimed at improvement of existing state laws and the improvement of their existing regulation and administration.

Although there has been a tendency to haphazardly use some of the recommendations by both industry and administrators, the Consumer Finance Section has commenced an open-minded, in-depth study of all of the recommendations to be correlated with its own research as related to Ohio's specific economic, geographic and demographic problems which we believe to be in keeping with the N.C.C.F. findings.

A new format of instruction has been drafted and will shortly be released to standardize and expedite the registration of debt securities by consumer finance companies, recognizing the idiosyncracies of this industry in the total concept of securities.

Procedural changes have been inaugurated in compliance examinations which result in less detail for both the industry and our personnel with the net result of much speedier cash refunds to the consumer on the occasional computation errors disclosed by compliance examinations.

In addition to the research proposed by the N.C.C.F., the Section is also supplying statistical information to Asst. Professor David R. Durst of the Department of Finance of the University of Akron who has recently completed a study and dissertation on the problems of the independent consumer finance company in Ohio. It is soon to be published in book form and he has received an additional grant from the university for further studies.

The Section continues to support and encourage education of the consumer in consumer credit transactions.

I expect to attend the National Convention of State Administrators of consumer credit, where I hope to acquire much additional information on the changing world of credit administration.

**CREDIT UNION****Share Deposit Insurance**

State chartered credit unions are eligible to apply for share deposit insurance under the federal program through the National Credit Union Administration. Of 700 state chartered credit unions in Ohio, approximately 130 have applied for and have been accepted for coverage under NCUA's program of insurance.

A growing interest in alternatives to federal share deposit insurance has spurred the necessary legislation to form The Ohio Credit Union Shareowner's Guaranty Association. Legislation introduced as S.B. 269 by Senator Morris Jackson (D-Cleveland) will be considered by the current session of the legislature.

S.B. 270 proposes to amend Chapter 1733 of the Ohio Revised Code, commonly known as the Ohio Credit Union Act. Designed as a house-keeping bill to correct language and nominal oversights in the present Act, the amendments seek to advance annual reporting dates for credit union financials from March 15 to January 31. The method of payment of the annual supervisory fee to the Division of Securities will be advanced to within 15 days of billing — which billing will be made after receipt of the annual financial report due January 31. The supervisory fee will be 1% of the assets of the credit union as of the preceding December 31, not to exceed \$2,000. Fee for examination will be billed as performed. Examination fee and Supervisory fee combined will not exceed \$2,000.

Section 1733.36 redefines suspension authority of the Division of Securities. It provides for more flexibility on the part of the Division in enforcement of the statute.

The current posture of the Division in relation to the supervision of credit unions in the state reflects emphasis more in the regulation of credit unions rather than supervision. Previous administrations placed much emphasis on the "how to" or "show me" attitude of the supervisory section, bringing credit unions around either to fiscal soundness or at least in compliance with statutes. The position of educational administration must be passed on to existing channels available to credit unions, their trade associations and regional associations.

Recent Division Orders, suspending normal operations of credit unions for either noncompliance with statutory provisions or impairment of shares due to excessive delinquency and deficient reserves, have alarmed and alerted the industry. The credit unions suspended, however, have indicated that the suspension of operations has brought about both a reorganization of official family and a rededication to the job to be done by the volunteer staff. Hopefully the prevailing positive attitude of these credit unions will be spread and lessen the need for future suspension orders.

**ENFORCEMENT*****State of Ohio vs Abdulla***

Having a law declared unconstitutional creates interesting problems for a regulatory agency. In the recent case of *State of Ohio vs. Abdulla*, the Ohio Securities Act, Chapter 1707, was declared unconstitutional by a visiting judge, sitting in Summit County, while hearing a pre-trial motion in a criminal matter. The basis of the judge's reasoning, as expressed in his opinion dated March 14, 1973, was that the law was applied unequally and that the decision whether or not to prosecute was made in an arbitrary and capricious manner, without any semblance of reasoning or standards.

What is the Enforcement Section doing in light of the decision in the Abdulla Case? How can one proceed under an "unconstitutional law"? The Enforcement Section is continuing to enforce the law of Ohio, pending the appeal of Judge Saunder's decision. One answer to the problem of equal application of the law might be to fully prosecute all violations no matter how technical in nature and not utilize any discretion at all — to charge all violators and to let the grand juries across the state make the decisions. This, of course, is not a reasonable alternative since all violations are not willful or flagrant and many violators are, in fact, ignorant of the law which they have violated. The Division will continue to make basic judgments with respect to the nature and effect of the violation following the investigation of complaints and will proceed on the basis of those determinations.

What are we doing about complaints and how are we handling them? Since January, the Enforcement Section has been employing additional staff. At the present time, this staff includes three full-time attorneys, three full-time investigators, one part-time investigator, and clerical support. This will enable this section to move forward both quickly and vigorously on all complaints received. In the near future, this section hopes to be able to handle all Form 39 penalty filings as well.

Veronica Dever

**FOREIGN REAL ESTATE****Foreign Land Sales**

Since enactment of the original Ohio Securities Act in 1913, the Division of Securities has had jurisdiction over the sale in Ohio of interests in foreign real estate. The law requires that the offering and sale of foreign real estate be preceded by the physical inspection and registration of the subdivision and concurrent licensing of the developer and other brokers participating in the selling effort.

Evolution of the recent interstate land sales boom is traceable from the mid-fifties with early Ohio registrants being Venice South, Lehigh Acres, Cape Coral, Port

Charlotte and Deltona. Earlier, smaller developments were offered in Ohio by mail and newspaper advertising only. Platted homesites were offered without thought or plan for amenities. Subdivisions now offer a range of one thousand to one hundred thousand acres or more. Developments now offer central sewerage, utilities and recreational facilities such as golf courses, lakes, parks, and green belts. Florida continues to be the most active development area with Disneyworld as the strong attraction.

Although the interstate land industry is beginning to comply with standards of development, the phenomenal expansion of the industry has brought on objectionable selling practices which have discredited the industry as a whole. In some instances, overzealous brokers and salesmen have been guilty of inducing sales using the following techniques: 1) Assuring the purchaser that he will be able to resell or that the company will be able to resell the property for him at a profit after only one year; 2) Creating the illusion that prevalent price increases by developers is evidence of value increase and of the assurance of a secondary market; 3) Selling elderly people extended pay-out contracts and delayed development commitments, patently evidencing probability purchasers will not live to use or profit from the purchase or the property.

A developing trend is the elimination of selling agreements with Ohio brokers as independent contractors. Developers are increasingly willing to place salesmen in Ohio to become authorized to do business in Ohio for assurance of direct control through its own agents. Many developers are organizing and licensing wholly owned subsidiary Ohio corporations as marketing outlets.

In the past year, Ohio has denied registration to four developments designated and offered as "improved acreage" when offered in minimum parcels of one and one-quarter acres. Such developments are deemed conceived and promoted on the basis of area appeal and publicity generated by Disneyworld and proximate competitive homesite developments. Improved acreage sites carry no restrictions on use. The minimal size, however, precludes an ultimate use except for homesite or commercial. Developers make no provision or commitments to insure development or amenities. Selling inducement must, of course, be pitched on an investment potential that is lacking from the outset. It follows that widely separated non-resident property owners are rendered ineffective to proceed on their own with potential value enhancement. In Polk County, Florida alone, there are 38 subdivisions of 1/2 acre minimal size lots with no provision for future improvements, even as basic as roads.

The public is now more alert to sales practices utilizing puffing, pressure, and promise of profit. Complaints arising from purchasers' reliance upon sales misrepresentations to their detriment are referred to the Office of the Attorney-Inspector in the Division of Securities. Complaints should be in writing and should contain a detailed statement of specific facts resulting in the complaint.

