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# 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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## COMMENTS OF THE COMMISSIONER

1. *Budgetary Constraints:* The Division's budget allocation for the remaining three quarters of fiscal 1974 has been set at $1,077,000 by the Department of Commerce. This represents an annual budget of approximately $1,435,500 including all personnel, maintenance items, and equipment. The Division had requested an allocation of approximately $1,675,000 including funds for a number of new activities initiated after the preparation last year of the initial budget for this biennium which was submitted to the Governor. Its current allocation therefore represents a reduction of $240,000 below the level which the Division has suggested as adequate to enable it to continue its aggressive new program at existing levels of performance.

The general level of regulatory activity of all divisions of the Department of Commerce has increased during the past year to such an extent that it is necessary for all divisions to compete for funds which in the aggregate are not sufficient to satisfy all of their objectives. As a result, all divisions will be operating this year on allocations which will require stringent new measures designed to achieve every possible economy in order to maintain performance at the highest attainable levels. In the Division of Securities, this will mean that non-essential functions will be eliminated so that available resources can be utilized in connection with matters of highest priority. It is not likely that an adverse impact upon personnel levels in all areas can be entirely avoided. For the time being, proposed new positions will not be created and existing positions which have remained vacant this past summer pending a determination of the Division's budget allocation will not be filled. Although every attempt will be made to retain current employees, cutbacks can be expected in certain areas in order to meet the expenditure levels which have been set.

Like most other divisions of the Department of Commerce, the Division of Securities produces more revenue annually than it absorbs in expenditures. Additional requirements for funding will result from the enactment of the proposed new Ohio Securities Act, particularly with respect to the need which will arise considerably in advance of the effective date of the new law for increased staff personnel to prepare rules and regulations. The best solution to this problem would be the creation of a rotary funding mechanism for the Division of Securities to ensure the availability to it of resources commensurate with the level of service contemplated by the fee structure contained in the legislation which it implements. The Division intends to devote a great deal of attention to this long range funding question as deliberations on the new Securities Act progress in the legislature.

2. *Progress on New Securities Act:* On Saturday, September 8, the Corporation Law Committee of the Ohio State Bar Association passed a resolution recommending endorsement of Senate Bill 338 by the association. This resolution was the culmination of an entire year of analysis of the proposed new act by the committee and various of its sub-committees and of a long series of discussions by committee representatives with the Division of Securities. The Corporation Law Committee has been of invaluable assistance to the Division in the preparation of this legislation and we at the Division are looking forward to a continuation of the fine relationship between the Division and the Bar which has been established as a by-product of the entire process. The support of the Ohio State Bar Association and of its members will certainly prove to be a vital ingredient in the attainment of this greatly needed new securities law for Ohio.

On Wednesday and Thursday, September 19 and 20, the Senate Commerce and Labor Committee, chaired by Senator Howard Cook of Toledo, continued its hearings on Senate Bill 338. A presentation was made by the Division of Securities which focused upon those provisions of the proposed new Act which had received critical comment during the Division's earlier exposure process. During a lively session, several additional witnesses presented testimony in opposition to a limited number of provisions which closely paralleled those to which the Division had addressed its own presentation. The hearings therefore served to ideally crystalize the issues which at this point remain a source of controversey in connection with this legislation. Among those matters discussed were provisions governing custody or control of customer's funds and securities by intrastate broker-dealers, limitations upon registration by notification and the impact of these limitations upon offerings by churches and consumer finance companies, and the transfer of jurisdiction over insurance company offerings from the Department of Insurance to the Division of Securities. The Division is extremely pleased with the results of these very productive hearings and it would appear that further consideration of this bill by the committee should proceed rapidly from this point forward. The Division has scheduled a series of meetings during the first week of October with representatives of groups which expressed opposition at the hearings in an attempt to satisfactorily resolve existing differences wherever possible. Revisions of the bill to be proposed by the Division will be presented to the Commerce and Labor Committee on October 22. The Division is gratified by the interest which Senator Cook and his committee have shown in this legislation and hopes that with the continued assistance of all of those who have helped in the preparation of the new Act, it can be made ready to be reported out of committee early during the next legislative session beginning in January.

3. *Redirection of Audit Function:* The Audit Section has historically carried on its activities for the most part independently of the general enforcement program of the Attorney-Inspector's office. It has divided its time between three functions on approximately the following basis: random sampling of pre-effective and post-effective registrations – 60%; processing of Form 23 Reports – 20%; and conduct of examinations in connection with Enforcement Section investigations – 20%. Although the first two of these three functions are acknowledged to be important, it would appear that the auditing resources of the Division could be utilized much more effectively if the bulk of these resources were devoted to specifically focused objectives set forth as an integral part of the overall Enforcement Section program of regulation. In this manner, attention could be focused in depth from time to time directly upon areas of securities activity which are particularly conducive to patterns of violation. Accordingly, the Audit Section of the Division has as of October 1, been incorporated into the Enforcement Section and will function in the future at the direction of the Attorney-Inspector.

4. *Securities Conference:* In the July issue of the **Bulletin**, an announcement was made regarding the Division's intention to convene a one day conference for the purpose of explaining the new corporate registration guidelines and answering questions which persons might have regarding policies and procedures of the Registration, Broker-Dealer, Audit and Enforcement Sections. Written indications of interest in attending such a conference were requested at that time. Although the response to the Division's announcement was not as great as had been expected, falling short of the one hundred potential participants which were considered necessary to justify this type of undertaking, the Division believes that the importance of providing communications with the Bar and industry is great enough that this conference should nevertheless be conducted but on a less formal basis. The Division therefore announces that a one day conference will be held on Friday, November 16, 1973, at the Neil House Hotel, 41 South High Street, Columbus, Ohio from 9:00 a.m. until 12:00 noon, and from 1:30 p.m. until 5:00 p.m. No specific arrangements will be made for the noon meal and persons attending will be requested to make individual luncheon arrangements. The program format will remain intentionally flexible. A presentation will be made by the Division regarding the new corporate registration guidelines and other new policy developments which have taken place during this year. Approximately half of the time available will be devoted to answering questions and receiving comments regarding Division policies, and the Commissioner, Deputy Commissioner, Chief Counsel, Counsel for Policy Development and Supervisors of the Registration, Broker-Dealer, and Enforcement Sections will be available to respond to inquiries which may be received. A nominal admission charge of $5.00 per person will be collected at the door. Despite the relative informality of this conference which results in part from uncertainty as to how large an attendance can be expected, the Division believes that it can be extremely productive and beneficial to those who participate. We therefore urge persons interested in Division policies to attend.

William L. Case, III

## POLICY DEVELOPMENTS

### Change in Division's Position Regarding Mergers and Consolidations

Contained in this issue of the **Bulletin** is an Interpretive Opinion regarding the availability of Ohio Revised Code Section 1707.03(K)(2) as an exemption from registration and licensing requirements for an offering of securities in connection with a merger or consolidation transaction involving two or more separate corporate entities. The conclusion reached in this opinion is that no exemption is available for such transactions by reason of this section. This conclusion is clearly the correct result as a matter of statutory interpretation, not only because of the absense of ambiguity in the language itself and the tortuous nature of the two-step legal fiction which had been created and perpetuated in the form of Administrative Ruling No. 2 to reach the contrary result but also because of the increased recognition of a need for regulatory control to assure adequate disclosure in transactions of this type evidenced by the current position of the Securities and Exchange Commission on mergers and consolidations as expressed in Rule 145.

The intention of the Division to implement a change of policy with respect to the interpretation of Section 1707.03(K)(2) was originally expressed in the Statement of Policy published in the **Ohio Bar** on September 20, 1971, and the Division announced in that statement that it would take a no-action position with respect to issuers proceeding with transactions in reliance upon Administrative Ruling No. 2 pending a final determination of the matter. No further statement has been forthcoming and as a result the Division has been following a course of action in connection with its registration and enforcement activities which is inconsistent with its own interpretation of the Ohio Securities Act for a much longer period of time than was originally anticipated. In the intervening period no convincing legal argument has been presented to the Division which would lead it to change its interpretation of the Act. It is convinced that there is no legal authority to justify the continuation of its no-action position on an indefinite basis. Therefore, the Division hereby announces that it will bring its administrative posture into conformity with its understanding of the law by rescinding its no-action position with respect to mergers and consolidations.

The Division realizes that requiring registration and licensing for transactions of this type will cause considerable inconvenience to some issuers. It has announced in the July issue of the **Bulletin** an expedited procedure for satisfying the licensing requirements and has included in the proposed new Ohio Securities Act a series of exemptions which will remove registration and licensing requirements from the vast majority of corporate reorganizations. In order to allow transactions which have already been initiated in reliance on its previous no-action position to be consummated the Division will withhold implementation of the change in its position which is announced herein until January 1, 1974.

**Report on the Status of Written Policy Guidelines 1973-2; Request for Comments**

As part of the process of developing, adopting, and publishing a comprehensive body of uniform regulatory standards which will govern the registration of securities and the regulation of the persons who sell them, the Ohio Division of Securities has undertaken to organize and restate, in the form of written policy guidelines, the basic policies and general standards which are currently being applied by the Division in making determinations as to whether or not a proposed offering of corporate securities is to be made upon grossly unfair terms. This first step has now been accomplished and the set of standards entitled "Written Policy Guidelines 1973-2", which were published in the three preceding issues of the **Ohio Securities Bulletin** (June, July and August 1973) are the fruits of that effort.

During the course of this undertaking, several things have become apparent to those of us who have been involved in this project. First, there are a number of subject matter areas where a specific Division policy had not previously been established and regularly applied (except perhaps on an *ad hoc* basis only) or, if it had been established, it had not been definitely formulated. Thus, in several instances, the Guidelines have attempted to fill in these gaps and to formulate a new policy which is to be followed in the future (unless, of course, it proves to be unworkable).

Second, it has also become evident that Division policy has changed considerably over the years and that the materials which have heretofore been published and disseminated as "Administrative Rulings" of the Division have not been revised so as to keep pace with and reflect this evolutionary development. Consequently, the Division has reconsidered the status of certain of these Administrative Rulings, i.e., those which interpret the phrase "grossly unfair terms", and has decided to rescind those Rulings which are no longer sufficiently indicative of what is actually being done by the Division insofar as the application of its registration policies is concerned. **Statement of Policy 1973-4,** which appears in this issue of the **Bulletin**, carries out this determination by announcing the rescission of Administrative Rulings numbered 16 through 20, inclusive, on October 1, 1973.

Third, the Division fully recognizes that it is difficult, if not impossible, to compile and to restate accurately within the period of a few short months all of the existing policies and standards which the Division may apply in evaluating a particular registration application. In the first place, it is impossible to anticipate and to provide for all of the varying fact patterns which are presented to the Division on a daily basis. It is even more difficult to determine whether the unusual or "exceptional" case is filed with enough frequency to warrant special treatment as an express exception to a general standard or whether it occurs so infrequently that the general standard should be "waived" as a matter of administrative discretion whenever such a case arises. Further, as almost everyone who has set his hand toward the task of drafting general rules knows, oftentimes it is difficult simply to state with precision that which is intended, i.e., what the standard actually is. Be that as it may, this first step has to be taken in order to let the public know what the standards are and also to provide a more orderly framework for future revision.

The next step in this particular phase of the rule-writing process is for the Division, with the aid of legal scholars, the securities industry and the organized Bar, to begin to re-evaluate, revise, redraft and republish the Guidelines in the form of a more comprehensive and definitive statement of policy – one which will have a more binding effect and which will ultimately be the basis for a comprehensive new set of Division Regulations to be promulgated pursuant to the Administration Procedure Act. As stated in the August issue of the **Bulletin**, the Division intends to reorganize, redraft and republish the Guidelines in a more usable form (probably as a booklet) in December of this year, with the material being organized on the basis of the subject matter covered rather than on the basis of reader interest. In this connection, the Division hereby formally announces that it is inviting written comments from the public on the form and substance of the Division's general policies with respect to the gross unfairness of corporate issues, as expressed in the Guidelines. Please address your comments to Mr. Nelson Genshaft, Ohio Division of Securities, 366 East Broad Street, Columbus, Ohio 43215.

Finally, in analyzing and commenting upon the Guidelines, it is important to bear in mind that these Guidelines are indeed "general standards"; they are, and will continue to be, no more than guides to aid the Division in the exercise of its discretion with respect to its evaluation of a particular registration application. Each proposed offering will continue to be judged on its own merits. It should also be emphasized that these Guidelines are intended to go hand-in-hand with the Division's **Statement of Policy 1973-2** entitled "Interim Registration Procedures", which was promulgated in the May, 1973 issue of the **Ohio Securities Bulletin.** That is to say, most of the Guidelines apply only to widespread *"public"* offerings of securities – which would include most offerings of the type not covered by Section II of the Statement of Policy on cursory review. The Guidelines are neither designed for, nor intended to apply to, the kind of limited offerings referred to in Section II because, in such cases, the offerees are presumed to be knowledgeable, experienced and resourceful enough to protect themselves and to make their own independent determinations as to the gross unfairness of a particular offering [see "Interpretation of Section II of Statement of Policy 1973-2", **Ohio Securities Bulletin**, August, 1973 at pp. 25-27]. Thus, all comments upon or applications of these standards should take into account this fundamental concept.

William L. Case III

## INTERPRETIVE OPINIONS

### "Merger and Consolidation"

The purpose of this interpretive opinion is to succinctly state as a final matter the Division's position on the meaning of Sections 1707.03(G)(2), 1707.03(I), and 1707.03(K)(2). It has come to the Division's attention that much confusion has resulted from the rescission of Administrative Ruling No. 2. in 1971, and the Statement of Policy which was published in the September 20th, 1971 issue of the **"Ohio Bar"**.

It is the position of the Division at this time that not all mergers and consolidations are exempt transactions, and that registration and licensing are therefore required unless a specific exemption for the particular security or transaction in question is available. Mergers, consolidations, transfers of assets, takeover bids, and tender offers, generally, will not be considered exempt transactions under Section 1707.03(K)(2). The only transactions which will be considered exempt under 1707.03(K)(2) are those involving exchanges by specific issuers with their existing security holders, where no third parties are involved. For example, if issuer "A" wishes to exchange its own convertible debentures for its own common stock with its existing common shareholders, such a transaction will be considered an exempt transaction under 1707.03(K)(2), so long as no remuneration or commission is given directly or indirectly for the solicitation of such exchange. In addition, any transaction which is merely a change in the issuer's domicile as provided for in Securities and Exchange Commission Rule 145(A)(2) will also be exempt.

The reasoning of Rule 145 is believed by the Division to be sufficient justification for applying the parameters of Section 1707.03(K)(2) to mergers, consolidations, and reorganizations in the manner described above. This interpretive opinion does not, however, apply solely to interstate transactions but will apply as well to transactions which are exempt from federal registration under either Section 3(a)(11) or Section 4(2) of the Securities Act of 1933.

The arguments proposed to the Division by members of the Bar concerning the various transaction exemptions contained in Section 1707.03 do not convince the Division that mergers and consolidations necessarily fit the requirements for these exemptions. One example is the claim that the exemption under Section 1707.03(G)(2) for the giving of any subscription rights, warrants, or options to purchase a security or the right to receive a security upon exchange, is available for a merger or share acquisition transaction with the completion of the transaction by the conversion of such right into another security of the same issuer also being exempt under Section 1707.03(I). This argument ignores the purpose of Section 1707.03(G)(2). It is the Division's position that this section specifically applies only to the situation where no sale is involved. Where consideration is tendered, there is a "sale" and no "giving" of the right as contemplated by (G)(2). The offeror in an exchange offer tenders a right to purchase its securities in return for consideration from the offeree in the form of the offeree's agreement to deliver his shares and, therefore no Section 1707.03(G)(2) transaction exists.

It should be pointed out to the members of the Ohio Bar that merger, consolidation or sale of assets transactions will be subject to registration, and that any such transaction which is consummated without registration will, unless otherwise exempt, be in violation of Chapter 1707 and give rise to civil remedies as well as possible administrative action by the Division. No immunity could have been derived from any previous contrary opinion by the Division concerning these sections nor would any such opinion be presumptive if relied upon, given Section 1707.45. The Division realizes that this provides little relief from the "inconvenience" of registration and licensing requirements, but because of the legislative history and the literal language of the statute, this result appears to be the clear intent of the drafters of the statute.

### Section 1707.06(A)(3): "Ten Persons"

The purpose of this interpretive opinion is to express the Division's interpretation of Section 1707.06(A)(3) and specifically the words, *"if the persons interested in such sale or any part of the subject matter thereof do not and will not, after such sale exceed ten . . .*

The question has arisen as to whether or not in the computation of the number of "persons", the individual partners in a partnership and the individual general partners and limited partners in a limited partnership would be included. This phrase, when applied to the definition of persons in 1707.01(D), could give rise to two interpretations. One might be that individual partners or general partners and limited partners should be included in the computation. However, in light of the legislative history of the Ohio Securities Act Section 1707.06 and its predecessor, Section 8624-6 of the General Code of Ohio, do not require this reading.

Therefore, the Division has chosen the alternative interpretation and considers the phrase in question to mean that in counting the number of persons, the partners in a partnership, the limited partners and general partners in a limited partnership, and the partners in a partnership association, as well as beneficiaries of a trust, or any other form of entity will not be included, and such entities will each be counted as one (1) person where they have previously been in existence, have an independent business purpose, and have not been created in order to provide a vehicle for investment in the securities being registered.

Alan P. Baden

## ILLUSTRATIVE RULINGS

*FACTS:* Corporation A (A-Corp) seeks to acquire control of Corporation B (B-Corp) through an exchange offer within the meaning of Section 368(a)(1)(B) of the Internal Revenue Code. Both are small, closely-held Ohio Corporations and an intrastate offering exemption is available. The directors of A-Corp meet with the directors of B-Corp to negotiate an exchange ratio; the directors of B-Corp have substantial holdings in A-Corp. Upon reaching a mutually agreeable ratio, the offer, in the form of a contract, is communicated to the shareholders of B-Corp who accept; but the contract contains an express provision that consummation of the transaction is conditioned upon approval by the Division of Securities of a registration by qualification.

*QUESTION:* May the Division properly entertain a registration of the securities of A-Corp under such circumstances.

*ANSWER:* Of course, the answer is no – registration by qualification is improper. At best, the entire transaction must be dissolved before proceeding with registration. One would think that this answer is obvious, but the Division has recently been plagued by filings with similar fact situations. Section 1707.01(C) of the Ohio Revised Code, in relevant parts, defines "sale" as:

> [A] contract to sell, an exchange, an attempt to sell, an option of sale, a solicitation of a sale, a solicitation of an offer to buy, a subscription, or an offer to sell, directly or indirectly, by agent, circular, pamphlet, advertisement, or otherwise . . .

The above fact situation falls squarely within said definition and it makes no difference that the actual exchange of securities is conditioned upon Division approval. Such a condition precedent may well have meaning under the law of contracts but is meaningless for purposes of Chapter 1707. The contention that a "sale" has not taken place because the securities have not yet been physically exchanged ignores the purpose of the Securities Act and negates the regulatory function of the Division. Clearly, registration is necessary *before* communication with the shareholders. Otherwise a violation of the Ohio Securities Act will result.

Briefly, the Division believes that an exchange offer should proceed in the following manner. The board of directors of the constituent corporations should meet and do what is minimally required to reach a satisfactory exchange ratio. Although, there is no clear exemption for such communications (assuming the directors are also shareholders) the Division does not intend to prohibit such communications so long as the negotiations are confined to those performing a management role. However, shareholders, even majority shareholders, should not be involved unless they are a part of management and are acting in an official capacity as an officer or director of the corporation. (Ideally, the negotiations would be conducted with directors who are not shareholders). Once the exchange ratio is achieved, the shares to be offered should be registered *before* the offer is communicated to the shareholders. What minimal disclosures need to be made to protect the corporation from potential liability can be handled through compliance with Rule 135 promulgated under the Securities Act of 1933.

The procedure outlined above is not intended to eliminate exchange offers in Ohio. We know that it is workable because interstate issuers follow it all the time in connection with federal filings.

Robert L. DeLambo

## REGULATORY STANDARDS

### STATEMENT OF POLICY 1973-4

**Rescission of Certain Administrative Rulings of the Ohio Division of Securities Regarding What Constitutes an Offering to be Made upon Grossly Unfair Terms**

In connection with the development and publication of **Written Policy Guidelines 1973-2,** the Division has reviewed some of the materials previously published and distributed to the public under the title "Administrative Rulings" of the Division, and has concluded that certain of these Rulings are no longer consistent with, or reasonably indicative of, the standards and policies which are now being applied in making determinations under Sections 1707.09 and 1707.13 of the Ohio Revised Code as to whether or not a proposed offering of corporate securities is to be made upon grossly unfair terms. As a result, the Division has decided to rescind Administrative Rulings numbered 16 through 20, inclusive, effective October 1, 1973. The reasons for the Division's action in respect of each of these Rulings is discussed below with the notice of its rescission.

I. *Administrative Ruling No. 16* (CCH Blue Sky Law Rep. ¶38,716)

While the Division agrees with the conclusion expressed in Administrative Ruling No. 16, it does not believe that Ruling 16 accurately states the existing policies of the Division insofar as they would apply to a widespread public offering of non-voting preferred stock by an undercapitalized promotional or start-up company. Further, the Division does not believe that the ultimate question of gross unfairness, in the case of a proposed public offering of non-voting preferred stock by a start-up company such as is described in Ruling 16, should be determined primarily by reference to standards of disclosure, that is, by the extent to which relevant information concerning the limitations on the rights of the holders of the preferred shares is to be made available to prospective purchasers of such preferred shares. For example, assuming that Ruling No. 16 describes a widespread *public* offering of non-convertible, non-voting, non-participating, cumulative preferred stock by an issuer which is a start-up or promotional company within the meaning of divisions I(O)(1) and (2) of the Guidelines, the Division would probably determine that the proposed offering is to be made upon grossly unfair terms in spite of the fact that the issuer proposes to make full disclosure to the prospective investor of the limitations on his rights as a preferred shareholder. The Division would probably so decide because of, among other things, the following:

(1) the issuer has no prior net earnings and cannot substantiate future net earnings (or demonstrate a substantial future net earnings capability) sufficient to cover the specified annual dividend requirements on such preferred stock [see divisions VII(A)(1)(a) to (b) and VII(B)(1) of the Guidelines; see also, division IX(A)(1)(a)];

(2) the holders of the preferred shares would not have the right to vote for the election of directors and to elect a specified percentage of the board of directors in the event of a cumulative default in the payment of eight (8) or more quarterly dividends [see division IX(B)(1) of the Guidelines];

(3) the proposed debt-to-equity ratio of the issuer would exceed the 3:1 standard set forth in division VII(A)(2) of the Guidelines; and

(4) it appears from the limited description of the facts that the equity investment of the promoters and managers of the issuer would not meet the minimum standard of 10% in cash and/or tangible assets, which is set forth in division III(A) of the Guidelines.

Also, if the Division were to look upon the "preferred stock" described in Ruling No. 16 as not being, "in the real sense of the word", a senior security or "preferred stock", but rather another class of "common stock" (as the Ruling suggests), then the "common stock" which is to be issued to management would be subject to all of the standards relating thereto [see, e.g., *inter alia,* divisions II(F), IV(A)(2), V(A) and IX(A)(2) & IX(D) of the Guidelines].

In sum, if the proposed offering described in Ruling 16 were in fact to be made to the public generally and not just to the holders of the "common shares", it would contravene a number of the existing policies of the Division, and, in such a case, the Division believes that the average public investor would neither understand nor appreciate the nature and significance of the limitations on his rights as a preferred shareholder, even if such limitations were adequately disclosed to him. Consequently, the suggestion in Ruling 16 to the effect that the defects in the proposed offering could be corrected merely by proof of effective disclosure and/or by adding provisions to the articles of incorporation so as to grant some voting rights to the holders of the preferred shares is considered to be incomplete and possibly misleading. On the other hand, if an offering of preferred stock such as is described in Ruling 16 were to be made only to the holders of the common shares, or only to a limited number of sophisticated investors in what was essentially a private offering, then the Division might well conclude that effective disclosure might be sufficient to render the foregoing policies inapplicable [see the Division's **Statement of Policy 1973-2** entitled "Interim Registration Procedures" (OSB, May 1973) and the "Interpretation" thereof in the **Ohio Securities Bulletin,** August, 1973]. Either way one views it, Ruling 16 does not give a clear indication as to how and why the Division is likely to react to a proposal of the type so described.

Accordingly, it is hereby announced that Administrative Ruling No. 16 is rescinded effective October 1, 1973 for the reasons stated above.

II. *Administrative Ruling No. 17* (CCH Blue Sky Law Rep. ¶38,717)

The Division continues to adhere to the principle expressed in Administrative Ruling No. 17, which is to the effect that the issuance and sale of non-cumulative preferred stock is not, in itself, grossly unfair, so long as the preferred shareholders will be entitled to vote in the event of a cumulative default in the payment of dividends [see division IX(B)(1) & (2)(c)], and so long as the other standards relating to the issuance and sale of preferred stock are met [see generally, divisions VII(A), IX(A) and IX(B)(1) & (2)]. The problem with Ruling No. 17, however, is that it deals with but one aspect of what is admittedly a rather complex problem [see generally, divisions VII(A) and IX(A), (B) & (D) of the Guidelines, and the discussion concerning Ruling 16 above]. Thus, while the Division believes that Ruling 17 does contain an accurate statement of existing policy, the Division also feels that it does not go very far in informing an applicant about the factors which will be considered in reviewing an application to register a public offering of non-cumulative preferred stock.

Because of the foregoing, it is hereby announced that Administrative Ruling No. 17 is rescinded effective October 1, 1973.

III. *Administrative Ruling No. 18* (CCH Blue Sky Law Rep. ¶38,718)

On the basis of the limited statement of facts contained in Administrative Ruling No. 18, this Ruling is considered to be an accurate reflection of the result which would obtain under the principles expressed in divisions IX(A)(1) & (2) and IX(D) of the Guidelines. Again, however, Ruling 18 does not indicate what other standards would be applied by the Division in its overall evaluation of the proposed offering.

Accordingly, it is announced that Administrative Ruling No. 18 is rescinded effective October 1, 1973, for the reasons stated herein.

IV. *Administrative Ruling No. 19* (CCH Blue Sky Law Rep. ¶38,719)

It is believed that Administrative Ruling No. 19 fairly states the general policy of the Division with respect to a proposed public offering and sale of securities of the same class to different purchasers at varying prices in the same offering or at approximately the same time [see division X(A) of the Guidelines]. However, Ruling 19 appears to apply this general standard in a case where a portion of the issue is to be offered to a "preferred list of employees" of the issuer for a price lower than the proposed net public offering price of the remainder of the issue. If it is assumed that such "preferred list of employees" includes some or all of the officers and directors of the issuer, and if it is also assumed that the issuer is a promotional company within the meaning of divisions I(O)(3) & (4) of the Guidelines, then the portion of the issue which is to be offered and sold to the insiders would probably be viewed as promotional shares (or cheap stock), in which case the offering would not be deemed grossly unfair, but merely subject to the standards concerning promotional shares [see, e.g., divisions II(F), IV(A)(2) and V(A) of the Guidelines]. If, on the other hand, the offering which is to be made to the employees of the issuer is to be made to all or a substantial number of the employees as a class, including non-supervisory employees and without regard to their position in the issuer's organization, then such employees might be viewed as but one segment of the general investing public; and, in the latter case, either the general principal expressed in division X(A) or possibly one of the special exceptions or exclusions described in division X(A) might be applied, depending upon how the underwriting and selling expense arrangements were framed. Also, if the issuer is a going concern rather than a promotional company, the proposed offering might be deemed unfair because of the proposed sale of cheap stock to insiders [see division IV(A)(1) of the Guidelines]. In short, Ruling 19 does not adequately indicate what considerations may be involved in the Division's review of an application to register an issue similar to that described in the Ruling. Moreover, to the extent that Question No. 2 of Ruling 19 implies that an underwriting commission equal to 20% of the aggregate selling price would be permitted, it must be viewed as being misleading [see division VI(A) of the Guidelines].

Consequently, it is hereby announced that Administrative Ruling No. 19 is rescinded effective October 1, 1973.

V. *Administrative Ruling No. 20* (CCH Blue Sky Law Rep. ¶38,720)

Administrative Ruling 20, like Ruling 19, appears to describe an offering wherein promotional shares (or cheap stock) will be sold to persons who are promoters or affiliates of a promotional company either prior to or in connection with a public offering of such issuer's equity securities. To the extent that Ruling 20 suggests that such an offering will be viewed as being grossly unfair *per se,* it must be deemed to be inaccurate and misleading, insofar as it purports to express the current policies of the Division [see the discussion of Rulings 16 and 19 above].

Accordingly, it is hereby announced that Administrative Ruling No. 20 is rescinded effective October 1, 1973 as being in conflict with division IV(A)(2) of the Guidelines.

## PROPOSED NEW STATEMENTS OF POLICY TO BE CONSIDERED BY THE CENTRAL STATES ADMINISTRATORS COUNCIL

The Central States Administrators Council is considering proposals to adopt four different statements of policy pertaining to voting trusts, blank perferred stock, the terms of escrow requirements for the escrow of cheap stock and certain investment and other restrictions for closed-end investment companies, respectively. In connection with its review of these matters, the Division of Securities is publishing the text of these proposals and calling for public comment and criticism on the relative merits of each. Accordingly, all interested persons are invited to submit written comments on these proposals so that the Division may take their comments into account before deciding whether (1) to vote for or against such proposals when they are formally considered by the Council, and (2) to adopt, modify or reject such proposals as part of the Division's announced policy on these subjects.

Please address your comments to Nelson Genshaft, Ohio Division of Securities, 366 East Broad Street, Columbus, Ohio 43215.

I. *Voting Trusts*

In connection with an equity public offering, a voting trust holding 25% or more of the total number of shares outstanding upon completion of the offering shall contain terms permitting each member thereof the opportunity to remove his shares from the trust at least once each year commencing on the second anniversary date of the trust's formation, upon 60 days prior written notice.

II. *Blank Preferred Stock*

(1) No preferred stock which is authorized, but unissued at the time of registration, and which does not contain the voting preference, if any, or basis of conversion, if any, shall:

(a) Be issued subsequent to the date of the offering if it has disproportionate voting rights unless such issuance shall be approved by a 2/3 vote of the outstanding shares.

(b) Be issued for anything other than fair and equitable consideration.

(c) Be convertible into common shares at a price less than the fair market value of the underlying common stock on the date of issuance.

(2) The foregoing provisions shall be prominently disclosed in the prospectus.

III. *Terms of Escrow Requirements*

As a condition of registration the administrator may require, as to any securities issued or to be issued to a promoter for consideration less than the public offering price, that such securities be deposited in escrow to the extent that the consideration paid for the securities is less than the public offering price.

(1) Cheap stock subject to an escrow agreement pursuant to a public offering may not be released until such time as the company has demonstrated by independent certified audited financials a net earnings per share, after tax and before extraordinary items, based on all issued and outstanding shares, adjusted for stock splits and stock dividends, of 5% of the public offering price per share for any 3 years following the public offering, 2 of which must be consecutive. If within 5 years after the date of the escrow agreement, the escrowed shares have not been released from the escrow requirements, the owners of the escrowed shares shall collectively elect to:

(a) return to the issuer and cancel a sufficient number of escrowed shares to cause the issuer's total five-year earnings per share, after tax and before extraordinary items, based on all issued and outstanding shares, adjusted for stock splits and stock dividends, to be 12% of the public offering price, in which case the escrow agreement shall be terminated and the remaining shares released from escrow; or

(b) Submit to the administrator a proposal for extension or modification of the escrow agreement. Notice of the proposal shall be given to all of the shareholders in such form as the administrator requires and a hearing thereon may be called at the request of any shareholder or the administrator. The burden of justifying an extension or modification of the escrow agreement shall be on the owners of the escrowed shares. After such notice and opportunity for hearing, the administrator may order extension or modification of the escrow agreement upon such terms as he deems fair and equitable. If the escrow agreement is not so extended or modified, the owners of the escrowed shares shall return shares to the issuer for cancellation as specified in subparagraph (a) of this section.

(2) The foregoing notwithstanding, securities may be released if the public offering is terminated and no securities were sold, or if all of the purchasers in the public offering join in petitioning for release of the securities from escrow.

(3) The shares held under an escrow agreement pursuant to a public offering, shall not have any right, title, interest, or participation in the assets of the company in the event of dissolution, liquidation, merger, consolidation, reorganization, sale of assets, exchanges or any transaction or proceeding which contemplates or results in the distribution of the assets of the company, until the holders of all unescrowed shares sold in the offering have been paid, or have had irrevocably set aside for them an amount equal to their purchase price per share, adjusted for stock splits and stock dividends. Subsequently, the escrowed shares shall be entitled to receive an amount equal to the tangible consideration furnished for the shares, and thereafter, all shareholders shall participate ratably.

(4) Shares held under an escrow agreement shall continue to have all voting rights to which those shares are entitled. Any dividends paid on such shares shall be paid to the escrow agent and held pursuant to the terms of the agreement. Such dividends may be used to satisfy the requirements of paragraph (3) of this policy.

(5) The administrator may require that the escrow agreement include provisions to permit the administrator, upon a finding of a violation of the securities act or rules thereunder, and where necessary for the protection of security holders and in the public interest, after prior notice and opportunity for hearing, to order the cancellation in whole or in part of any escrowed securities.

(6) The terms and conditions of the escrow agreement may be terminated, revoked, modified, or released only upon the written consent of the administrator.

This policy is designed to standardize the conditions under which cheap stock is escrowed and released. Cheap stock would be subject to escrow to the extent that its purchase price is less than the public offering price.

**Example:** Promoters purchase 10,000 shares of Class A Common at $1 per share. The total consideration paid for such shares is $10,000. Class A Common is sold to the public at an initial offering price of $10 per share. In this case the promoters would be required to escrow 9,000 shares of their stock (the $10,000 paid for the cheap stock would have purchased 1,000 shares at the public offering price).

Performance criteria, based on earnings per share, are established for release of the escrowed securities. It is recognized that these performance criteria may not be appropriate for every business. Some new enterprises may not be expected to show a profit for several years. For these unique businesses, the administrator may choose to impose different escrow requirements or none at all or he may impose the requirements and place the burden of justifying an extension of the escrow agreement on the owners of the escrowed shares under paragraph (1)(b).

The policy also specifies additional terms and conditions under which the escrowed securities may be released, the voting and dividend rights of the securities while in escrow, and the authority of the administrator to order cancellation of the securities.

IV. *Closed End Investment Companies*

The offer or sale of securities of a closed-end investment company, as defined in the Investment Company Act of 1940, may be deemed unfair and inequitable to the purchasers thereof unless its prospectus, advisory contract, or organizational instruments include provisions satisfying the following requirements. Each registered investment company shall notify the administrator promptly when it is not in compliance with any of the following requirements, and its registration statements shall be subject to revocation or suspension.

(1) "Closed-end fund" means an investment company as defined in the Investment Company Act of 1940, the equity securities issued by which are not redeemable.

(2) No closed-end fund shall be registered for public offering in this state unless such fund adheres to, and discloses in its prospectus, each of the following policies:

(a) The fund shall not at any time, as to 100% of its total assets, at the time of purchase:

(1) invest more than 30% of its total assets in restricted debt securities; unless permitted by the administrator upon proper justification;

(2) invest more than 15% of its total assets in all forms of illiquid securities, including, but not limited to, commodities, real estate, general and limited partnership interests, oil and gas interests, options and warrants, puts, calls, straddles, spreads, and restricted securities, except as provided in (1) above;

(3) invest in securities carrying more than 10% of the voting rights of any issuer;

(4) invest in more than 10% of the equity securities of any one issuer;

(5) invest more than 10% of its total assets in the securities of real estate investment trusts or other investment companies, provided that investments in excess of 10% may be permitted by the administrator upon a showing that such investments involve no duplication to management or advisory services with those of the fund.

(b) The fund shall not at any time, as to 75% of its total assets, invest more than 5% of such assets in the securities of any one issuer.

(c) The fund shall not effect any brokerage transactions in its portfolio securities with any broker-dealer affiliated directly or indirectly with its investment adviser or manager, unless such transactions (including the frequency thereof, the receipt of commissions payable in connection therewith, and the selection of the affiliated broker-dealer effecting such transactions) are not unfair or inequitable to the shareholders of the fund.

(d) The aggregate annual expenses of every character paid or incurred by the fund, including management and advisory fees but excluding interest, taxes, brokerage commissions, and extraordinary expenses, whether such expenses are payable by the fund of its shareholders, calculated at least quarterly on a basis consistently applied, shall not exceed 1½% of the first $30,000,000 of its net assets and 1% of any additional net assets. The investment adviser or manager shall reimburse the fund not less often than annually for the amount by which such aggregate annual expenses exceed the amounts herein provided, up to an amount not exceeding its management and advisory fees for the period for which reimbursement is made, prior to publication of the company's annual report. The administrator may require the investment adviser or manager to maintain financial resources reasonably sufficient to enable it to meet its reimbursement obligations hereunder.

(3) Notwithstanding paragraph (2) above, because of the possible risk to the investor, no closed-end fund which engages in any of the following or related speculative activities shall be registered for public offering in this state unless the appropriate disclosure is made in bold face type on the cover of both the preliminary and final prospectuses, or on a prospectus supplement satisfactory in form to the administrator, as follows:

"These securities may involve a high degree of risk because the fund is authorized:

(a) to engage in short term trading resulting in portfolio turnover greater than 100% annually (see page )

(b) to leverage more than 10% of its total assets (see page )

(c) to invest more than 5% of assets in restricted securities exclusive of debt securities (see page )

(d) to engage in short sales (see page )

(e) to invest more than 5% of its total assets in foreign securities where fund pays interest equalization tax

(f) in relation to 85% of its total assets, to invest more than 5% of such assets in any one issuer."

## THE SECTIONS

### REGISTRATION SECTION
**Current Registration Problems**

This is my first article as Supervisor of the Registration Section, and I would like to discuss two critical problems which constantly arise within that section: (1) the proper time to register securities to be exchanged in mergers and stock-for-assets acquisitions, and (2) the necessity of an opinion of counsel when an issuer claims an exemption from federal registration.

## I. Mergers and Sale of Assets

### *A. Mergers*

Clearly, mergers constitute sales of securities and as such are registerable events, as Rule 145, promulgated under the Securities Act of 1933, indicates. Moreover, the Division now no longer recognizes any express exemption for these transactions and the Division's "no-action" posture in this regard will be rescinded as announced in the Policy Developments section of this issue of the **Bulletin**.

The only question which remains is when to register. If one analyzes a merger in terms of the classical definition of sale, the "offer" occurs when proxy solicitations are sent to the decedent company's shareholders, and the "acceptance" follows when the executed proxies are voted by management in favor of approval. The Division considers the proxy solicitation as a "sale" for purposes of Chapter 1707. Therefore, registration *must* be effected *before* the proxies are sent to the decedent's shareholders.

### *B. Sales of Assets*

Rule 145 clearly states that stock-for-assets acquisitions involve a sale of securities for purposes of the Securities Act of 1933. Similarly, the Division maintains that such transactions are registerable under the Ohio Securities Act.

In the past, issuers have attempted to avoid registration by claiming that the transaction should be considered in two parts: first a sale of assets to the offering corporation in exchange for its stock, and then a distribution of the offeror's stock in liquidation of the selling corporation (if the seller does not liquidate, then probably no registerable sale occurs). The issuer claims a "sale to an institutional investor" to exempt the first part, and a "distribution to existing shareholders" to exempt the second.

If the transaction were divisible into two steps, then the interaction of Sections 1707.03(D) and 1707.03(K)(2) would probably exempt it, but the Division feels that such a "step transaction" approach is inappropriate. The reality of a stock-for-assets acquisition is that the constituent corporations embark upon a single plan of distribution of the offeror's securities to the seller's shareholders, who must ultimately make an investment decision to accept a new security when they vote upon the sale of assets. Clearly a registerable event arises and registration *must* be effected prior to mailing the proxies to the shareholders of the selling corporation.

## II. Opinions of Counsel

Recently, the Registration Section has required an opinion of counsel whenever an issuer has claimed an exemption from federal registration. This practice has occurred most frequently with respect to private placements and intrastate offering exemptions. The reasons for such a policy are simple: 1) It would be unfair for the Division to permit an investor to involve himself in an offering which does not comply with federal registration provisions or is not exempt therefrom since a resulting lawsuit by other investors or by the SEC might jeopardize his investment, 2) Should an investor subsequently realize the deficiency, he may well be unable to effectively exercise his own rescission rights if he himself has been prejudiced, e.g., the issuer may be bankrupt or otherwise unable to return the investment, and; 3) It is against public policy for the Division to register an offering which will substantially violate state or federal law. Clearly, the Division has the right and the *duty* to ensure itself that the issuer complies with both the state and federal securities laws which are applicable.

Of course, we do not expect an attorney to become an insurer of an underwriter's conduct, nor do we expect him to render opinions *in futuro.* All we want is an opinion expressing that the attorney has advised his client of the elements of the claimed exemption and that based upon the client's individual circumstances and the intended plan of distribution, the offering will be exempt from federal registration. By "individual circumstances" we mean those aspects of the client's business which may relate to the claimed exemption. For example, we hardly expect an opinion stating that an issuer may avail itself of an intrastate offering exemption when the issuer's principal place of business is outside Ohio.

The Division will continue its policy of *uniformly* requiring opinions of counsel whenever a private placement pursuant to Section 4(2) of the 1933 Securities Act is claimed; and this will apply to *all* filings including those for which cursory review has been requested. With respect to intrastate offerings, we will selectively request an opinion if the filed documents indicate a questionable claim. "Intrastate Offerings" which clearly do not meet the tests of Section 3(a)(11) of the Securities Act of 1933 *will not be cleared* until brought into compliance by an appropriate federal filing or a restructuring of the offering.

Robert L. DeLambo

## ENFORCEMENT SECTION

### Inspection of Division Records

Section 1707.12 of the Ohio Revised Code states as follows:

"Documents open to inspection. All applications and other papers filed with the Division of Securities shall be open to inspection at all reasonable times, except for unreasonable or improper purposes, but information obtained by the division through any investigation shall be retained by the Division and shall not be available to inspection by persons other than those directly interested in it."

Some of the material contained in Division records consists of inter-office communications containing the comments of examiners. This type of data is considered to be the work product of the Division and is thus not available for inspection, even by interested persons. If the comments of examiners were not deemed privileged, communications between staff members and their supervisors would be less candid or would not be written at all. This would result in less effective regulation.

The Division is given broad discretion by the statute with regard to the disclosure of material obtained through investigation. Statements of witnesses and other primary data will be made available for inspection only when the Division deems it appropriate to do so. Reports of investigators are, like inter-office communications, considered to be the work product of the Division and are thus not available for inspection. Investigatory reports often contain confidential material as well as hearsay and other information which is not verified.

Persons desiring to inspect Division records must apply in writing for permission to make such inspection. If the person making the request is an attorney, his client must be identified.

Copies of documents filed with the Division are available upon request at the expense of the person making the request. If desired, these copies will be certified by the Division pursuant to Section 1707.30 of the Ohio Revised Code.

Veronica M. Dever

## BROKER-DEALER SECTION

**Self-Regulation and Compliance Within The Industry**

The following thoughts concern the compliance problems of interstate securities dealers and is intended as a guide to indicate various aspects of a firm's self-regulatory responsibilities. The primary duty of a firm's compliance department is to prevent unlawful activities by anyone, including its employees and customers. This outline may include items not applicable to some firms and omit matters which other firms consider important, but it would nevertheless appear desirable to give it general circulation as an aid to compliance efforts. Many of the ideas contained herein should be equally applicable to intrastate securities dealers to the extent that their individual resources allow:

*I. A Good Regulatory Program is Good Business*

1. It should place the interests of the firm above those of any individual in the firm.
2. It should reduce problems with customers and lead to better customer relations.
3. It should reduce adverse publicity.
4. It should reduce money spent on litigation, both governmental and private.
5. It should assist in the early identification of problem areas.
6. It should set such internal standards of conduct that it will encourage fair competition, both within and without the firm.

*II. A Good Regulatory Program Begins At The Top*

1. The firm as a whole must sincerely want to properly discharge its regulatory responsibilities.
2. A competent person must be put in charge.
   a. He must have proper training.
   b. He must have adequate experience.
3. He should have broad responsibilities.
4. He must be given adequate authority.
5. He must have an adequate staff.
6. He should be responsible directly to the firm's chief operating officer.
7. He must be given reasonable job security so that he can make difficult decisions without fear of losing his job.
8. He must have sufficient funds and appropriate allocation of EDP and other resources to carry out his responsibilities.
9. All regulatory functions should be placed in one department.

*III. Duties Of The Regulatory Responsibilities Department*

1. Consultation on hiring of sales and other key employees.
2. Training of new and existing salesmen.
3. Preparation and maintenance of a compliance manual.
4. Design and review of papers for new customer accounts.
5. Review of computer runs or other statistical data relating to transactions by the firm and its customers.
6. Establishment of procedures concerning purchase recommendations to customers.

7. Establishment of procedures concerning sales of securities.
8. Establishment of procedures concerning foreign customers.
9. Oversight of research department.
10. Oversight of firm's trading and market making activities.
11. Oversight of firm's back-office operations.
12. Oversight of firm's financial condition.
13. Review and disposition of customer complaint letters.
14. Inspection of branch offices.
15. Liaison and cooperation with regulatory authorities.
16. Initiation of disciplinary actions.
17. Review of adverse personnel actions.
18. Coordination of litigation.
19. Oversight of firm's advertising.
20. Review of prospective underwritings.
21. Review of outside connections of firm personnel.
22. Consultation on selection of new branch offices and determination of internal controls required for each.

IV. *Consultation On Hiring Of Sales And Other Key Employees*

1. Design and use an application form which will provide sufficient information to identify potential problem employees.
2. Make a detailed background check with emphasis on problem areas.
3. Be alert to background items which may indicate possible problems (high-pressure selling, job switching, lawsuits or disciplinary proceedings).
4. Make sure prospective salesmen are capable of understanding the duties imposed on them by the securities laws.
5. Ascertain that prospective salesmen have a willingness to comply with these requirements.

V. *Training New and Existing Salesmen*

1. Include compliance and regulatory matters along with sales techniques.
2. Alert them to what they can and cannot do.
3. Direct them to take problems to their supervisor.
4. Eliminate any firm policies which tend to put undue pressure on salesmen to produce, such as quotas or special arrangements as to certain securities.
5. Discourage them from necessarily emulating the tatics used by the biggest producer in the office.
6. Discuss actual problems.
7. Suggest appropriate solutions to such problems.

VI. *Preparation And Maintenance Of Compliance Manual*

1. Make sure it supports rather than replaces training.
2. Provide general operating instructions for salesmen in routine matters.
3. Include discussions of common problems and recommended solutions.
4. Make sure it contains reports or summaries and interpretations based on relevant regulatory and self-regulatory disciplinary actions.
5. Have it properly indexed for easy reference.
6. Include in the compliance manual.
   a. Opening of accounts, including knowing your customer.
   b. Handling of orders, including:
      1. Sales of securities not purchased through the firm.
      2. Definition of "solicited" and "unsolicited".
      3. Marking of orders as "solicited" or "unsolicited".
   c. Extensions of credit.
   d. Relations with customers.

e. Requirements of the securities laws and self-regulatory organizations with particular emphasis on such matters as:
   1. Insider trading.
   2. Sales of unregistered securities.
   3. Churning.
   4. Mutual fund switching and break points.
   5. Unsuitable recommendations.
   6. Recommendations of securities not on firm's approved list.
   7. Regulation T.
   8. Discretionary accounts.
   9. Unauthorized transactions.
   10. Brokers conflicts of interest.
   11. Relationships between salesmen and officials of public companies.
   12. Profit sharing and other financial interests in customers' accounts.
   13. Fictitious or nominee accounts.
   14. Check kiting.
   15. Free riding.
   16. Short selling.
   17. Securities transactions outside of the firm.
   18. Supervision of branch offices.
   19. Outside connections.
   20. Compliance with Rules 10b-5 and 10b-6.
   21. Manipulation.

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Elbridge Lewis

*(To Be Continued)*

## FOREIGN REAL ESTATE SECTION
**Secondary Market**

It has come to the attention of the Division that certain persons are attempting to establish secondary markets in foreign real estate. The current approach to this type of activity is the solicitation of advertising contracts. For a fee, persons will advertise an owner's property for sale in a catalog. It is the Division's position that these persons must be licensed pursuant to Section 1707.33 and 1707.331, since they *"sell, lease or otherwise deal in any interests in real estate not situated"* in the State of Ohio. The Division will attempt to prevent persons who have been sold poor real estate investments in the past from being taken advantage of again in their attempt to extricate themselves from their plight.

Basically, there have been two types of plans for which applications have been made to the Division for licensing. The first type involves merely a listing service which for a fixed fee, provides an advertising vehicle for a landowner. There is no relationship with the owner other than provision of their advertising service.

The Division believes that this listing service should be distinguished from newspaper advertising, since the publisher actively solicits advertising from individual owners by direct contact. A newspaper may solicit advertising, but does so primarily through its own advertising. With the listing service, on the other hand, salesmen know who are the owners cf foreign real estate in Ohio. They contact each owner individually and make a pitch for the listing service. For the protection of Ohio owners of foreign real estate, the Division believes that the listing service should be licensed. A broker-dealer's license should be obtained under Section 1707.331. In addition, the Division believes that a limitation should be placed upon the amount of the advertising fees. A maximum of $200 per lot is currently being allowed.

The Division also believes that to protect the Ohio owner from being placed on a "sucker list" no lister of foreign real estate in a secondary market should have a license to sell foreign real estate on a primary basis. The Division will ignore corporate forms in determining the affiliate relationships between any applicant for a secondary market license and any persons who hold a license to deal in a primary market.

The other type of secondary market operation is one where, again, a listing service is created, but the broker goes one step further and provides a personal sales vehicle for the owner. In this situation, the Division again believes that the fees should not exceed $200 prior to consummation of the sale. Should the individual be charged a commission for consummating the sale, the total fees should be limited to 6% of the final agreed sales price.

The Division will require that any person who is licensed to advertise foreign real estate owned by another for a fee have personal knowledge of the property. The Division will consider a personal inspection of the development in which the property is located to be equivalent to personal knowledge. Any person wishing to obtain a license from the Division must be willing to place conspicuously in each of his contracts, a statement setting forth the basis of his knowledge of the properties to be sold.

All secondary market advertising must be submitted to the Division for approval prior to its use. For the purposes of anonymity advertising must not contain the names of the individual owners. The Division does not intend to allow the circulation of additional "sucker lists" in the form of advertising catalogs.

Secondary market offerings must be limited to properties in developments previously registered with the Division, pursuant to Section 1707.33 or properties which qualified for an exemption from Chapter 1707 at the time sold.

It should be emphasized that the above requirements, and any others which may be imposed by the Division for the protection of Ohio owners of foreign real estate, are not exclusive and do not eliminate the necessity for an applicant's meeting the normal broker-dealer requirements set out in the Ohio Revised Code and in Division Regulations.

A secondary market in foreign real estate presents many legal problems due to the nature of land contracts which are used by developers, and the many laws which may come into play in interstate offerings through an advertising vehicle. The Division will reserve further comments on secondary markets for a later date, after the effects of these offerings upon Ohio consumers can be assessed. Meanwhile, no licenses will be granted for more than the period extending to the end of the current year.

Alan P. Baden

## CONSUMER FINANCE SECTION
### Money-Finders and Branch Compliance

During the past year, unregulated "money-finders" have been the object of complaints to the Division citing a variety of deceptive practices on their part. Quite often, federal and state Fair Trade Practice laws have been violated by these people in the conduct of their activities. In a few instances, second mortgage and small loan licensees have been found to be affiliated with them in one manner or another.

Involvement in the activities of these money-finders by legitimate second mortgage or consumer finance companies through referral arrangements or otherwise could establish these licensees as co-conspirators in formal actions by state and federal agencies. The Director of Commerce has broadcast consumer warnings throughout Ohio regarding the unconscionable operations of a few of these "arrangers" of loans who have been acting under the guise of being professional mortgage brokers. It is my hope that all contacts with unethical operators of this type by Division licensees can be prevented with the cooperation of the consumer finance industry. I would appreciate being notified of any solicitations by such persons which are received by managers of branch offices of regulated companies.

A poll was recently directed to Division examiners regarding the most frequent problems which are encountered in compliance examinations. A universal complaint concerning licensees cited the lack of knowledge on the part of branch managers of the applicable law governing their respective operations. Many managers have never seen the Revised Code of Ohio. A part of our field examination consists of a questionnaire to be filled out by the branch manager. Many managers do not do at all well in answering these questionnaires.

A branch manager should be well informed regarding the laws governing his operations, since experience and fitness are prerequisites to a license under Ohio Revised Code Section 1321.04(A). We are presently constructing a test designed to determine the extent of a person's knowledge of the basic elements of the small loan act and the second mortgage act. This test will be given to those managers whose apparent weakness in this area might constitute a violation of Section 1321.04(A). I am aware of the burdens carried by branch personnel but feel that a manager's knowledge of the laws under which he operates is fundamental to his job.

Robert P. Fickell

## CREDIT UNION SECTION
### Central Banking Function

The need for an institutional mechanism to provide liquidity to credit unions has been demonstrated dramatically in the past few months as the credit squeeze has steadily grown and interest rates have set new records.

It has been reported that six billion dollars of credit union funds are in liquid form and available for distribution among members of the industry. However, the means for clearing and reporting these funds is lacking. In Ohio, a few prominent credit unions have informally exercised a central banking function, but only to a limited extent and not without complications.

The Ohio Credit Union Shareowner's Guarantee Association, recently approved by the state legislature, will provide an additional source of liquidity for credit unions which are members of this corporation, but that is not its principal function.

The U.S. House of Representatives' Sub-Committee on Domestic Finance, under the chairmanship of Congressman Wright Patman, held hearings recently on HR-7, proposed legislation which would create a Credit Union National Bank. This bank would provide a source of funds to participating credit unions. Membership would be mandatory for all federally insured credit unions and would be available to other credit unions upon application. A purchase of capital stock in an amount equal to 1% of the assets of the subscribing credit union would be required.

The part of the bill which has stirred the most controversy is the mandatory provision that *all* federally insured credit unions *must* participate, including state-chartered credit unions which are insured through the National Credit Union Administration.

No opposition has been raised to the concept of a central banking facility. However, it appears that the industry and the administration are divided as to the best means to provide access to liquid funds available within the industry.

The President's report of August 3, 1973 entitled "Recommendations for Change in the U.S. Financial System," which is based upon the Hunt Commission's report, recognizes the need for creation of a facility to provide liquidity to credit unions. However, it differs from the industry-sponsored approach in that it recommends a central discount facility to be within and under the control of the executive branch of the federal government.

The establishment of a really effective central liquidity mechanism for credit unions remains far from a reality. The proper relationship of state-chartered credit unions to such an institution as may at some point be established will need to be very carefully considered.

John Gouch

## OTHER DEVELOPMENTS

On August 31, Lee Passell left the Division to join a "big eight" accounting firm in Cleveland. Lee was the Division's resident expert on investment companies as well as on accounting matters related to registrations. In addition he headed the non-corporate team in the Registration Section which handles real estate, oil and gas, cattle and all other types of limited partnership syndications. Lee was the originator of a number of the registration policies which have been published in earlier issues of the **Bulletin**. Although we regret his leaving the Division, we are fortunate to have someone as capable as Mike Jones available to take over the considerable responsibilities involved in heading the non-corporate registration team.

On August 17, the relationship of Ken Royalty to the Division was changed from employee to special consultant. Ken will continue to assist the Division with the proposed new Ohio Securities Act and with the development of regulatory standards through the end of this year. Working very closely with him in both of these areas will be Nelson Genshaft, who has taken over Ken's previous responsibilities within the Division as the new Counsel for Policy Development.

Ron Lembright has recently joined the Registration Section as an attorney examiner assigned to the interstate corporate team. He is a graduate of Ohio State University and Cleveland Marshall College of Law, Cleveland State University.

William L. Case, III

## ADMINISTRATIVE ACTIONS

### Summary of Credit Union Administrative Actions for August, 1973

Suspensions of Activities

Calvary Baptist Church Credit Union, Inc. 8- 6-73

Mergers Approved

ESCO Employees Credit Union, Inc. – NCR Employees Credit Union

Pantorium Employees Credit Union, Inc. – NCR Employees Credit Union

Copeland Employees Credit Union, Inc. – NCR Employees Credit Union

Charters Cancelled

Certainteed Credit Union, Inc.

### Summary of Consumer Finance Activity for August, 1973

| | Issued | Cancelled |
|---|---|---|
| Small Loan Licenses | 16 | 6 |
| Second Mortgage Licenses | 26 | 1 |
| Insurance Premium Finance | 1 | 0 |

Note: 286 Compliance Examinations Made
12 Financial Examinations Made

### Consumer Finance Hearings Held Pursuant to Sec. 1321.04

C.I.T. Financial Services, Inc.
1846 E. Second Street
Defiance, Ohio

Avco Financial Services of Ohio, Inc.
606 Taywood Road
Englewood, Ohio

C.I.T. Financial Services, Inc.
50 Boardman-Canfield Road
Boardman, Ohio

Credithrift of America, Inc. No. 3
15 E. Winter Street
Delaware, Ohio

Credithrift of America, Inc. No. 3
925 Wheeling
Cambridge, Ohio

C.I.T. Financial Services, Inc.
2041 Woodville Road
Oregon, Ohio

## Indictments Sought and Returned in August

Sales of Unregistered Foreign Real Estate by Unlicensed Salesmen

Cuyahoga County Grand Jury

1. Robert L. Yelsky
2. Vincent Culotta
3. Ronald J. Penn
4. Ronald F. Lustig
5. Martin Silverberg

Sales of Unregistered Securities

Summit and Noble County Grand Juries

1. New World Cosmetics
2. Teen and Twenty
3. Just for You Teen Centers

**Restraining Orders Obtained:**

Franklin County Common Pleas Court

1. New World Cosmetics
2. Teen and Twenty
3. Just for You Teen Centers

## STATISTICS

| Registration | Certificates |
|---|---|
| 5-A | 2 |
| 3-0 | 510 |
| 6-A1 | 186 |
| 6-A1 With Offering Circular | 8 |
| 6-A2 | 119 |
| 6-A3 | 32 |
| 6-A4 | 11 |

| | Applications Received | Orders |
|---|---|---|
| Interstate Corporate | 20 | 18 |
| Stock-Option & Pur. Plan. | 5 | 1 |
| Intrastate Corporate | 5 | 1 |
| Investment Companies | 20 | 20 |
| R.E.I.T. | 0 | 6 |
| Real Estate Ltd. Partnerships | 17 | 31 |
| Oil & Gas Offerings | 20 | 22 |
| Cattle Funds | 1 | 0 |
| Other Non-Corporate | 5 | 4 |
| Form 39 | 16 | 13 |

Note: 31 Requests for Cursory Review
28 Withdrawals

## Securities Broker-Dealer Applications (Form 15) Received in August

| | |
|---|---|
| Wainoco, Inc. | 8- 6-73 |
| The Eberstadt Fund, Inc. | 8- 6-73 |
| First Continental Investment Corp. | 8- 6-73 |
| Security Supervisors Inc. | 8- 9-73 |
| Waste Management, Inc. | 8-10-73 |
| James F. Smith | 8-13-73 |
| K.S.T. Oil & Gas Co., Inc. | 8-13-73 |
| Groves Associates | 8-17-73 |
| The Okonite Company | 8-20-73 |
| Thetford H. Callahan | 8-27-73 |
| E. I. duPont deNemours and Company | 8-29-73 |
| Vindale Corporation | 8-30-73 |
| Allied Products Corporation | 8-31-73 |
| Idelser of Medina, Inc. | 8-31-73 |

## Foregin Real Estate Broker-Dealer Applications (Form 331A) Received in August

| | |
|---|---|
| The Welles-Bowen Company | 8- 1-73 |
| Padre Island Investment Corporation | 8- 3-73 |
| Listing Systems, Inc. | 8- 6-73 |
| Denham Realty, Inc. | 8-10-73 |
| Land of America, Inc. an Ohio Corporation | 8-22-73 |
| Adrian Hoff, Jr. | 8-23-73 |
| Kincoa Sales, Incorporated (Kino Springs) | 8-30-73 |

## Salesman Applications Received in August

| | |
|---|---|
| Form 16 – Securities | 278 |
| Form 331B – Foreign Real Estate | 110 |
| Total Salesman Applications for August | 388 |

# ERRATA

PLEASE NOTE THE FOLLOWING CORRECTIONS IN THIS ISSUE OF THE BULLETIN:

Page 3 Column one, paragraph three:
"Division Regulation COs-1-05(G) (formerly R-8B) provides...."

Page 3 Column two, paragraph five:
"Under Section 1707.02(I) of the Ohio Revised Code...."

Page 4 Column one, paragraph four:
"In addition, they must make non-transferrable case contributions to the partnership equal to the amount of the total maximum proceeds of the offering, multiplied by 10%, and multiplied further by one minum the percentage of specificity achieved by the program prior to registration. A contribution in excess of $100,000 will not be required."

Page 6 Column one, paragraph one:
"An offering of oil or gas interests covered by these Guidelines will be entitled to Cursory review and will be treated in that way if the offering qualifies under the provisions outlined in Section II of Statement of Policy 1973-2,...."

WE REGRET THE UNUSUALLY LARGE NUMBER OF TYPOGRAPHICAL ERRORS CONTAINED IN THIS ISSUE OF THE BULLETIN.