

ohio securities bulletin

State of Ohio
John J. Gilligan, Governor

Department of Commerce
Dennis Shaul, Director

Division of Securities
William L. Case III, Commissioner

TABLE OF CONTENTS

Comments of the Commissioner	1
Policy Developments	3
Interpretive Opinion	4
Illustrative Rulings	5
Regulatory Standards	6
The Sections	9
Administrative Actions	15
Statistics	16

COMMENTS OF THE COMMISSIONER

1. *Securities Conference Well Received:* Based upon comments received from various persons who attended the Securities Conference presented by the Division of Securities in Columbus on November 16, it would appear that this special program was of considerable benefit to members of the Bar and securities industry in enabling them to achieve a better understanding of both the application and rationale of the new regulatory standards adopted and published by the Division during the months of May through October of 1973. Twenty members of the Division staff participated in presentations covering such subjects as: cursory review and the administrative appeals system; the new corporate fairness guidelines; mergers and acquisitions, fairness hearings and other matters of statutory interpretation; the *Statement of Policy on Real Estate Programs* of the Midwest Securities Commissioners Association and modifications proposed for adoption in Ohio; opinions of counsel and other registration matters; broker-dealer examinations and licensing requirements; and Form 39 applications, inspection of Division records, suspension procedures, and enforcement policies. In addition, the seventy-five persons who attended the conference were given the opportunity to direct questions to members of the Division staff regarding all matters of Division policy and to comment upon and voice criticisms of such policies as well as various aspects of the operational performance of the Division.

Those of us who participated in this program on behalf of the Division were pleased with the composition of the group in attendance and with the attitude with which those persons approached the first face-to-face exchange of views on policy between the Division and a large cross-section of representatives of persons subject to its regulation. In addition to many familiar faces, a number of younger attorneys were present who had only recently begun practice in the securities field. The entire group was primarily inter-

ested in learning about Division policies and their application rather than in throwing brickbats at Division personnel. It was particularly gratifying to find from the Registration Panel session that few of those in attendance had complaints about the responsiveness or accessibility of Registration Section examiners who have been working diligently this year to improve the efficiency of the entire registration process. In general, this conference was extremely beneficial to the Division in providing a vehicle for direct and objective communication on matters of general concern with the people who deal with it on a more subjective and adversary basis throughout the year. Due to the success of this first undertaking, the Division is planning to present a second Securities Conference on an expanded format in Cleveland in the spring of next year.

2. *Public Hearing on New Credit Union Rules:* On November 14, a public hearing was held at the offices of the Ohio Credit Union League in Columbus on the proposed new credit union regulations being promulgated pursuant to the Administrative Procedure Act. Approximately seventy-five representatives of state-chartered credit unions were present to hear the Division's position on the new regulations and to present testimony in support of or in the opposition to various provisions contained therein. As expected, the provisions which proved to be most controversial were those dealing with the mandatory annual audit by independent certified public accountants, the charge-off of unreserved investment losses against retained earnings, and the limitations upon official family borrowing. The Division found this public hearing to be very productive in facilitating a final determination of the form and content of the new regulations, and in response to comments received it has been decided that certain modifications will be made in all three of the aforementioned provisions as well as both substantive and technical changes in several others.

The Division has decided that, due to the threat of a lawsuit by the Public Accountants Society of Ohio which

might delay the implementation of the new regulations in their entirety and due to the shortness of the period between the final promulgation of these regulations and the time for performance of the audits which they would require, the mandatory audit provision will be severed from the regulations and replaced by the discretionary audit provision which appeared in an earlier draft of the regulations disseminated throughout the industry. However, the Division intends to promulgate this mandatory audit provision, separately and in a form virtually identical to that contained in the most recent draft of the proposed regulations, during the early part of next year for application in 1975 and to pursue its implementation through whatever litigation might arise as a result of opposition from industry or professional groups. A fundamental element of the new regulatory posture of the Division is the recognition of its statutory role as a verifier and enforcer of compliance with the credit union laws and regulations. Compliance itself, including the protection of share account holders' investments, and the demonstration of such compliance is the primary obligation of the individual credit unions and not of the Division, and the burdens of compliance and the demonstration thereof should accordingly be borne by the former and not by the latter.

The mandatory audit requirement will provide increased protection for the investments of share account holders of the large credit unions whose assets comprise the great bulk of the assets of all state-chartered credit unions in Ohio while at the same time allowing the limited resources of the Division to be concentrated upon verifying and enforcing compliance on the part of the smaller credit unions which require closer supervision. This combination of regulatory mechanisms should provide a degree of regulatory effectiveness and share account holder protection far greater than that obtainable under the present system.

3. Rules Project for 1974: With the completion in the November and December issues of the **Bulletin** of the written policy guidelines governing modifications to the Statement of Policy on Real Estate Programs of the Midwest Securities Commissioners Association and the proposed guidelines governing registrations of foreign real estate for sale in Ohio, the Division's rule-writing efforts for 1973 will come to a close. Additional statements of policy and written policy guidelines governing modifications to the *Statement of Policy on Real Estate Programs* of the Midwest staff during the first six months of 1974. If the proposed new Ohio Securities Act is not passed by the legislature before its adjournment next year, the development of regulatory standards is expected to continue at roughly the same pace indefinitely. However, if the new securities law is enacted during the spring of next year, as we have reason to believe it might be, with an effective date of July 1, 1975, it will be necessary in order to implement this legislation that the Division conduct throughout the year prior to that date, a massive rule-writing project extending in scope far beyond the existing staff capacity of the Division.

The Division is currently exploring various possibilities for obtaining the human and financial resources necessary to complete this project. The Division does not believe that the addition to its staff of a large number of new young

attorneys to work on rules is the answer to this problem since experience in securities law will be very important and since the majority of these staff positions would be only temporary. Nor does the Division believe that asking the Bar, through the Corporation Law Committee of the Ohio State Bar Association or otherwise, to undertake this project on a purely volunteer basis is a realistic solution since the organized Bar has just completed an exhaustive year of work on the new statute itself and has other matters to which it must turn its attention and since the Division must maintain a greater degree of control over both the substance and the mechanics of the rules project than this kind of arrangement would allow. The approach which the Division sees as most likely to produce a superior set of rules within the limited time available involves enlisting the assistance of a number of individual attorneys and law firms throughout the state on a compensated special counsel basis, but at reduced rates which would amount to a partially paid and partially pro bono participation by the Bar.

The Division would like to suggest to and receive comments and indications of interest from the Bar on the following *modus operandi*. The Division would, as soon as the new law is enacted, open project offices in both Cleveland and Columbus staffed with adequate clerical personnel and at least one Division staff attorney at each location. The Division would contract with law firms to obtain between ten and twenty thousand hours of the services, on a half-time or full-time basis, of experienced associates who have knowledge of securities law and practice. These attorneys would work on rules at the project office and would be compensated at the rate of \$10.00 per hour or such greater figure as would defray the out-of-pocket costs to the firms of their salaries and associated expenses. This staff of special counsel would be supervised by a committee of six to eight senior securities specialists, including both practicing attorneys and law professors, who would likewise serve on a partially compensated basis. This committee would meet periodically to review the work of the project staff and would submit to the Commissioner rule proposals for adoption by the Division. Upon the effective date of the new statute at the end of the project, the rules which have been developed to implement this legislation will be promulgated pursuant to the Administrative Procedure Act.

It is obvious that the rules project as outlined above is an extremely ambitious undertaking, but it is absolutely necessary that this huge magnitude of work be completed prior to the effective date of the law. The two key elements of this plan are the willingness of law firms and individual attorneys to participate and the ability of the Division to secure funds on the order of \$300,000.00 to \$400,000.00 to underwrite the expected costs involved. The Division is exploring funding possibilities at this time. If adequate funding can be obtained, we will be contacting law firms early next year to make arrangements for staffing this project. We hope that the Bar will be willing to assist in this major undertaking since, if it is not successfully completed, we will not be able to put the new securities law into effect.

William L. Case, III

POLICY DEVELOPMENTS

Foreign Real Estate

In an effort to elicit comment from interested parties and publicize its interest in curbing abusive practices in this area, the Ohio Division of Securities will publish proposed policy guidelines dealing with the registration and sale to the public of foreign real estate. Section 1707.33 Ohio Revised Code, prescribes the procedure to be followed for the qualification of transactions in foreign real estate. Subsection 1707.33(G) requires the Division to make a determination that the "proposed sale, lease, or disposal is not on grossly unfair terms . . . and that said real estate will not be sold, leased, or dealt in, in a method or on terms that might defraud or deceive persons in this state . . ." Thus, while the Foreign Real Estate Section is operated independently from the Registration Section, using its own forms and procedures, the Division has frequently applied some of the concepts of registration and not others in its evaluation of the gross unfairness of the offering.

In an exercise of this statutory discretion, the Division is announcing the immediate implementation of certain practices such as a limit of one year on the effectiveness of a foreign real estate registration. All division orders currently being issued to acknowledge the qualifications of such offerings contain this limitation of twelve months. Registrants must re-qualify such offerings at the expiration of this term of effectiveness. The Division is considering several approaches to this re-qualification procedure, although no final decision has been made on this matter. (See Foreign Real Estate Section.)

Transactions in foreign real estate not in compliance with Chapter 1707. may be qualified under Section 1707.39, Ohio Revised Code, in much the same manner as that prescribed by the filing of Division Form 39. This section allows qualification of the securities when the Division is satisfied that no person has been "defrauded, prejudiced, or damaged" and that no willful violation has occurred through non-compliance with the statute.

A recurring problem has been the failure of many registrants to file successive ninety-day periodic reports of progress pursuant to the Division Order. The Division regards such failure to file as grounds for suspension under Section 1707.13, Ohio Revised Code, as a violation of a requirement of the Division. Therefore, all registrants must correct this deficiency by filing current progress reports.

Section 1707.331(B) specifies that the Division may waive, in whole or in part, the written examination required for the issuance of a dealer's or salesman's license. The Division has decided to include a written examination covering the applicant's knowledge of the securities laws of this state as a requirement for obtaining such license. This is being done in an effort to keep those persons who most often deal with prospective investors fully informed of the statute, including the related guidelines and rules.

Over the period of the next few months, the Division will propose written policy guidelines covering various aspects of foreign real estate transactions. The following are summaries of a number of these proposed guidelines:

I. *Disclosure.* In addition to a HUD property report reflecting all current material changes, all sales solicitations in Ohio must be accompanied by the delivery of an offering circular. Such offering circular shall contain a brief (maximum of 10 pages) summary of the most significant characteristics of the public offering and shall include the following descriptions: (i) the terms of the offering (unit size, price per unit, financing arrangements, period in which contract is voidable, etc.); (ii) the offered properties, (size, physical characteristics, location, etc.); (iii) the status of various improvements and existing utilities (roads, electricity, gas, sewage, water, telephone service, etc.); (iv) the risk factors involved including the absence of a secondary market for such properties; (v) the condition of the title to the property including a disclosure of the material terms of any encumbrances, deed restrictions or zoning regulations that could affect the purchaser's use of the property; (vi) any taxes, special assessments or fees, which the purchaser will be required to assume; (vii) the character of the registrant, including its background and operating history, all affiliated entities or persons, its capital structure, and a list of its principal officers and directors and their principal occupations for the preceding five years; (viii) certified financial statements for the most recent fiscal year and unaudited financial statements for the last quarterly period preceding the registration application, and; (ix) various exhibits including an overall map of the entire area and a representative map of the properties offered to the public. As required by the Division, the offering circular may contain on the cover page a general legend pointing out the speculative nature of the proposed investment or identifying specific risks which are associated with the program.

The offering circular shall also contain a questionnaire, in the form of a detachable tear-off sheet to be prescribed, which shall list various activities considered by the Division of Securities to be unfair or deceptive practices. Such tear-off sheet shall provide spaces in which the offeree may indicate any of these unfair or deceptive practices he believes to have occurred with respect to the particular public offering involved. The tear-off sheet must inform the purchaser that he may directly notify the Ohio Division of Securities of such complaints by sending the completed questionnaire to the Division.

II. *Unfair and Deceptive Practices.* The Division proposes to prescribe certain promotional activities and selling practices by any licensed dealer or salesman as grossly unfair, *per se*. Such practices shall include inducing persons to attend sales meetings with the promise of receiving any free gift or complimentary meal or misrepresenting by any method the availability of parcels of land, the status of improvements, or the value, location, or quality of the subject properties. The Division must be given advance notice of any planned sales or promotional meetings to be held within this State. All interstate telephone solicitations of Ohio residents (i.e., WATS solicitation from outside Ohio) will be prohibited unless made by a licensed dealer or salesman.

III. *Land Installment Contracts.* Certain restrictions will be proposed for all land installment contracts. Such restrictions shall include a ten-day cooling off period immediately

after signing the contract in which the investor has an unqualified right of rescission. In addition, the investor may rescind the land sales installment contract within thirty days of performing an on-site inspection of the property, provided that the inspection is made within a reasonable time following the sale and provided that such property is accessible for the on-site inspection. It is suggested that six months is a reasonable period in which the investor must make an inspection of the property.

In the case of a default in payment of the land installment contract, forfeiture of the interest of the purchaser under the contract may be enforced only after the expiration of 30 days from the date of default. At the expiration of this 30-day period, the purchaser under the contract shall be given notice describing the contract and the terms of the contract which have not been satisfied. This notice must indicate that the purchaser's rights under the contract will be forfeited unless he complies with such terms within ten days of service of notice.

IV. Minimum Investment and Suitability. The Division will consider a proposed public offering of foreign real estate to be on grossly unfair terms unless an initial minimum cash investment is required. In no case shall such minimum investment be less than the greater of either 20% of the purchase price of the property or \$1,000. Sales should be made only to those persons who are deemed suitable based on their net worth or annual gross income. In the case of properties which have been improved and are capable of immediate habitation following construction, persons deemed suitable shall have a minimum net worth of \$10,000 or an annual gross income of at least \$8,000. Properties that are still in the developmental stages shall be sold only to persons considered suitable due to their having a minimum net worth of \$20,000 or an annual gross income of at least \$15,000. Net worth shall be computed exclusive of home, furnishings, or automobiles.

V. Advertising. Advertising, which includes any form of written or oral communication through the mail, television, radio, telephone, magazines, or newspapers, shall first be cleared by the Division. The Division shall make a determination on such advertisement as to its tendency to defraud or deceive purchasers in this state. Generally, such standards shall prohibit any claims which distort, misrepresent, or create misleading impressions. Prohibited advertisements include those that suggest improvements which are not planned to be in existence within the next five years, those that distort the condition of actual improvements on the property, or those that are misleading with respect to the location of the property and its distance from other residential and commercial areas.

Midwest Statement of Policy Regarding Real Estate Programs

This issue of the *Bulletin* contains *Written Policy Guidelines 1973-5* which are the general standards designed to modify the *Statement of Policy Regarding Real Estate Programs* adopted by the Midwest Securities Commissioner's Association on February 28, 1973. (CCH Blue Sky Reporter, paragraph 4821). It was announced in the May, 1973 issue of

the *Bulletin* at page 6 that the Division was applying these standards as general guidelines with the exception of four areas in which the Division would adopt its own standards in variation with the *Midwest Statement of Policy*. These four areas of previously announced departure are (1) the general applicability of these standards to real estate programs in corporate form [*Midwest Statement of Policy*, Section I(A)], (2) fees, compensation and expenses [Section IV], (3) non-specified property programs [Section VI], and (4) voting rights [Section VII(B)]. The guidelines published in this *Bulletin* and continued in the December, 1973 issue will refine these sections of the *Midwest Statement of Policy*. In addition, the Division will announce modifications to other sections including (1) suitability [Section II(E)] and (2) the use of projections in disclosure materials [Section VIII(D)].

These new standards are designed to supercede the entire captioned section to which they apply. Ultimately, they will be incorporated into the *Midwest Statement of Policy* as it is applied in this State. Such final version will be used by the Division in evaluating the gross unfairness of the terms of a proposed public offering under Sections 1707.09 and 1707.13, Ohio Revised Code, covering registrations of real estate programs by description and by qualification.

As stated in the general applicability section of the corporate guidelines, *Written Policy Guidelines 1973-2*, these standards are designed to "aid the Division in exercise of its discretion" and do not represent rigid rules in the determination of whether a proposed offering is to be made on grossly unfair terms. However, any material variation in the terms of a proposed public offering will be a persuasive factor in a finding by the Division that such offering should be denied. The listed sections of *Written Policy Guidelines 1973-5* should be read to supercede the corresponding sections of the *Midwest Statement of Policy*.

Nelson E. Genshaft

INTERPRETIVE OPINIONS **Sections 1707.03(M) and 1707.03(N)**

It is the purpose of this interpretive opinion to attempt to outline briefly the exemption provided for certain transactions in Section 1707.03(M) and (N) of the Ohio Revised Code.

It has come to the Division's attention that there is some confusion as to the proper application of these two sections and when certain transactions are qualified for an exempt status under these two sections. Basically, sub-section (M) breaks down into three categories. The first category is the basic exemption for any sale by a "licensed dealer". The second element is an unavailability of that exemption if one

of three circumstances exists. If any of these three circumstances exists, an exemption under (M) does not exist. It should be pointed out that 1707.03(M) is apropos only to the sale of "issued and outstanding" securities, or in other words, "secondary market" trading.

The first of these sets of circumstances is set out in 1707.03(M)(1) which basically is intended to cover unsold allotments or subscriptions by dealers under a firm commitment or brokers in a dealer management group. There are two very crucial statutory definitions involved in sub-section (M)(1). The first is the term "underwriter" which is defined in sub-section (N) of Section 1707.03.

It is quite obvious from this sub-section and its language that sub-section (N) was intended to invoke the federal language and policy surrounding Section (2)(11) of the Securities Act of 1933. It is the Division's intention to apply to sub-section 1707.03 (N) the federal case law and the rules of the Securities and Exchange Commission concerning the definition of "underwriter" in 2(11) for the purpose of determining when a person is an "underwriter".

Second, it should be pointed out that the definition of "issuer" in this section by statutory language includes persons who own beneficially one-fourth or more of the outstanding securities of the class involved in transaction. This definition is qualified by the fact that a dealer must have knowledge or reasonable cause to believe that the "issuer" owned one-fourth of the outstanding securities.

The second disqualification of the exempt status under sub-section (M) is sub-section (2). This applies when securities to be sold are of a class which has less than 25 record owners.

The third and probably the most troublesome of the disqualifications for exemption under sub-section (M) is sub-section (3). The difficulty obtained in this section probably results more often from sub-section (M)(3)(a) than any of the other sub-sections involved. Sub-section (M)(3) basically deals with a secondary market transaction where the securities were not qualified for sale in Ohio originally, but were qualified for sale in some other jurisdiction. The third element of the (M) and (N) series of exemptions now comes into play.

The (M)(3) qualification that securities that fit into this transaction are not exempt is again qualified to reinstate the exemption if one of the five sub-categories listed in (M)(3)(a) through (e) applies. Therefore, for an issuer to claim an (M)(3) exemption he would have to claim that (3) applied, but that one of the five qualifications of (a) through (e) also applied. This "in-and-out" type of exemption is difficult to interpret other than in its literal language. The obvious intention is that certain transactions are "tainted" and therefore require registration. If they are qualified by a certain kind of informational status or have been reviewed by the Division these "tainted" securities might be considered exempt and without the review of the Blue Sky Administration for fairness and full-disclosure.

Sub-paragraph (M)(3)(a) is the "securities manual exemption" in Ohio. The Division feels the literal language should be applied here in requiring a balance sheet no less than 18 months old and a profit and loss statement for either a fiscal year or the most recent year of operations. As to which securities manuals the Division recognizes, currently the Division has in its possession and does recognize Standard and Poor's and the Moody's Service as meeting the requirements of (M)(3)(a).

The second qualification of (M)(3) is sub-section (b) which requires that there be a registration of the securities to be issued or securities of the same class within one year of the sale of securities under either section 1707.05 or 1707.09 of the Ohio Revised Code. This sub-section requires that the registration or qualification is in full force and effect.

The third qualification of (M)(3) is contained in sub-section (c) and basically provides that the transaction is exempt if the "issuer" meets the requirements of Section 1707.05.

Sub-section (d) basically follows the language in 1707.03(B) which is the bona fide owner exemption.

Sub-section (e), which is the fifth and final qualification, brings in transactions similar to those exempt under 1707.03(L), (K), and (I), as well as 1707.06(A).

The complex and confusing nature of this section makes it a difficult one to interpret other than on its literal language. The Division welcomes commentary from the practicing Bar and interested parties as to the problems which may arise under its interpretation.

Stock Options and Stock Purchase Plans

The Division is at the present considering the posture that it will take under sub-sections (G)(2) and (I) of 1707.03 as it relates to stock purchase plans and stock options. The Division welcomes commentary from the Bar and interested parties as to a proper interpretation of this section and hopes to publish its interpretation of these two sections in a future issue of this Bulletin.

Alan Baden

ILLUSTRATIVE RULINGS

Compliance with Section 1707.06(A)(3)

I. *Facts:* ABC Syndicators, Inc. proposes to develop a modern apartment complex, funded by the sale of limited partnership interests. The complex contemplates three, 40-unit structures, requiring an equity investment of \$200,000 per structure. Rather than file one registration by qualification covering enough partnership interests to fund the entire project, ABC Syndicators chooses to file three Form 6 (A)(3)'s, one for each structure. In each partnership, ABC Syndicators serves as the general partner. The partnerships are established in close proximity of time, and

an interlocking management contract is proposed governing all three structures. Each partnership has ten persons in interest unrelated to the individuals involved in the other two.

Question: Should these three offerings be treated separately for purposes of Section 1707.06(A)(3)?

Answer: Of course, the answer is *no*. If ever there was a clear example of "integrated offerings", this is it. Undeniably, the above fact situation indicates a unified plan of financing for a single project. It would be a sham to permit the project to be "broken down into its component parts" and allow a registration by description for each part. When presented with this fact situation, and related ones, the Division will integrate the offerings and allege a violation of Section 1707.06(A)(3) if the parties, in the aggregate, exceed ten.

II. *Facts:* Joint Ventures, Inc. wishes to syndicate a small partnership pursuant to Section 1707.06(A)(3), but would like to involve more than ten persons in interest. A scheme is devised whereby the partnership will sell ten five thousand dollar interests to seven investors, in contemplation of immediate resale of half the interest to seven additional persons.

Question: Is Section 1707.06(A)(3) available for this transaction?

Answer: No. Again, this is a sham transaction designed to abuse the privilege in section 1707.06(A)(3).

Robert J. DeLambo

REGULATORY STANDARDS

WRITTEN POLICY GUIDELINES 1973-5

Modifications to the Midwest Securities Commissioner's Association's Statement of Policy Regarding Real Estate Programs

The Ohio Division of Securities is applying the *Statement of Policy Regarding Real Estate Programs* adopted by the Midwest Securities Commissioner's Association on February 28, 1973 to registrations of real estate programs to be sold in Ohio. However, the Division has adopted certain modifications to this Statement of Policy. These modifications, as set forth below, are designed to supercede the corresponding sections of the *Midwest Statement of Policy*.

Midwest Statement of Policy, Section I(A)(1)

A. Application

1. The rules contained in these Guidelines apply to registrations by qualification and registrations by description of real estate programs in the form of limited partnerships and

will be applied by analogy to real estate programs in other forms. In the case of such programs in the form of corporations these Guidelines shall be applied as consistently as possible with the general corporate guidelines contained in *Written Policy Guidelines 1973-2*. Where these Guidelines are applied to real estate programs in corporate form, the application of inconsistent corporate guidelines will not be required. While applications not conforming to the standards contained herein shall be looked upon with disfavor, where good cause is shown certain Guidelines may be modified or waived by the Administrator.

Midwest Statement of Policy, Section I(B)(14)

14. *Non-Specified Property Program* — A program where, at the time a securities registration is ordered effective, less than 75% of the maximum amount of proceeds to be received from the sale of program interests is allocable to the purchase, construction, or improvement of specific properties. Reserves shall be included in the non-specified 25%.

Midwest Statement of Policy, Section III(E)

A. *Presumptive Suitability Standards.*

Unless the Administrator approves a lower suitability standard, participants shall have a minimum annual gross income of \$20,000 and a minimum net worth of \$20,000, or, in the alternative, a minimum net worth of \$75,000. Net worth shall be determined exclusive of home, furnishings, and automobiles.

In the case of high risk or principally tax oriented offerings a higher suitability standard shall be required. Participants shall have a minimum net worth of \$50,000 and be in a federal income tax bracket of at least 50 per cent, or, in the alternative be able to demonstrate a minimum net worth of \$100,000. In the case of sales to fiduciary accounts, the suitability standards shall be met by the fiduciary or by the fiduciary account or by a donor who directly or indirectly supplies the funds to purchase the interests in the program.

Midwest Statement of Policy, Section VI

VI. *Non-Specified Property Programs.*

The following special provisions shall apply to all non-specified property programs.

A. *Experience of Sponsor.* The sponsor or sponsors must establish that they have sufficient experience and expertise to undertake their responsibilities as sponsors. They shall be required to demonstrate that they have the equivalent of the following numbers of years of experience in the areas of development, selection, brokerage, financing, construction, or management of real estate projects:

1. Ten years' experience in the general real estate business;
2. Five years' experience with each of the specific type of property to be acquired by the program according to the Investment Objectives outlined in Section VI(C) of these Guidelines;
3. Five years' experience in each of the specific types of services to be rendered by the sponsor or any of its affiliates to the program; and

4. Two years' experience as a principal sponsor of a publicly funded real estate program.

At least one individual must meet the requirements of paragraphs (1) and (4) above. Separate individuals may collectively meet the requirements of paragraphs (2) and (3) insofar as different types of properties or services are concerned.

The offering circular shall contain a detailed summary of the sponsor's business experience and a summary of the performance of other real estate programs in which he has participated as a sponsor during the ten years preceding the filing of the registration. This requirement shall also apply to key operational employees and affiliated persons or entities who propose to render substantial services to the program.

B. Financial Responsibility. In order to demonstrate sufficient economic interest and financial capacity to assure his continuation with the program and his incentive to seek optimum performance, the following standards of financial responsibility shall apply:

1. The sponsor shall have, prior to the registration of the proposed public offering, a net worth equal to at least 10% of the maximum aggregate offering. In addition to this amount, the sponsor shall have a net worth equal to at least 10% of the aggregate capital contributions to other programs in which he is currently a sponsor;

2. In his discretion, the Administrator may require an opinion of counsel to the effect that the sponsor satisfies the "substantial assets" requirements of the rules and regulations under the Internal Revenue Code of 1954 with respect to the sponsor's personal liability and the tax status of the program. [See Internal Revenue Code of 1954, Regulations, Section 301.7701-2(d)(2)]; and

3. The sponsor shall make a non-transferable cash capital contribution to the program in an amount equal to at least 10% of the total maximum proceeds of the public offering. However, the mandatory cash contribution may be decreased by an amount equal to \$1,000 multiplied by the total percentage of specificity achieved by the program prior to filing the registration.

Notwithstanding the foregoing provisions a sponsor shall not be required to make a cash contribution in excess of \$100,000.

C. Disclosure of Investment Objectives. The offering circular shall contain a detailed description of the type or types of properties that the program intends to acquire. Without limiting the generality of the disclosure which may be required, this description shall include all of the following:

1. The type of properties to be acquired (i.e., multi-family residential, office buildings, shopping centers, etc.) including an itemization of the percentage of funds to be allocated to each type of property described;

2. A detailed summary of the tax aspects with respect to each type of property (i.e., depreciation policies, the effect of acquiring first or subsequent user properties, depreciation recapture, investment credit, etc.);

3. A tabular representation of the approximate percentage of net proceeds to be used in the acquisition of each type of property to be acquired at the maximum and minimum capitalization levels.

4. A detailed description of the financing policies to be followed by the program, including but not limited to, leverage restrictions, mortgage terms, sale and lease back terms, ground leases or sales, junior mortgages, balloon financing, refinancing policies, and joint venture arrangements.

5. A detailed description of the criteria to be followed by the program in the selection of property (i.e., age of properties, historical cash flow, appraisal policies, contemplated return objectives, appreciation potential, geographical location, etc.) Included within such investment criteria shall be the following policies:

(i) Unimproved or non-income producing property shall not be acquired except in amount and upon terms which can be financed by the program's proceeds or from cash flow; and

(ii) Investments in junior trust deeds and other similar obligations shall be limited to no more than 10% of the gross assets of the program;

6. A description of the program's criteria with respect to the sale, exchange, or other disposition of properties;

7. Detailed information regarding the types of temporary investments to be made pending the acquisition of properties, including the anticipated net return from such investments, anticipated duration of such investments, and the approximate percentage of funds to be invested in this manner.

8. A graphic illustration, contained on the second page of the offering circular, which indicates the amount of proceeds to be expended for the organization and offering of the program, the amount to be used for specified projects, and the amount to be used for non-specified purposes;

9. A legend prominently displayed on the covering page of the offering circular which points out the extent of discretion being vested in the sponsors pursuant to the program's Investment Objectives and encourages each prospective investor to carefully consider the suitability of such investment for his own personal circumstances.

D. Capital Structure

1. A proposed non-specified property program shall provide for a minimum paid-in capital of an amount which is considered necessary to achieve the basic objectives contemplated in the offering circular. In no case shall such amount be less than the greater of the following:

(i) \$1,000,000, exclusive of all organization and offering expenses; or

(ii) 25% of the maximum aggregate public offering price.

The foregoing amount of minimum paid-in capital shall be escrowed with a non-affiliated financial institution, observing the same procedural requirements used in the registration of corporate offerings, as specified in Division V(B)(2)(a) of *Written Policy Guidelines 1973-2*.

2. In order to insure adequate diversification in the application of the proceeds of the offering, no more than 40% of total net proceeds shall be committed to any single property. In the case of a "best efforts" public offering, no more than 40% of the amount raised at the time of the commitment may be used for the purchase of any single property.

3. Any proceeds of the public offering which have not been committed to the construction, purchase, or improvement of specific properties within 18 months after the date of the initial public offering shall be returned to the participants pro rata as a return of capital.

4. Programs requiring assessments or deferred payments shall not be permitted, except that the Division may in its discretion modify or waive this standard for any offering of securities which involves an offer to sell the entire issue on an installment basis or pursuant to one or more installment purchase agreements, so long as the same offer is to be made to every prospective purchaser of securities which constitute a part of that issue, and so long as the issuer or applicant demonstrates to the satisfaction of the Division that such an installment arrangement will not involve an extension of credit which would be in violation of the rules and regulations prescribed by the Board of Governors of the Federal Reserve System under the Securities Exchange Act of 1934 (i.e., Regulation T; see CFR §§220.7(a), 220.8, 220.123 and 220.124) and that such installment payments will provide the specific minimum amount of funds necessary at appropriate times to finance the various stages of the proposed plan of business of the issuer.

E. *Affiliate Transactions*

1. The program shall not purchase, lease, or otherwise acquire properties wherein the sponsor or any affiliates of the sponsor have an interest.

2. It shall be considered a basis for a finding that a program is being offered on grossly unfair terms where it appears that the primary motivation of the program is to generate fees, commissions, or other compensation payable to the sponsor or any of its affiliates.

3. All fees, commissions, or other compensation to be paid to the sponsor and/or any affiliates must be prominently disclosed in tabular format indicating the name of the person or entity receiving the compensation, the amount to be received, and the method of computing such fee or compensation, as specified in Section IV(A)(3) above.

4. The subscription agreement must contain a provision indicating that all fees and compensation payable for services to be performed by the sponsor and/or any affiliates of the sponsor shall be on terms no less favorable than those reasonably available from third party non-affiliated persons doing business in the same geographic area.

F. *Prohibition on Voluntary Withdrawal.* To the extent that such agreement is not inconsistent with the provisions of Chapter 1781., Ohio Revised Code, similar versions of the Uniform Limited Partnership Act, or the Internal Revenue Code of 1954, including the rules and regulations promulgated thereunder, the sponsor may not voluntarily withdraw from the program for a period of ten (10) years from the date of the initial public offering unless the sponsor can offer a substitute person or entity that is suitable and accepted by the participants, pursuant to a majority vote.

G. *Minimum Investment.* In all non-specified property programs a minimum initial cash purchase of \$5,000 shall be required. Subsequent transfers of such interests shall be limited to no less than a minimum unit equivalent to an initial minimum purchase, except for transfers by gifts, inheritance, intra-family transfers, family dissolutions, and transfers to affiliates.

H. *Suitability Standards.* Unless the Administrator approves a lower suitability standard, investors in a non-specified property program that is income-producing and non-developmental shall have a minimum annual gross income of \$30,000, and a minimum net worth of \$30,000, or, in the alternative, a minimum Net Worth of \$75,000 (exclusive of home, furnishings, and automobiles).

In the case of high risk, developmental or principally tax motivated programs, investors shall be limited to those persons having a minimum Net Worth of \$50,000 and who are in a federal income tax bracket of at least 50%, or, in the alternative, have a Net Worth of at least \$100,000.

I. *Multiple Program.* Generally, sponsors shall not be permitted to offer for sale more than one non-specified property program at any one time unless the programs have substantially different investment objectives. Similarly, new offerings by the same sponsor shall not be permitted unless the sponsor has committed or placed the funds raised from pre-existing non-specified property programs.

J. *Special Report.* At least quarterly, a "Special Report" of real property acquisitions within the prior quarter shall be sent to all participants until the proceeds are either committed or returned to the participants as set forth in paragraph D(3) above. Such notice shall describe the real properties, and include a description of the geographic area and of the market upon which the sponsor is relying in projecting successful operation of the properties. All facts which reasonably appear to the sponsor to materially influence the value of the property should be fully disclosed. The Special Report shall include, by way of illustration and not of limitation, a statement of the date and amount of the appraisal value, if applicable, a statement of the actual purchase price including terms of the purchase, and a state-

ment indicating the amount of proceeds in the program which remain unexpended or uncommitted. The statement regarding the status of program proceeds shall be in terms of both the dollar amount and percentage of the total amount of proceeds derived from the public offering.

THE SECTIONS

REGISTRATION SECTION

Limited Partnerships - Forming the Issuing Entity

I. Statement of Problem

Under the Ohio Securities Act, promoters of limited partnerships are faced with a dilemma regarding registration: the statute contemplates the issuance of interests by an *existing* entity, but forming the issuing entity may well be a registerable *event* under the Ohio Revised Code. Unlike a corporation which may avail itself of an exemption (Section 1707.03(O) Ohio Revised Code) to form an issuing entity, the limited partnership has no express exemption to exclude its very formation from the registration sections of the Act.

Pursuant to Section 1781.02 of the Ohio Revised Code, a limited partnership is *not* formed until there has been "substantial compliance in good faith with the requirements of Division (A) of (the above cited section)." Among the requirements of Division (A) are the following: 1. The name and place of residence of each member with general and limited partners being respectively designated; 2. The amount of cash and a description of the agreed value of the other property contributed by each limited partner; and 3. Filing for record the certificate in the office of the Clerk of Court of Common Pleas of the county in which the principal place of business of the partnership is located. A brief reading of these requirements would indicate that a "sale" takes place within the meaning of Section 1707.01(B) just to organize the issuing entity.

This problem occurs not only with filings pursuant to Section 1707.09, but with filings under 1707.06(A)(3) as well. Technically, the original limited partnership interests "sold" to establish the issuing entity are often being sold in violation of Chapter 1707 of the Ohio Revised Code. The purpose of this article is to discuss three possible ways of avoiding the issuing entity problem.

II. Methods of Formation

One method to circumvent the issuing entity problem is the use of an institutional investor to purchase the original limited partnership interests, thereby claiming an exemption pursuant to Section 1707.03(D). Thus, the entity is established to transact the contemplated public offering and the original interest can be retired once the offering is completed.

Although this method may be theoretically sound, it may not be practical. With respect to small partnership offerings, it is certainly inconvenient, if not costly, to incorporate

simply to establish an original limited partner, and it may not be easy to find an existing corporation which will be accommodating. Such a method would lend itself more readily to large partnership offerings wherein the potential gain will offset the initial expenditures of time and money.

B. Preformation Partnership Interests

Some law firms have devised the preformation partnership interest in answer to the issuing entity problem. This device is widely used in the large series offerings common to cattle funds, and large oil and gas programs. Here, the limited partnerships are not formed until the desired amount of proceeds are received by the promoters. At that point, the promoters form a number of limited partnerships, converting the preformation interests into partnership interests.

This also does not lend itself to ease of administration and creates real problems as to whom is the issuer (see 1, *Loss Securities Regulation* at 456-60). More than likely, the promoters themselves would be deemed issuers, and their risks and liabilities would probably be analogous to those assured by promoters in a corporate venture. Also, the issuer must register the preformation interests, as well as the post-formation interests (see *Loss*, supra at 457). Further, it is difficult to imagine the "issuers" doing more than gathering proceeds prior to the partnership's formation. For example, should the "promoter-issuer" contract to buy property for the nonexistent partnership, he would probably have to do so in his own name, which would raise conflict-of-interest problems when he transfers it to the entity, once it is formed.

Furthermore, there is some question as to "what an investor really has" when he purchases such a security. The Ohio Limited Partnership Act probably never contemplated such an interest, and is silent as to "preformation rights" of limited partners *in futuro*, as well as the duties of the intended general partners. For example, under the preformation arrangement, does the intended general partner stand as a fiduciary to the proposed limited partners, should he start committing the proceeds to use prior to formation of the partnership? What if the intended general partner is slow in causing the entity to be formed, thus losing business advantage; could the preformation interest-holders compel formation in equity? These are just a few of the problems I envision with the preformation interest.

C. Joint Venture

In light of Professor Coffey's fine article, *The Economic Realities of a "Security": Is there a more Meaningful Formula?* 18 *Case Western Reserve Law Review* 367 (1967), and the recent decision of *State of Hawaii v. Hawaii Market Center, Inc.* 485 P. 2d. 105 (1971), the Division believes that a joint venture approach may well solve the issuing-entity dilemma. In dictum, the *Hawaii* case posits that the right of control over the investment will take the transaction out of the securities context. If each participant in a capitalized venture has a practical and actual control over his investment, then a "security" does not exist. Applying this to our partnership problem, if a small group of promoters seek to form an issuing entity with themselves as general partners, they need only have one of the general partners take the original limited partnership interest. At

that point, an issuing entity would be formed, and no "security" sold since the limited partner would have control of his investment by virtue of his dual general partner status. This approach is consistent with Chapter 1781, because Section 1781.12 allows an individual to participate in a limited partnership as both a limited and general partner.

III. Conclusion

It is most unfortunate that the Ohio Securities Act does not have a private placement or some other express exemption to permit formation of an issuing entity for limited partnerships. Nevertheless, I have attempted to outline three possible solutions to the problem so that an issuer may be in technical as well as practical compliance with the Ohio Securities Act.

Robert J. DeLambo

ENFORCEMENT SECTION

Dennis Shaul Et Al., vs Cathedral of Tomorrow, Inc.

An Offer of Repayment was mailed to the 4000 security holders on November 1, 1973. Many long hours of negotiation went into the final terms of this Repayment Offer requiring more than 100 changes in substance and form prior to the mailing of the document. One of the hardest fought items was the option allowing the time certificate holders to donate these notes to Cathedral. The State felt that such an alternative would destroy the integrity of the entire plan which had been agreed to in Court on May 25, 1973. To allow a rescission offer to become a solicitation for additional funds would be deemed to be beyond cavil.

A court hearing was held in Cincinnati on October 29, 1973. At that time, Judge Paul Riley agreed with the State's position and all references to donations were ordered removed from the Offer of Repayment.

Note holders have 60 days in which they can reply to the offer. If every security holder were to tender their debt instrument, they would be repaid a pro rata share of \$.32 on the \$1.00 from a trust fund which totals at this time \$4,000,000.00. Such trust fund is to continue until all debt instruments have been satisfied.

Welfare Finance Inc. vs. State of Ohio *National Finance Inc. vs. State of Ohio*

On September 26, 1973, the Division of Securities issued a suspension order suspending the above mentioned registrations or debt securities amounting to \$490,000,000.00. An administrative hearing was scheduled for October 4, 1973, but was postponed by mutual consent until November 1, 1973, following the issuance of an amendment order on October 16, 1973.

On October 29, 1973, the attorneys for National and Welfare Finance Co. filed an appeal in the Common Pleas Court of Hamilton County, at which time the plaintiff's attorneys also requested and were so granted an all-pervasive court order, suspending the Division of Securities administrative sanctions or remedies.

The Division filed a motion requesting that the appeal be dismissed and that the order be dissolved. Both motions were granted November 2, 1973. The motion to dismiss was granted on the grounds that the plaintiff had not availed himself of an administrative hearing and thus had not appealed from a final order. Since the appeal action was premature, the court could not issue a suspension order in an area where it did not have jurisdiction.

It is interesting to note that November 5, 1973, the plaintiffs sued the six Department of Commerce and Division personnel for \$100,000,000 in damages. On November 6, 1973, Welfare Finance, Inc. filed a Chapter 11 Bankruptcy Action in Federal District Court of Southern Ohio, and on November 7, 1973, the plaintiffs filed an appeal in the Ohio State Court of Appeals from the decision allowing the dismissal of the appeal taken in Hamilton County.

Vernoica M. Dever

BROKER-DEALER SECTION

I would like to say something in a pedestrian vein about applying for and keeping a license to sell securities. We receive daily inquiries about these matters, so comment at this time may be helpful.

1. Mergers and Acquisitions

A Form 15 application must be submitted with a copy of the proxy material and merger agreement. At the same time Form 15-B must be sent to a local newspaper of general circulation or to The Columbus Dispatch, Columbus, Ohio 43215, if the broker-dealer is located out of state. Upon receipt of Form 15, with fees attached, an open-book test must be taken by an elected corporate officer of the applicant. When the test is returned with an appropriate oath of such officer, attesting that he and he alone took the test, the Division will issue the license (if the proof of publication is returned to the Division and one week has elapsed since the proof of publication appeared in the paper). References, minimum capital, and related financial data requirements will be waived.

2. Test Requirements

Every applicant must pass a written examination which covers his knowledge of the securities laws of Ohio. This is the **State Law Test Requirement** and may not be waived under any circumstances. We believe that the general portion of the test can be waived if applicant is a member of an accredited stock exchange or NASD. The applicant for a

Foreign Real Estate license will have the real estate portion of the test waived if he is a licensed real estate broker. Passing scores of 75% on each portion must be accomplished to satisfy this requirement.

3. General Information

The Division does not issue licenses to box numbers. The statute specifies name and address. This rule applies to all applicants, including salesmen as well as dealers. We will honor mailing requests, but we must insist on having proper residence addresses listed on applications and our records.

Any dealings between our section that concerns a salesman must be carried on through *his* broker-dealer. This is according to statute.

In listing the officers of a corporation it should be noted whether they are elected or appointed. An application will be held up until this distinction is made clear. It may be necessary to ask for a copy of the minutes electing the officers in question. One elected (executive) officer may be designated broker-dealer of record; he would be required to take the broker-dealer exam and be held responsible for books and records, reports and compliance. The other elected officers would function under his accreditation. If he leaves, it is the broker-dealer's responsibility to notify the Division of this fact. Division examiners check for this, and suspension will follow if the Division is not notified of his leaving. *Executive* officers actively selling must also take the broker-dealer test. Appointed officers must take the salesman exam and file Form 16 accordingly.

4. Broker-Dealer Compliance

Every licensed broker-dealer and issuer must submit financial reports to us on call in accordance with DS-9 and in accordance with Q-2 in the case of issuers selling their own securities. Briefly stated, these regulations call for a minimum of two reports a year, one of which must be audited, both to be certified as to veracity by an authorized officer.

The reports are to be sent in response to the *Division Call Letters* that are sent out in the spring and in the fall.

DS-6 requires the broker-dealer to maintain books and records and have them available at all times. Reference is made to our comments on this subject in the May *Ohio Securities Bulletin*, Page 15, and July *Ohio Securities Bulletin*, Page 26.

Our examiners will cite lack of compliance with DS-6 as a violation along with Adjusted Net Worth below \$10,000. We calculate Adjusted Net Worth in accordance with DS-10. Accounts of questionable liquidity will be disallowed.

The suspension process will start upon receipt of the examiner's report of any violation. This procedure is in accordance with directives from our Enforcement Section.

G. A. Stott

FOREIGN REAL ESTATE SECTION

As a result of various organizational changes within the Division of Securities, I have been assigned the additional duty of functioning as Acting Supervisor of the Foreign Real Estate Section. Said status shall remain in effect until such time as Commissioner Case employs someone on a permanent basis who will have the necessary experience and qualifications. Until then, I shall allocate as much of my time as possible to the supervision of this Section, keeping in mind the constraints imposed by my dual responsibilities.

In delegating this new duty, the Commissioner has expressed his desire to curb the abuses and "sharp practices" to which the Ohio investing public have been subjected as a result of the activities of some members of the foreign real estate industry. Furthermore, keeping in mind that the Acting Supervisor's experience and expertise in foreign real estate are conspicuous by their absence, the Commissioner's directives will be implemented in the following manner: first, all existing regulatory standards will be reduced to writing and published as soon as possible; in the interim, procedural memos will be promulgated to curb blatant abuses that must be immediately corrected; finally, there will be a complete "overhaul" of the existing regulatory standards designed to make them more responsive to current problems and changes in the industry. The following is an explanation in greater detail of the rationale, procedures and hopefully constructive results which will ensue from the implementation of the above.

Phase I. Publication of Existing Policies

All of the current policies which have been "passed on" from supervisor to supervisor with more or less "consistent inconsistency" will be identified, catalogued and inventoried. Subsequently, they will be published as regulatory standards in the *Ohio Securities Bulletin*. It is possible that they will also be made available for separate distribution at a nominal cost to anyone who so requests. The writing and publication of the current regulatory standards will serve the dual purpose of assuring that there is uniform application and compliance.

Phase II. Interim Procedural Memos

While the first phase is being implemented, certain abuses and reprehensible activities which for one reason or another have not yet been regulated must be checked by more immediate means than the drafting and publication of comprehensive new guidelines. Therefore, as an interim measure, a series of procedural memos will be issued to the staff of the Foreign Real Estate Section regarding the more blatant abuses and deficiencies in our present system of regulation. To the extent that confidentiality will allow, relevant procedural memos will be made public in one manner or another. Once Phase II is completed, all procedural memos will be reevaluated to determine whether or not they should be discontinued or given the stature of a published regulatory standard.

Phase III. Analysis and Up-Dating of Policies

Upon the completion of Phase II, there shall be an exami-

nation of the areas which are the most subject to abuse and fraud and which were not previously regulated at all. At an appropriate time, members of the Bar and the industry will be invited to participate with the Division in an attempt to formulate more meaningful and relevant regulatory standards.

Regulation might be more effective and less fraud might be perpetrated upon the investing public if a greater burden of responsibility were to be imposed upon the developer. It should be his duty to inquire whether or not a particular broker/dealer with whom he plans to contract for the sale of his product in Ohio is in fact reputable (Food for thought: Our referral of fingerprints of salesmen to the Bureau of Criminal Investigation has resulted in a 39% rejection rate on the basis of criminal records). To induce the developer to maintain a higher degree of responsibility, it is conceivable that the Division might require, as a condition of registration, that no legitimate complaints be outstanding against the developer and his sales representatives. It is expected that all parties directly affected by the above policies will, in fact, benefit from their implementation. The industry members will be aware of the conditions for registration and the requirements imposed thereafter so that compliance with said policies will be greatly facilitated. The quality of the regulation of the Foreign Real Estate Section will be substantially improved since its personnel will know what standards must be applied. The following new policies have been implemented by Interim Procedural Memo as of November 1, 1973:

1. Effectiveness of Division Orders issued Pursuant to 1707.33 O.R.C.

In the past, division orders issued pursuant to a Form 33 filing contained no time limitation. As a result of this deficiency, certain developers would obtain their division orders and never be heard from again. Obviously, this type of procedure does not provide for a very efficacious supervision of the registrant during the effectiveness of its registration. This laxity in post-effective regulation has been compounded by the fact that the ninety day reports required by the Division have very seldom been submitted.

Orders issued pursuant to a Form 9 filing have been limited with certain exceptions to a one year period of effectiveness by authority of the language contained in the concluding paragraph of Section 1707.09(K) which reads in part "when any securities have been qualified . . . , any licensed dealer may thereafter sell such securities under such qualification, *so long as such qualification remains in full force . . .*" (emphasis added). The Division has interpreted the above language to mean that the Legislature intended to delegate to the Division of Securities the authority to impose appropriate limitations on the effectiveness of division orders issued under Section 1707.09.

The Division views Section 1707.33 to prescribe the manner of qualifying foreign real estate sales in Ohio. The above conclusion is based upon language found in Section 1707.33(G) which reads in part "If the Division is of the opinion that the proposed sale or disposition is not on *grossly unfair terms*, that Sections 1707.01 to 1707.45, in-

clusive of the Ohio Revised Code, have been complied with . . . it shall allow the *qualification* of such real estate for sale . . ." (emphasis added.) Based on the above wording which by strong inference refers to Section 1707.09 and the fact that it calls for the Division's finding that the offering is not on grossly unfair terms, the Division has concluded that the substantive standards contained in Section 1707.09 also apply to filings made pursuant to Section 1707.33

Therefore, as of November 1, all division orders issued pursuant to a Form 33 filing will be effective for a period of only one year following the date of the division order. However, it should be noted that although an issuer's ability to legally sell in Ohio terminates at the end of the period of effectiveness of its registration, the issuer's commitments to provide improvements extend beyond that period. The Division would be most remiss in its duties and obligation if, upon termination of the effectiveness of division orders, the Division were to relinquish its regulatory powers. The Division will attempt to assure to the best of its ability that the improvements promised by the developer (which in most, if not all, cases account for the substantial difference between the developer's acquisition costs and its sales prices) will, in fact, materialize.

Unfortunately, I have not yet had the opportunity or "gotten my feet wet enough" to develop the form and substance of the filing requirements that will be imposed as a condition for issuance of a new division order. As a matter of fact, the only substantive determination that has been made is that all division orders will have a one year period of effectiveness. No decision has been made yet as to whether or not a continuation of the effectiveness of the original division order will require an additional registration or a renewal or amendment of the original order. Furthermore, the substantive requirements to be complied with as a condition of continued sales activities have not been formulated either. However, it is contemplated that in addition to "some sort of filing," the following matters will be considered in evaluating this question: the number and frequency of valid complaints; the extent of satisfaction thereof; and the record of the developer in meeting commitments made for improvements at the time of registration. In all probability, additional fees will be required to reimburse the State for time spent on reviewing the additional filing. Due to the gravity of the abuses generated by "open end" division orders, the Division believes that the public interest will be better served by implementing the one year requirement immediately rather than wait for an additional month at which time the above questions will be answered. Inquiries as to retroactivity of the effectiveness of the new policy and the existence of grandfather clauses, if any, will also be answered at a later date.

2. Ninety Day Reports

For the past several years, the final paragraph of all division orders issued pursuant to a Form 33 filing contained in part the following language: "It is ordered further that registrant make successive ninety day periodic reports of progress of the development, improvements and amenities completed, conformity with development schedules . . ." The great

majority of registrants have violated their division orders by failing to comply with the above condition subsequent (it is most distressing to observe that since several other states have similar requirements, even though Ohio has not had any specific requirements as to the form and content of those reports, compliance with the division order could have been easily achieved by merely sending to the Division copies of the reports submitted to such other states.)

The importance of monitoring developers' activities to determine whether or not improvements are being constructed as planned cannot be emphasized too strongly. Therefore, the ninety day reports that are due must be submitted within thirty days from the end of the ninety day period. The Division is in the process of preparing a uniform reporting form that will be sent to all developers who have effective division orders and will accompany subsequent division orders. This form will be a fair compromise between a statement that "everything is going ok" and mountains of statistical information and computer printout which can only be interpreted by the person who programmed the computer. Since these reports will consistently require, and the Foreign Real Estate Section will receive, the same kinds of information from the same developers, this new reporting method will enable examiners to perform a comparative analysis of subsequent reports of the same developer.

It is conceivable that as a result of the practical impossibility of performing annual on-site inspections of all registered developments, such examinations will be waived in the case of developers whose reporting practices are particularly satisfactory.

3. *Unregistered Sales of Foreign Real Estate*

In the past, whenever the Foreign Real Estate Section was apprised of the fact that a developer had sold unregistered lots, the developer received from this office a letter by certified mail informing him, among other things, that he was selling unregistered securities and that he was to refrain from continuing to do so until such time as he registered such lots pursuant to a Form 33 filing. Nowhere in Chapter 1707 is there any provision for a "free first violation." Therefore, any future sale of unregistered foreign real estate will have to be corrected (as in the case of sales of other types of unregistered securities) by filing a registration pursuant to Section 1707.39. It must be kept in mind that the Division has discretionary power as to whether or not it will entertain a Form 39 filing. Based on the facts of the case, and whether or not the violation was intentional, it is not inconceivable that in appropriate circumstances legal actions will be initiated by the Enforcement Section.

It must be noted that a Form 39 filing is not an alternative method of registration, but rather a remedial provision. All disclosure documentation such as a property report, documents, exhibits, etc., which would have been submitted had a filing been timely submitted to the Division pursuant to Section 1707.33 will also be required as a condition for registration pursuant to Section 1707.39.

4. *Time of Payment of Fee for Examination and Reexaminations*

In the past, it has been the practice of the Division to request the necessary funds for an on-site inspection shortly prior to its scheduling. As a result of such advance notice the Division has found in two particular instances that the books and records of developers have been timely stripped of all potentially damaging evidence denoting illegal activities. Obviously, this procedure has reduced the effectiveness of our inspections and the following procedure is therefore being implemented in an attempt to correct this deficiency. Beginning on February 1, 1974, all new registrations must be accompanied by a check in the amount of \$850.00 (\$150.00 for examination of application and \$700.00 for field inspection). All developers who already have outstanding and effective division orders by projects which have not yet been examined must send \$700.00 to the Division by January 31, 1974 to cover the costs of such inspection. In the next issue of the **Bulletin** there will be published additional information as to the period of time within which such inspections will in fact be completed.

5. *Information Required Pursuant to DS-6*

One of the problems which the Enforcement Section has encountered in its attempt to investigate complaints and obtain information evidencing securities violations is that in a number of cases foreign real estate dealers are "operating from their checkbooks" (incidentally, this rather peculiar method of "keeping books" is not restricted to foreign real estate dealers). In fact, in several instances, examiners from the Broker/Dealer Section have been unable to perform their examinations to determine compliance with DS-4, 6 and 10 as a result of foreign real estate dealers' failure to keep books and records. (In at least one case there was a grave misunderstanding as to the type of books required. Thus, an unannounced inspection revealed that a particular dealer had on the premises a modicum of records including a copy of the examinations, answers and all, administered in conjunction with the issuance of broker-dealer and salesman's licenses. This unorthodox type of record keeping might partially account for the unusually large percentage of applicants successfully passing the examination the first time around, 94% last year, and the complete absence of failures the second time. The Broker/Dealer Section is in the process of taking action to correct this situation).

Therefore, to facilitate the work of both the Enforcement and Broker/Dealer Sections in their attempts to insure compliance with Chapter 1707 and regulations issued thereunder, and at the same time to clarify which types of books and records which must be kept and made available upon request to the Division, the following is a list of the material that must be kept at all times on the premises in Ohio of all dealers selling foreign real estate in this State:

1. Copy of dealers license
2. Copy of salesman license(s)
3. Copies of all sales contracts originating from that office
4. Complaint record —
 - a. name and address of complainant

- b. nature of complaint
 - c. disposition of complaint
5. Copies of all advertising material being utilized in the dealer's immediate vicinity.
 6. Copy of the dealer's contract with the developer.
 7. Schedules of all commissions received by the dealer and salesmen in connection with sales contracts originating from that office.

Regulation DS-6 must be strictly adhered to and strict enforcement actions will be taken in the event of non-compliance.

6. *Waiver of Whole or Part of Broker/Dealer and Salesman Examinations*

The failure of foreign real estate dealers and salesmen to comply with the Ohio Securities Act, has, in many cases, resulted from sheer ignorance of the law, rather than from any intent on the part of its perpetrator to violate the law. Most of the exposure of foreign real estate dealers to securities other than foreign real estate is rather minimal. Until they started selling foreign real estate, a great majority of them did not even know that the Ohio Securities Act existed, let alone how to comply with it. The Division, to some degree, helped perpetrate this ignorance by adopting a most liberal interpretation of the second paragraph of Section 1707.33, which reads in part "... the requirement of an examination may be waived in whole, or in part, by the Division, if an applicant is licensed to sell securities or as a real estate broker or salesman by any state." Therefore, in an attempt to remedy the above problems and insure that salesmen and brokers will at least have a minimum knowledge of the sections of the Ohio Securities Act applicable to their activities, the Division has implemented the following policy: As of January 1, 1974, no waiver of the *securities* portion of the examination will be granted.

7. *Requests for Price Increase*

In the past, it has been the Division's policy to "automatically" grant annual 10% increases in the sale price of foreign real estate. The only supporting material that was required to be submitted to the Division consisted of an affidavit stating something like "the cost of doing business went up." Needless to say, the above could hardly be categorized as a profound revelation. That type of corroborating document does not provide much evidence to enable the examiner to make an informed decision as to what course of action should be taken.

The Division does not want to prohibit price increases. On the contrary, the Division will favorably entertain any reasonable price increase that is demonstrated to be justifiable. It is recognized that the justification of price increases might be based on highly subjective considerations peculiar to a particular developer. On the other hand, it would seem that certain considerations and factors are common to all price increases. Therefore, all developers desiring to file an

application for a price increase should also submit information and data that is relevant, understandable and not too voluminous. The Foreign Real Estate Section will analyze the material and formulate a decision on a case-by-case basis.

My staff and I will endeavor to identify objective criteria and formulate policies that will be applied to subsequent requests for price increases.

Bernard G. Boiston

CONSUMER FINANCE SECTION "Minimum Loans Under the Mortgage Loan Act"

There have been many questions directed to the Section as to how small a loan can be made under the Mortgage Loan Act, § 1321.51 through 1321.60, Ohio Revised Code. We offer our opinion herewith as the statute makes no reference to a minimum loan, although there are certain conflicts which can involve unconscionable abuses to the borrowers.

The genesis of this act was the "loan-sharking" by private, unregulated lenders in the State making second mortgage loans on real estate as a result of increased consumer demand for larger loans and statutory preclusion of this type of loan by the regulated, chartered, or licensed financial institutions.

The evolution of the Mortgage Loan Act into practical lending operations was, for the most part, the small loan licensee, operating under Sections 1321.01 et. seq. Ohio Revised Code, who had the funding and expertise to meet demands. However, § 1321.12, states in part: "no licensee shall take a lien upon real estate as security for any loan made under such sections except such lien as is created upon the filing or recording of a certificate of judgment." Further, 1321.12, Ohio Revised Code, states in general that no other business shall be conducted on the premises if the other business tends to conceal evasion of such sections, etc. These problems were resolved by allowing the small loan licensee to operate as a registrant under the same roof and as a separate corporation with divided records.

Since the small loan clientele of the Section 1321.01 licensee is thus exposed to the solicitation and conversion to a mortgage loan and since the mortgage loan can be made on real and/or personal property, certain loans made on personal property under the Small Loan Act could be refinanced to a loan under the Mortgage Act and result in charges greater than the small loan charges by inclusion of the minimum \$200.00 service investigation fee under Section 1321.57(F). In my opinion, this would be an unconscionable charge. On the other hand, the only security for a loan of \$1,000.00 might be a second mortgage on real property requiring an attorney for title search, or an appraisal and real estate closing, yet we would not want to preclude a borrower from his right to make a loan under these somewhat unusual circumstances.

My opinion, therefore, is as follows:

1. A loan under the Mortgage Loan Act, Sections 1321.51 thru 1321.60, wherein the security is personal property only or a combination of personal property and real property could be involved in a unconscionable overcharge when the maximum charges including interest, service, and investigation fee would exceed the maximum charges permitted under Section 1321.13 of the Small Loan Law. However, a loan under the Mortgage Loan Act could still be accomplished by discounting the service and investigation fee to a rate corresponding to Section 1321.13.

2. A loan made under the Mortgage Loan Act with real property being the only security would not be in conflict with the Small Loan Law and can be for any minimum amount in accordance with the maximum charges permitted under Section 1321.57, provided the borrowers have no other loans with the lender or its affiliates under the Small Loan Law or the Mortgage Act.

Robert P. Fickell

CREDIT UNION SECTION New Rules Hearing

The case for an independent audit of credit unions by certified public accountants has been made an issue of current importance recently with the publishing of the proposed rules of the Division for the regulation of credit unions and the subsequent hearing held on November 14, 1973.

The hearing on the promulgation of rules was held at the offices of the Ohio Credit Union League, the trade association serving the credit union industry in Ohio. Representatives of the industry, leaders of major credit unions, attorneys for the trade association as well as individual credit unions were given the opportunity to voice their objections to the proposed rules.

Significant objections were raised on the question of an audit of the state-chartered credit unions by certified public accountants rather than by either certified public accounts or public accountants in general. This objection was filed by the Public Accountants Society of Ohio.

It was unfortunate that much of the objection centered on qualification of accountants; whether certified or public accountants in general, rather than on the real issue, that being whether or not a mandatory audit should be required.

Based on year-end 1972 analysis and recapitulation of state-chartered credit unions in Ohio, 131 credit unions out of 692 carried assets in excess of \$1,000,000. Requirement, by rule, that these credit unions be audited annually by an independent accountant would make available to the Division as well as to the industry an accounting of 80% of the assets of State-chartered credit unions in Ohio.

The examination procedure of the Division currently is devoted to financial reporting, copying, and dollars and cents reporting. While significant, and in no way meant by the current posture of the Division to be of less importance, we find that the examinations of credit unions, especially those of considerable asset size, demand a more comprehensive analysis of method, procedures, and management. Delegating to outside firms the financial reporting of these credit unions will relieve the Division of the time-consuming procedure of financial copying and reporting. This will enable staff of the Division to devote more time to objective analysis of the prepared financials, and thereby a more in-depth review of policies and procedures with a view toward implementing corrective measures necessary to insure sound operations.

The Ohio Credit Union Act, as amended effective November 22, 1973, provides that each credit union will pay annually a "supervisory fee" equal to one-tenth of one percent of its assets. Further, the credit unions will be billed at the time of the annual examination for the actual cost of the examination, time, and travel of the examiner. In no event shall the supervisory fee and the examination fee be greater than two thousand dollars. The concept initiated here is the separate assessment of the supervisory fee, which was included as part of the examination fee, prior to the most recent amendments to Chapter 1733.

The primary objection of the industry to the mandatory independent audit is the additional expense of the audit, while expressing the feeling that they are already subject to annual fees of \$2,000. The difference expressed in these rule changes should indicate to the industry that the Division does not base its charges solely on the expense of the examination and that the additional expenses incurred by the credit unions for the services performed in furnishing an accountant's report is of primary benefit to the credit unions.

John Gouch

ADMINISTRATIVE ACTIONS

Summary of Credit Union Section Administrative Actions for October, 1973

Suspension of Normal Operations

Everybody's Credit Union

10-19-73

Mergers Approved

Circle Credit Union-Ohio Central Credit Union

New Charter Approved

A.S.B. Lorain Employees Credit Union

Administrative Hearings Held

Warren Metal Decorating Employees Credit Union	10-16-73
Carpenters Local 1438 Credit Union	10-25-73
Everybody's Credit Union	10-30-73
Calvary Baptist Credit Union	10-31-73

Summary of Consumer Finance Activity for October, 1973

	Issued	Cancelled	Suspended
Small Loans Licenses	7	7	1
Second Mortgage Licenses	2	3	1
Premium Finance Licenses	1	0	0
Pawnbroker Licenses	2	0	0

Note: 394 Compliance Examinations Made
4 Financial Examinations Made

Hearings Held Pursuant to Section 1321.04

Midland-Guardian Company
2000 West Henderson Road
Columbus, Ohio

C.I.T. Financial Services
4460 Mayfield Road
South Euclid, Ohio

Household Finance Corporation
145 East Liberty Street
Wooster, Ohio

Summary of Enforcement Activity for October, 1973

Broker-Dealer Suspensions

J. E. Hinton & Co., Inc.	10-29-73
Provident Securities	10-29-73

Salesmen Suspensions

Ronald F. Lustig	10-23-73
------------------	----------

Registration Suspensions

Welfare Finance Corporation	Amended Order	10-16-73
National Finance Corporation	Amended Order	10-16-73

Hearing - Denial of Salesman License

O'Neill Fishbaugh	10-11-73	10-11-73
-------------------	----------	----------

Indictments Sought and Returned

Martin Silverberg - Medina County Grand Jury

STATISTICS

Registration	Certificates
3-0	362
6-A-1 With Offering Circular	4
6-A-1	82
6-A-2	35
6-A-3	16
6-A-4	8

Applications Received

<u>Interstate Corporate</u>	21
<u>Stock-Option & Purchase Plan</u>	8
<u>Intrastate Corporate</u>	3
<u>Investment Companies</u>	13
R.E.I.T.	6
Real Estate Ltd. Partnerships	25
Oil & Gas Offerings	24
Cattle Funds	3
<u>Other Non-Corporate</u>	3
<u>Form 39</u>	15
5 A's	1
2 B's	29

Note: 30 Requests for Cursory Review
5 Withdrawals

(Due to an administrative oversight, statistics for Registration Orders in October are unavailable).

Securities Broker-Dealer Applications (Form 15) Received in October

E P C Securities, Inc.	10- 1-73
Miles N. Shearer, Jr.	10-11-73
Jon W. Matthews	10-12-73
Real Capitol Securities, Inc.	10-12-73
Capital Securities Corporation	10-15-73
Orion Energy Corp.	10-15-73
BancOhio Corporation	10-16-73
Tele-Media Corporation	10-18-73
Rockefeller Industries, Inc.	10-19-73
Value Line Securities, Inc.	10-23-73
Frank B. Hall & Co., Inc.	10-23-73
Suplee-Mosley, Inc.	10-23-73
Darlib Associates, Ltd.	10-23-73
William D. Fissinger	10-24-73
MCI Communications Corporation	10-29-73
Kenneth R. Whiting	10-29-73
Houston Natural Gas Corp.	10-29-73

Foreign Real Estate Broker-Dealer Applications (Form 33a (Form 331-A) Received in October

Florida-Southland Sales Corporation	10- 1-73
Ross A. Marino dba Resco Realty	10- 4-73
Southern Properties, Inc.	10- 3-73
Carolina Blythe Development Company (A Joint Venture)	10-12-73
Organization Ideal, S.A. de C.V.	10-31-73

Salesmen Applications Received in October

Form 16 - Securities	190
Form 331-B - Foreign Real Estate	126
Total Salesmen for October	316