

# OHIO SECURITIES BULLETIN

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## Promissory Notes Become Potential Investment Poison

By Desiree Shannon

Over the years, certain types of investments have caused widespread misery to the investing public. In the early nineties, investors lost untold amounts of money investing in "penny stock," in scenarios where several intrastate brokers sold inexpensive but highly risky stock issued by start-up companies. In many cases, commission-hungry brokerages' representatives did not inform investors of the risky nature of the stock. The new millennium seems to be ushering in yet another toxic investment trend: the sale of high-risk promissory notes by securities professionals, as well as individuals with little or no experience in the sale of securities.

### Ohio Blue Sky Act Deems Promissory Notes to be Securities

The Ohio Securities Act expressly deems promissory notes to be securities. Revised Code section 1707.01, which defines what constitutes a "security," lists promissory notes as being a security. However, under certain circumstances, sales of promissory notes do not have to be registered with the Division. R.C. section 1707.02 states that commercial paper and promissory notes are exempt from the registration provisions under the Ohio Securities Act (R.C. Sections 1707.08 through 1707.11 and 1707.39) as long as

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## Notes: The Nine-Month Maturity Exception Under Federal Securities Law

By Jennifer Basil

### I. Introduction

An increasingly familiar defense that securities regulators must combat is the claim by salespersons that promissory notes maturing in nine months or less (hereinafter referred to as "short-term notes"), are not subject to state and federal securities laws. This defense is apparently based on the exemption from registration in the Securities Act of 1933 (the "1933 Act") and the exclusion of short-term notes from the definition of a security in the Securities Exchange Act of 1934 (the "1934 Act") (The 1933 Act and the 1934 Act are hereinafter collectively referred to as the "Securities Acts"). These salespersons mistakenly believe that they do not need a license to sell short-term notes, nor do they believe they need to register or notify their brokerage firms before selling short-term notes. The salespersons argue that short-term notes are either not securities or are exempt

from registration under the Securities Acts and, therefore, the salespersons do not need a license to sell them, nor do such sales constitute "selling away."

The purpose of this article is to show that such arguments are without merit because short-term notes are not automatically exempt or excluded from the purview of the Securities Acts. First, this article will discuss the current test to be applied in determining whether a note is a security for purposes of the Securities Acts. Second, this article will examine the discrepancy between the definitions of a security in the 1933 Act and the 1934 Act. The 1933 Act includes all notes within its definition of a security,<sup>1</sup> but the 1933 Act exempts from registration notes maturing in nine months or less.<sup>2</sup> In contrast, the 1934 Act excludes from its definition of a security any note which matures in nine months or less.<sup>3</sup> Finally, this article will address the federal

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# OHIO

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they are not "offered directly or indirectly for sale to the public." This straightforward exemption is further addressed in Ohio Administrative Code rule 1301:6-3-02(C). This rule allows an exemption for commercial paper and promissory notes when they...

are not offered for sale directly or indirectly to the public where their sale is restricted to: (a) Sales to officers or directors of the issuer, of the parent corporation of the issuer, or of a corporate general partner of the issuer; (b) Sales to general partners of the issuer (c) Sales to persons who directly or indirectly control the management and policies of the issuer by ownership of voting securities, by contract, or otherwise; or (d) Sales by the issuer of the security to not more than ten persons in this state during any twelve month period, provided that (i) The issuer reasonably believes after reasonable investigation that the person is purchasing for investment; (ii) No advertisement, article, notice, or other communication shall be published or broadcast by the issuer in connection with the sale other than an offering circular or other communication delivered by the issuer to selected individuals (iii) The aggregate commission, discount, and other remuneration paid or given directly or indirectly for sale of the commercial paper and promissory notes of the issuer, excluding legal, accounting and printing costs, does not exceed ten percent of the initial offering price of the commercial paper and promissory notes; and (iv) any commission, discount, or other remuneration for sales of commercial paper and promissory notes in reliance on this exemption in this state is paid or given only to dealers or salesmen licensed pursuant to Chapter 1707 of the Revised Code...

So generally, sales of promissory notes are exempt from registration with the Division as long as they are not offered for sale to the public and meet the qualifying conditions outlined in O.A.C. rule 1301:6-3-02. This does not preclude the Division from exercising jurisdiction over their sale if other provisions of the Ohio Securities Act are violated, such as the anti-fraud provisions found in R.C. section 1707.44.

Many issuers and salespersons have tried to argue that short-term promissory notes (i.e. notes with maturity dates of nine months or less) are either not securities subject to state or federal regulation, or are entitled to an exemption from registration. The basis for these arguments is found in the Securities Act of 1933 and the Securities Exchange Act of 1934. The Division's position is that, in most cases, such short-term notes are indeed within the purview of the Ohio Securities Act and are afforded the same limited exemption available to longer-term notes, as outlined above. (*See the article in this issue: "Notes: the Nine-Month Maturity Exception Under Federal Securities Law"*.)

## Note Scams Proliferate in Ohio and Nationwide

The Division has recently dealt with several high-profile cases dealing with the sales of promissory notes. In 1998, the Division suspended Andrew P. Bodnar's right to sell securities in Ohio after he sold promissory notes to dozens of Ohio investors without seeking registration or a valid claim of exemption for the sales. The Securities and Exchange Commission eventually investigated Bodnar and his associates concerning note sales in a company called CBT-Ohio, Ltd. The SEC charged them with engaging in a scheme to defraud investors and misappropriate money through the fraudulent offer and sale of unregistered securities.

Promissory note scams have become so prevalent that several states, including Ohio, have together formed a task force called States Working Intrastate Fraud Together (SWIFT), to coordinate efforts to combat the problem. This coordination effort was led by securities regulators in Florida. Typically, insurance agents, securities salespersons or investment advisers sell nine-month promissory notes in risky, capital-deficient (sometimes even

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Desiree T. Shannon, Esq., Editor

The *Ohio Securities Bulletin* is a quarterly publication of the Ohio Department of Commerce, Division of Securities. The primary purpose of the *Bulletin* is to (i) provide commentary on timely or timeless issues pertaining to securities law and regulation in Ohio, (ii) provide legislative updates, (iii) report the activities of the enforcement section, (iv) set forth registration and licensing statistics and (v) provide public notice of various proceedings.

*The Division encourages members of the securities community to submit for publication articles on timely or timeless issues pertaining to securities law and regulation in Ohio. If you are interested in submitting an article, contact the Editor for editorial guidelines and publication deadlines. The Division reserves the right to edit articles submitted for publication.*

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courts' interpretation of the nine-month maturity exception, as well as the interpretation of the position of the Securities and Exchange Commission (the "SEC"), and the legislative histories of the Securities Acts.

### II. *Reves v. Ernst & Young*: The Federal Test for Notes as Securities

One of the primary purposes of this article is to examine and explain the discrepancy that appears in relation to promissory notes under the definition of "security" in the 1933 Act, as contrasted with the 1934 Act. However, the United States Supreme Court in *Reves v. Ernst & Young*,<sup>4</sup> determined that a plain reading of the statute alone is insufficient for purposes of resolving whether a promissory note is a security. Consequently, the *Reves* case must be reviewed before addressing the inconsistencies in the Securities Acts.

For several decades after the enactment of the Securities Acts, the federal courts were primarily preoccupied with litigation involving investment contracts as securities. In the 1970's, the federal courts began to address actions involving notes as securities. After two decades of the circuit courts individually setting forth varying tests, the Supreme Court, in *Reves v. Ernst & Young*, established a single test for determining whether a note is a security.<sup>5</sup> In *Reves*, the issue was whether promissory notes, payable on demand by the holder and sold to raise money for the general business operations of a 23,000 member agricultural cooperative, were securities as defined by Section 3(a)(10) of the 1934 Act.<sup>6</sup> The notes were advertised as an investment program and sold to members and non-members of the cooperative.<sup>7</sup> The notes were uncollateralized and uninsured but paid a variable interest rate.<sup>8</sup> The cooperative filed for bankruptcy and a class of note holders filed suit alleging fraud.<sup>9</sup> The district court awarded the plaintiffs a \$6.1 million judgment.<sup>10</sup> The United States Court of Appeals for the Eighth Circuit reversed and held that the demand notes were not securities.<sup>11</sup> On certiorari, the

Supreme Court reversed the Eighth Circuit and remanded.<sup>12</sup>

In *Reves*, the Supreme Court unanimously adopted the "family resemblance test" to determine whether a note is a security.<sup>13</sup> The family resemblance test requires the following analysis: The test begins with a presumption that any note is a security because the broad definitions of a security in the Securities Acts provide that "any note" is a security.<sup>14</sup> But the Supreme Court recognized that certain notes are never securities.<sup>15</sup> Therefore, it held that the presumption can be rebutted by showing that the note at issue is contained on an enumerated list of "non-securities" set forth by the Second Circuit.<sup>16</sup> The presumption can also be rebutted by showing that the note at issue strongly resembles the enumerated list by applying four criteria.<sup>17</sup> These four criteria are: 1) the motivations that prompted a reasonable buyer and seller to become involved in the transaction; 2) whether "common trading" existed; 3) the expectations of the purchasing public; and 4) whether any risk reducing factors were present.<sup>18</sup>

The Supreme Court also addressed the scope of the coverage of the family resemblance test with respect to the 1933 Act and the 1934 Act.<sup>19</sup> This was necessary because the action in *Reves* was brought only under the 1934 Act.<sup>20</sup> The Supreme Court reaffirmed its earlier position that despite the differences in the definitions of a security between the 1933 Act and the 1934 Act, the definitions are "virtually identical" and that "the coverage of the two Acts may be considered the same."<sup>21</sup> Therefore, the Supreme Court made the family resemblance test applicable to determining whether a note is a security under both the 1934 Act and the 1933 Act. The family resemblance test is to be applied regardless of whether the determination is for purposes of the 1933 Act or the 1934 Act. If the determination is made that the note is not a security, then the note falls outside the purview of the Securities Acts. However, if it is determined that the note is a security, the analysis must continue. A note which is a security may still be exempt under the 1933 Act or excluded from the definition of a security in the 1934 Act if the note matures within nine months.

Unfortunately, the Supreme Court in *Reves* declined to take advantage of the

opportunity to consider the nine-month maturity exception. As previously discussed, the 1933 Act includes all notes within its definition of a security,<sup>22</sup> but exempts from registration notes maturing in nine months or less.<sup>23</sup> The 1934 Act excludes from its definition of a security, any note that matures in nine months or less.<sup>24</sup> This means that a short-term note may not be subject to the provisions of the 1934 Act. The majority of the circuit courts have addressed the nine-month maturity exception numerous times and held that it was Congress' intent to exempt or exclude only "commercial paper"<sup>25</sup> that matured within nine months.<sup>26</sup>

In *Reves*, the respondents argued that the notes at issue were not securities, even if they otherwise qualified as such under the family resemblance test, because they could mature in less than nine months and, therefore, were excluded from the definition of a security in the 1934 Act.<sup>27</sup> Petitioners urged the Supreme Court to reject a plain reading of the 1934 Act and to consider the context of the transaction in order to determine whether Congress intended the 1934 Act to apply to the notes at issue.<sup>28</sup> Petitioners argued "with some force" that Congress intended the nine-month maturity exception of the 1934 Act be applicable only to commercial paper and not investments.<sup>29</sup>

In holding that the notes at issue in *Reves* matured in more than nine months under federal law because they were demand notes,<sup>3</sup> the majority implicitly declined to consider the nine-month maturity exception. In a concurring opinion, Justice Stevens supported the circuit courts' interpretation of the nine-month maturity exception that "when Congress spoke of notes with a maturity not exceeding nine months, it meant commercial paper, not investment securities."<sup>31</sup> Justice Stevens also extended the commercial paper interpretation to apply to both the 1933 Act and the 1934 Act.<sup>32</sup> However, in the dissent, four justices argued for a plain reading of Section 3(a)(10) of the 1934 Act that any note with a maturity date of less than nine months is excluded from the definition of a security.<sup>33</sup>

Therefore, even though *Reves* established a single test to determine whether a note is a security, the Supreme Court left

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unresolved the issue of whether notes maturing in nine months or less are automatically exempted from registration under the 1933 Act or excluded from the definition of a security in the 1933 Act. This leaves two possible interpretations of the nine-month maturity exception when a note is determined to be a security and matures in less than nine months: 1) the note is exempt or excluded because it is "commercial paper" or 2) the note is exempt or excluded solely because of its maturity date. While the Supreme Court will ultimately need to address this issue, the most persuasive argument, based on case law, the legislative history of the Securities Acts, and the SEC's interpretation, is that the nine-month maturity exception applies only to prime quality commercial paper as set forth below.

### III. The Securities Act of 1933

The purpose of the 1933 Act is to "regulate the initial distribution of securities by issuers to public investors."<sup>34</sup> It requires that a registration statement be filed and contain truthful information in sufficient detail to inform potential investors about the nature and character of the security.<sup>35</sup> The 1933 Act also contains anti-fraud provisions.<sup>36</sup> The definition of a security under Section 2(a)(1)<sup>37</sup> includes all notes, but Section 3(a)(3)<sup>38</sup> exempts notes with a maturity date of less than nine months from registration. This would appear to cause all notes with a maturity of nine months or less to be exempt from complying with the registration requirements of the 1933 Act, but not exempt from the anti-fraud provisions. Indeed, based on the plain language in Section 2(a)(1), it has been argued that any note is a security<sup>39</sup> and, therefore, if the note matures in nine months or less, it is exempt from complying with the registration requirements of the 1933 Act.<sup>40</sup> The legislative history of the 1933 Act, however, indicates that this argument is incorrect.

First, the language "any note" is not to be read literally. An examination of the legislative history of Section 3(a)(3) of the 1933 Act reveals that Congress intended Section 3(a)(3) to apply only to commer-

cial paper not intended to be sold to the general public. The Senate Report stated, "[n]otes, drafts, bills of exchange, and bankers' acceptances which are commercial paper and arise out of current commercial, agricultural, or industrial transactions, and which are not intended to be marketed to the public, are exempted ... It is not intended under the bill to require the registration of short-time commercial paper which, as is the usual practice, is made to mature in a few months and ordinarily is not advertised for sale to the general public."<sup>41</sup> The House Report added, "[p]aragraph (3) exempts short-term paper of the type available for discount at a Federal Reserve Bank and of a type which is rarely bought by private investors."<sup>42</sup> Thus, the legislative history indicates that the exemption for notes maturing in nine months or less applies only to commercial paper and not to short-term investments normally made available to the general public.

Second, the legislative history of the 1933 Act supports that Congress did not intend that the registration requirements be applicable to commercial paper. The comments of the Federal Reserve Board to the House and Senate Committees on the proposed legislation<sup>43</sup> dealt only with exempting commercial paper from the registration requirements because it was believed that requiring commercial paper to be registered would unduly burden the market.<sup>44</sup>

However, short-term notes are still subject to the anti-fraud provisions.<sup>45</sup> In fact, Section 17 of the 1933 Act prohibits fraudulent interstate transactions and provides that the exemptions of Section 3 are not applicable to the anti-fraud provisions.<sup>46</sup> The exemptions under Section 3 are also inapplicable for purposes of Section 12, which imposes civil liabilities for using interstate commerce or the mails to communicate or transport false information in connection with the offer or sale of a security.<sup>47</sup> The result is short-term notes which are commercial paper, while exempt from complying with the registration requirements of the 1933 Act, are subject to the anti-fraud provisions of the 1933 Act.

The SEC concurs that the exemption for notes maturing within nine months applies only to commercial paper.<sup>48</sup> In 1961, in Release No. 4412, the SEC inter-

preted the nine-month maturity exception to apply only to prime quality commercial paper. The SEC set forth four criteria for determining whether a note is prime quality commercial paper that is exempt from the registration requirements under Section 3(a)(3) of the 1933 Act.<sup>49</sup> To be exempt, a note must be 1) prime quality; 2) used to finance current transactions; 3) not offered to the public; and 4) discountable at a Federal Reserve Bank.<sup>50</sup> Note that later no-action letters issued by the SEC indicate that the fourth criterion need not be met, as the Federal Reserve Bank no longer discounts commercial paper.<sup>51</sup> Further, the SEC emphasized that prime quality commercial paper maturing in nine months or less is exempt only from the registration and prospectus requirements of Section 5, but not the provisions for civil liabilities in Section 12(2) and anti-fraud in Section 17 of the 1933 Act.<sup>52</sup>

Therefore, when determining whether a note is a security for purposes of the 1933 Act, the family resemblance test should be applied. If the note is determined not to be a security, the 1933 Act does not apply to the note at all. If the note is a security, then it must comply with the provisions of the 1933 Act unless it matures within nine months and is commercial paper which meets the three criteria set forth by the SEC. If the note meets the three criteria, then it is exempt only from the registration requirements of the 1933 Act, but is still subject to the anti-fraud provisions.

### IV. The Securities Exchange Act of 1934

The 1934 Act has a different purpose than the 1933 Act. The 1934 Act "provides for the regulation of the securities exchange markets and the operations of the corporations listed on the various national securities exchanges", and created the SEC to be in charge of such regulation.<sup>53</sup> The majority of the lawsuits filed for securities fraud are brought under section 10(b) of the 1934 Act, which prohibits manipulative and deceptive devices and schemes.<sup>54</sup> The definition of a security under Section 3(a)(10) excludes notes maturing in nine months or less from the definition of a security in the 1934 Act.<sup>55</sup>

The Senate Report for the 1934 Act does not directly mention the exclusion of notes maturing in less than nine months. It only states that the definition of a security in the 1934 Act is “substantially the same” as that in the 1933 Act.<sup>56</sup> However, several circuit courts have applied SEC Release No. 4412 and the legislative history of Section 3(a)(3) of the 1933 Act to Section 3(a)(10) of the 1934 Act.<sup>57</sup> These courts found that Congress intended that the exclusion from the definition of a security in the 1934 Act for notes maturing within nine months, applies only to prime quality commercial paper and not investments.<sup>58</sup>

Therefore, as with the 1933 Act, when determining whether a note is a security for purposes of the 1934 Act, the family resemblance test should be applied. If the note is determined not to be a security, the 1934 Act does not apply to the note at all. If the note is a security, then it must comply with the provisions of the 1934 Act unless it matures within nine months and is prime quality commercial paper that meets the three criteria set forth by the SEC. If the note meets the three criteria, it is excluded from the definition of a security in the 1934 Act.

## V. After Reves

After the Reves decision, the lower federal courts inconsistently applied the family resemblance test to determine whether notes were securities. First, the Supreme Court in Reves gave no indication of the weight that should be attributed to the four criteria of the family resemblance test.<sup>59</sup> Certain courts balanced them and applied equal weight to each.<sup>60</sup> Other courts attributed more weight to some criteria than others.<sup>61</sup> At least one lower court held “that the absence of even one [of the criteria] could not rebut the presumption of coverage.”<sup>62</sup> Second, the Supreme Court stated in a footnote in Reves, that when a note matures within nine months, there is no presumption in favor of or against whether the note is a security.<sup>63</sup> As a result, “the courts used their own discretion in deciding whether or not to apply the presumption.”<sup>64</sup>

Nevertheless, when confronted with a note maturing in less than nine months, the lower courts are seemingly rejecting the

plain language interpretation that all short-term notes are automatically exempt from registration under the 1933 Act or excluded from the definition of a security in the 1934 Act. Rather, they are holding that case law, the SEC’s interpretation, and the legislative histories of the Securities Acts indicate that the exemption and exclusion for short-term notes apply only to prime quality commercial paper.<sup>65</sup>

## VI. Conclusion

Limiting the exemption in the 1933 Act and the exclusion from the definition of a security in the 1934 Act for notes maturing in nine months or less to prime quality commercial paper, is the most logical way to reconcile Congress’ intent with the actual language of Section 2(a)(1) of the 1933 Act and Section 3(a)(10) of the 1934 Act. Congress never intended that the Securities Acts be “a broad federal remedy for all fraud.”<sup>66</sup> Rather, “Congress’ purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called.”<sup>67</sup> An analysis of a note maturing in less than nine months to determine whether it is prime quality commercial paper guarantees the inclusion of notes that are investments and excludes notes that are merely commercial transactions.

The proper analysis should be as follows: The family resemblance test should be applied to determine whether the note at issue is a security. It should be presumed that notes maturing in greater than nine months are securities, but there should be no presumption for short-term notes. If the note is determined not to be a security, it is not subject to the Securities Acts. If the note is a security and its maturity is longer than nine months, it is subject to the Securities Acts. If the note is a security and matures within nine months, the three factors set forth by the SEC should be applied to determine whether the note is prime quality commercial paper. If the note is not prime quality commercial paper, it is subject to the Securities Acts. If the note is prime quality commercial paper, it is exempt under Section 3(a)(3) of the 1933 Act from registration but not the anti-fraud provisions, and excluded from the definition of a security in Section 3(a)(10) of the 1934 Act.

Salespersons claiming that the notes they sell are not securities rarely are selling prime quality commercial paper. The majority are selling promissory notes which are purchased as investments. Thus, unless the salespersons can demonstrate the notes they are selling are either not securities under the family resemblance test or are prime quality commercial paper exempt under the 1933 Act or excluded from the definition of a security in the 1934 Act, the salespersons must be licensed, the securities must be registered, and their brokerage firms must be notified.

*Jennifer Basil is an Enforcement Attorney with the Ohio Division of Securities. This article originally appeared in NASAA's Enforcement Law Reporter, 1999.*

## ENDNOTES

- 1 15 U.S.C. §77b(1) (1994).
- 2 15 U.S.C. §77c(a)(3) (1994).
- 3 15 U.S.C. §78c(a)(10) (1994).
- 4 494 U.S. 56 (1990).
- 5 *Id.* at 67.
- 6 *Id.* at 58-60.
- 7 *Id.* at 59.
- 8 *Id.* at 58.
- 9 *Id.* at 59.
- 10 *Id.*
- 11 *Id.*
- 12 *Id.* at 73.
- 13 *Id.* at 64-65.
- 14 *Id.* at 65.
- 15 *See id.* at 65.
- 16 *Id.* at 65 (quoting Exchange Nat. Bank of Chicago v. Touche Ross & Co., 544 F.2d 1126, 1138 (2d Cir. 1976)) (“types of notes that are not ‘securities’ include ‘the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a ‘character’ loan to a bank customer, short-term notes secured

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- by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business”).
- 17 *Id.* at 65-67.
- 18 *Id.* at 66-67.
- 19 See *id.* at 62-73.
- 20 *Id.* at 56 & 60.
- 21 *Id.* at 61 n.1 (quoting *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 847 n.12 (1975)).
- 22 15 U.S.C. §77b(1) (1994).
- 23 15 U.S.C. §77c(a)(3) (1994).
- 24 15 U.S.C. §78c(a)(10) (1994).
- 25 The SEC intended “commercial paper” to mean only “prime quality commercial paper of a type not ordinarily purchased by the general public.” Securities Act Release No. 33-4412, 26 Fed. Reg. 9158 (Sept. 20, 1961).
- 26 *Holloway v. Peat, Marwick, Mitchell & Co.*, 879 F.2d 772 (10th Cir. 1989), vacated and remanded on other grounds, 494 U.S. 1014 (1990), *aff’d*, 900 F.2d 1485 (10th Cir. 1990); *Bellah v. First Nat’l Bank of Hereford*, 495 F.2d 1109 (5th Cir. 1974); *Sanders v. John Nuveen & Co. Inc.*, 463 F.2d 1075 (7th Cir. 1972), cert. denied, 409 U.S. 1009 (1972).
- 27 494 U.S. at 70.
- 28 *Id.*
- 29 *Id.* at 70-71.
- 30 *Id.* at 71.
- 31 *Id.* at 74 (quoting *Sanders v. John Nuveen & Co., Inc.*, 463 F.2d 1075, 1080 (7th Cir. 1972), cert. denied, 409 U.S. 1009 (1972)).
- 32 *Id.* at 76.
- 33 *Id.* at 81.
- 34 *Elisabeth Keller & Gregory A. Gehlmann, Introductory Com-*
- ment, A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 329, 330 (1988).
- 35 *Id.* at 330.
- 36 15 U.S.C. §771(a)(2) (1994); 15 U.S.C. §77q (1994).
- 37 15 U.S.C. §77b(1) (1994).
- 38 15 U.S.C. §77c(a)(3) (1994).
- 39 *Llanos v. United States*, 206 F.2d 852 (9th Cir. 1953), cert. denied, 346 U.S. 923 (1954); *Prentice v. Hsu*, 280 F. Supp. 384 (S.D.N.Y. 1968); *Securities and Exchange Commission v. Gulf Intercontinental Finance Corp.*, 223 F. Supp. 987 (S.D. Fla. 1963); *Securities and Exchange Commission v. Addison*, 194 F. Supp. 709 (N.D. Tex. 1961).
- 40 494 U.S. at 79-80.
- 41 S. REP. NO. 47, 73d Cong., 1st Sess. 3-4 (1933).
- 42 H.R. REP. NO. 85, 73d Cong., 1st Sess. 15 (1933).
- 43 *The Exchange Nat’l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126, 1131-32 n.7 (1976) (interpreting Hearings on H.R. 4314 Before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 180 (1933))
- 44 544 F.2d at 1131-32 n.7 (1976) (interpreting Hearings on H.R. 4314 Before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 180 (1933), see also S. REP. NO. 47, 73d Cong., 1st Sess. 3-4 (1933) (letter to Congress from the Committee on Banking and Currency)).
- 45 544 F.2d at 1131-32 n.7 (1976) (interpreting Hearings on H.R. 4314 Before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 180 (1933), see also S. REP. NO. 47, 73d Cong., 1st Sess. 3-4 (1933) (letter to Con-
- gress from the Committee on Banking and Currency)).
- 46 15 U.S.C. §77q(c) (1994).
- 47 15 U.S.C. §771(a)(2) (1994).
- 48 Securities Act Release No. 33-4412, 26 Fed. Reg. 9158 (Sept. 20, 1961).
- 49 *Id.*
- 50 *Id.*
- 51 *General Electric Capital Corp., SEC No-Action Letter*, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶79,946, (July 13, 1994) (citing Brief of the SEC Amicus Curiae at 40 n. 21; *American Federation of State, County and Municipal Employees v. Federal Deposit Insurance Corporation*, (D.C.D.C. 1992) (Civil Action No. 91-0626 (RCL))).
- 52 *Id.*
- 53 *Keller & Gehlmann, supra note 23*, at 330.
- 54 15 U.S.C. §78j(b) (1994).
- 55 15 U.S.C. §78c(a)(10) (1994).
- 56 S. REP. NO. 792, 73d Cong. 2d Sess. 14 (1934).
- 57 *Zeller v. Bogue Electric Manufacturing Corp.*, 476 F.2d 795, 799-800 (2d Cir. 1973), cert. denied 414 U.S. 908 (1973); *Sanders* 463 F.2d at 1080.
- 58 *Zeller v. Bogue Electric Manufacturing Corp.*, 476 F.2d 795 (2d Cir. 1973), cert. denied 414 U.S. 908 (1973); *Sanders v. John Nuveen & Co., Inc.*, 463 F.2d 1075, 1079-80 (7th Cir. 1972), cert. denied, 409 U.S. 1009 (1972).
- 59 *Janet Kerr & Karen M. Eisenhauer, Reves Revisited*, 19 PEPP. L. REV. 1123, 1157 (1992).
- 60 *Id.* at 1157 & n.296.
- 61 *Id.* at 1157 & n.297.
- 62 *Id.* at 1157 & n.298.
- 63 *Reves*, 494 U.S. at 65 n.3.

*Continued on page 12*

## Limited Exception for Private Investment Advisers Now Available

Effective May 25, 2000, Ohio law provides a new limited exception from investment adviser regulation for certain persons who privately advise a small number of sophisticated clients. This new exception is very limited in scope. Specifically, new Ohio Administrative Code Rule 1301:6-3-01(K)(1) provides that a person is excluded from the Ohio definition of “investment adviser” if the person, during the course of the preceding twelve months: (1) had fifteen or fewer clients; and (2) did not hold himself or herself out generally to the public as an investment adviser; and (3) had as clients only the sophisticated, trust or family entities specified in the Rule.

A person must satisfy all three of these conditions in order to qualify for this exclusion. Under Ohio law, “person” is defined to include both natural persons and most business entities. Persons relying on this exclusion need not make a filing with the Division, but the Division recommends that such persons keep their own records of reliance on Rule 1301:6-3-01(K)(1).

This new exception is separate from, and has no impact on, the licensing exception for investment advisers who have no place of business in Ohio and have not more than five clients in the state (usually referred to as the “de minimis” exception and set out in Ohio Revised Code 1707.141(A)(4)). In other words, an out-of-state adviser is still limited to five clients if such out-of-state adviser wants to avoid Ohio licensure.

Persons who fit within new Rule 1301:6-3-01(K)(1) are excluded from the provisions of Ohio securities law that apply to “investment advisers,” like licensing and recordkeeping requirements. However, such persons are not excluded from the provisions of Ohio securities law that apply to “persons,” like Ohio Revised Code 1707.44(B)(5), which prohibits a person from making or causing to be made false representations of material facts in the giving of investment advice for compensation.

## Saving and Investing Education Week

Governor Bob Taft declared April 2000 to be Saving and Investing Education Month in the State of Ohio, demonstrating his commitment to improving financial literacy in the Buckeye State. The goal of this annual event is to provide education and promote awareness about the importance of saving, investing, and making wise personal financial decisions. During April the Division of Securities engaged in educational outreach efforts throughout the state.

During last year’s Saving and Investing Education event, Director of Commerce Gary Suhadolnik announced a partnership with the Ohio Department of Education for the educational initiative “Financial Literacy 2001.” This program consists of a high school-level personal finance curriculum that was distributed to teachers throughout Ohio. In support of this initiative, Division personnel made approximately 80 presentations to over 2,000 students throughout the state during April. In addition, Division personnel made nearly a dozen investor education presentations to civic and community groups around Ohio.

The Division maintains a large inventory of investor education material that is available, free of charge, through the Division’s internet home page, [www.securiteis.state.oh.us](http://www.securiteis.state.oh.us), or by telephoning the Division at 1-800-788-1194.

## Division Enforcement Section Reports

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### *Administrative Orders*

#### **PHILLIP F. MEYERS AND BLUE STAR MATERIAL TECHNOLOGIES, INC.**

On October 8, 1999, the Division issued Order No. 99-406, a Cease and Desist Order with Consent Agreement, against Phillip F. Meyers and Blue Star Material Technologies, Inc. The Respondents reside in Ohio.

On July 15, 1999, the Division issued Order No. 99-311, a Notice of Opportunity for Hearing to Phillip F. Meyers and Blue Star Material Technologies, Inc. The Divisions alleged that the Respondent violated Ohio Revised Code 1707.44(C)(1) by selling securities that were not registered by description, coordination or qualification.

The Respondents sold unregistered stock to Ohio residents. The Order notified the Respondent of the Division's intent to issue a Final Cease and Desist Order against him. The Respondent did not timely request a hearing. Therefore, the Division issued its Cease and Desist Order, No. 99-406.

#### **DENNIS RAY OWENS**

On October 14, 1999, the Division issued Order No. 99-431, a Cease and Desist Order, against Dennis Ray Owens. The Respondent is an Ohio resident.

On August 31, 1999, the Division issued a Notice of Opportunity for Hearing, Division Order No. 99-345, to the Respondent pursuant to Ohio Revised Code Chapter 119. The Division alleged the Respondent had violated the provisions of Ohio Revised Code 1301:6-3-19(A)(19) by effecting a securities transaction not recorded on the regular books and records of the dealer that the salesman represents. Additionally, the Division alleged that the Respondent violated Revised Code 1707.44(C)(1) and 1707.19(A)(9), respectively, by selling unregistered securities and by conducting business in

violation of such rules and regulations as the Division prescribes for the protection of investors. The Order also alleged that the Respondent violated Revised Code Section 1707.44(G) which provides that no person in selling securities shall knowingly engage in an act or practice which is, in this chapter, declared illegal, defined as fraudulent, or prohibited (the Respondent failed to disclose material facts while engaging in the sale of securities). The Division's allegations stem from the Respondent's sales of promissory notes in FLIC (First Lenders Indemnity Corporation) that were purportedly partially secured by collateral that included automobile loan portfolios. The notes were not registered or claimed from exemption with the Division of Securities. The Respondent also failed to disclose to investors that several state securities regulators had issued Cease and Desist Orders against companies affiliated with the issuance of the notes. Further, the Division notified the Respondent of his rights to an adjudicative hearing pursuant to Ohio Revised Code Chapter 119. Respondent failed to timely request an administrative hearing pursuant to Ohio Revised Code Chapter 119. Therefore, the Division issued its Cease and Desist Order, Order No. 99-343.

#### **JEFFREY GEORGE GREENE**

On October 14, 1999, the Division issued Order No. 99-432, a Cease and Desist Order, against Jeffrey George Greene. Respondent is a resident of Michigan.

On September 1, 1999, the Division issued Division Order No. 99-348, a Notice of Opportunity for Hearing, to Jeffrey George Greene. The Division alleged that the Respondent had violated the provisions of Revised Code sections 1707.44(C)(1) and 1707.44(G), respectively, by selling unregistered securities and knowingly engaging in fraudulent practices in conjunction with the sales of securities (namely, failing to disclose material facts in conjunction with the sale of securities).

The Division's allegations stem from the Respondent's sales of promissory notes in FLIC that were purportedly partially secured by collateral that included automobile loan portfolios. The notes were not registered or claimed from exemption with the Division of Securities. The Respondent also failed to disclose to investors that several state securities regulators had issued Cease and Desist Orders against companies affiliated with the issuance of the notes. The Division also notified the Respondent of his rights to an administrative hearing pursuant to Chapter 119 of the Revised Code. Respondent did not timely request an administrative hearing as permitted by Chapter 119 of the Ohio Revised Code. Therefore, the Division issued its Cease and Desist Order No. 99-432.

#### **SAMUEL HERBERT FOREMAN**

On October 28, 1999, the Division issued Order No. 99-442, a Revocation of Ohio Securities Salesperson License, against Samuel Herbert Foreman. Respondent is an Ohio resident.

On September 23, 1999, the Division issued to Respondent its Suspension of Ohio Securities Salesperson License; Notice of Intent to Revoke Ohio Securities Salesperson License; Notice of Opportunity for Hearing, Order No. 99-388. The Division alleged that Respondent was not of "good business repute" as that term is defined in Revised Code Section 1707.19(A)(1) and Ohio Administrative Code Rules 1301:6-3-19(D)(2), (6), (7), and (9). The Division's issuance of the Notice of Opportunity for Hearing gave the Respondent notice of intent to revoke his Ohio securities salesperson license. Respondent failed to timely request an administrative hearing pursuant to Ohio Revised Code Chapter 119. Therefore, the Division issued its Revocation of Ohio Securities Salesperson License, Order No. 99-442.



## CAROLYN FAY MUNN

On October 28, 1999, the Division issued Division Order No. 99-443, a Revocation of Ohio Securities Salesperson License, against Carolyn Fay Munn. The Respondent is an Ohio resident.

On September 23, 1999, the Division issued to Respondent a Suspension of Ohio Securities Salesperson License; Notice of Intent to Revoke Ohio Securities Salesperson License; Notice of Opportunity for Hearing, Order No. 99-390, to Carolyn Fay Munn. The Division alleged that Respondent was not of "good business repute" as that term is defined in Ohio Revised Code Section 1707.19(A)(1) and Ohio Administrative Code Rules 1301:6-3-19(D)(2), (6), (7), and (9). The Division's issuance of Division Order No. 99-390 gave the Respondent notice of intent to revoke her Ohio securities salesperson's license. The Respondent failed to timely request an administrative hearing pursuant to Ohio Revised Code Chapter 119. Therefore, the Division issued its Revocation of Ohio Securities Salesperson License, Order No. 99-443.

## MARTIN WILLIAM COLLINS

On November 19, 1999, the Division issued Division Order No. 99-483, a Cease and Desist Order, against Martin William Collins. The Respondent is an Ohio resident.

On October 19, 1999, the Division issued to Respondent a Notice of Opportunity for Hearing to Martin William Collins. The Division alleged that Respondent violated provisions of Revised Code Sections 1707.44(C)(1) and 1707.44(G), respectively, by selling unregistered securities and knowingly engaging in fraudulent practices in conjunction with the sales of securities (namely, failing to disclose material facts in conjunction with the sale of securities). The Division's allegations stem from the Respondent's sales of promissory notes in FLIC that were purportedly partially secured by collateral that included automobile loan portfolios. The notes were not registered or claimed from exemption with the Division of Securities. The Respondent also failed to disclose to investors that several state securities

regulators had issued Cease and Desist Orders against companies affiliated with the issuance of the notes. The Division also notified the Respondent of his right to an administrative hearing pursuant to Chapter 119 of the Revised Code. Respondent failed to timely request an adjudicative hearing pursuant to Chapter 119 of the Ohio Revised Code. Therefore, the Division issued its Cease and Desist, Order No. 99-483.

## TRULUCK ENTERPRISES, LLC

On November 19, 1999, the Division issued Division Order No. 99-484, a Cease and Desist Order, against Truluck Enterprises, LLC. The Respondent's business address is Texas.

On October 18, 1999, the Division issued Division Order No. 99-435, a Notice of Opportunity for Hearing, to Truluck Enterprises, LLC. The Division alleged that the Respondent violated Revised Code 1707.44(C)(1) by selling securities that were not registered by description, coordination or qualification, nor exempt from registration. The Division also notified the Respondent of its rights to an adjudicatory hearing pursuant to chapter 119 of the Revised Code. The Respondent failed to make a timely request for a hearing. Therefore, the Division issued its Cease and Desist Order No. 99-484, incorporating the allegation noted above as finding.

## ATM USA CORPORATION

On November 23, 1999, the Division issued Division Order No. 99-487, an Order to Cease and Desist, against ATM USA Corporation. The Respondent is located in Texas.

On April 22, 1999, the Division issued Division Order No. 99-193, a Notice of Opportunity for Hearing, against ATM USA Corporation. The Division alleged that the Respondent violated Revised Code 1707.44(C)(1) by selling securities that were not registered by description, coordination or qualification, nor exempt from registration. The Division also notified the Respondent of its right to an administrative hearing pursuant to Chapter 119 of the Revised Code. Service was refused by the Respondent, the Notice was

published. The Respondent did not timely request an administrative hearing. Therefore, the Division issued its Cease and Desist Order, Order No. 99-487.

## DAVID LEE COLWELL

On November 24, 1999, the Division issued Order No. 99-493, a Cease and Desist Order, against David Lee Colwell. The Respondent is an Ohio resident.

On October 21, 1999, the Division issued Division Order No. 99-440, a Notice of Opportunity for Hearing and Notice of Intent to Revoke Securities Salesperson License against David Lee Colwell. The Division alleged that the Respondent had violated the provisions of Ohio Revised Code 1301:6-3-19(A)(19) by effecting a securities transaction not recorded on the regular books and records of the dealer that the salesman represents. Additionally, the Division alleged that the Respondent violated Revised Code 1707.44(C)(1) and 1707.19(A)(9), respectively, by selling unregistered securities and by conducting business in violation of such rules and regulations as the Division prescribes for the protection of investors. The Order alleged that the Respondent violated Revised Code section 1707.44(G) which provides that no person in selling securities shall knowingly engage in an act or practice which is, in this chapter, declared illegal, defined as fraudulent, or prohibited (namely, failing to disclose material facts in conjunction with the sale of securities). The Division's allegations stem from the Respondent's sales of promissory notes in FLIC that were purportedly partially secured by collateral that included automobile loan portfolios. The notes were not registered or claimed from exemption with the Division of Securities. The Respondent also failed to disclose to investors that state securities regulators had issued Cease and Desist Orders against companies affiliated with the issuance of the notes.

The Division also notified the Respondent of his right to an administrative hearing in accordance with Ohio Revised Code Chapter 119. On or about November 12, 1999, a Form U-5 was filed with the National Association of Securities Dealers,

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Inc. by WMA Securities, Inc. reporting that Respondent was permitted to resign. This made it unnecessary to revoke his licence. Therefore, the Division issued its Cease and Desist Order, Order No. 99-493.

### **INTERNATIONAL FOREX INVESTMENTS LTD. AKA FOREX FINANCIAL GROUP INC.; AND BRYAN DARROW, TOM MORRISON**

On November 26, 1999, the Division issued Division Order No. 99-494, a Cease and Desist Order, against International Forex Investments LTD., aka Forex Financial Group Inc. and Bryan Darrow, Tom Morrison. The Respondents' business is in New York.

On April 22, 1999, the Division issued a Notice of Opportunity for Hearing, Division Order No. 99-191, to the Respondents pursuant to Ohio Revised Code Chapter 119. The Division alleged that the Respondents violated the provisions of Ohio Revised Code 1707.44(C)(1) which prohibits the sale of unregistered securities or securities that are not exempt from the registration by description, coordination or qualification. The Division also alleged that the Respondents violated the provisions of Ohio Revised Code 1707.44(K), which declares that no person, with the purpose to deceive, shall make, record, or publish or cause to be made, recorded, or published, a report of any transaction in securities which is false in any material respect. The Respondents did not timely request an administrative hearing. Therefore, the Division issued its Cease and Desist Order, Order No. 99-494.

### **KEVIN LEE MILLER**

On November 29, 1999, the Division issued Division Order No. 99-500, a Cease and Desist Pursuant to Consent Agreement, against Kevin Lee Miller. The Respondent is an Ohio resident.

On August 26, 1999, the Division issued a Notice of Opportunity for Hearing, Division Order No. 99-344 to Kevin Lee

Miller. The Division alleged that Respondent had violated the provisions of Revised Code Sections 1707.44(C)(1) and 1707.44(G), respectively, by selling unregistered securities and failing to disclose material facts in conjunction with the sales of securities, thereby engaging in acts which are declared illegal, defined as fraudulent or prohibited. The Division's allegations stem from the Respondent's sales of promissory notes in FLIC that were purportedly partially secured by collateral that included automobile loan portfolios. The notes were not registered or claimed from exemption with the Division of Securities. The Respondent also failed to disclose to investors that several state securities regulators had issued Cease and Desist Orders against companies affiliated with the issuance of the notes. The Division also notified the Respondent of his rights to an adjudicatory hearing pursuant to Chapter 119 of the Revised Code. Upon receipt of the Order, Respondent requested an administrative hearing. Respondent later withdrew his request. The Division and the Respondent entered into a Cease and Desist Pursuant to Consent Agreement incorporating these allegations and conclusions. The Respondent was required to waive appeal rights in this matter and to stipulate and agree to the findings, conclusions and orders found in the Cease and Desist Order.

### **GARY ALAN VOSICK**

On December 6, 1999, the Division issued Division Order 99-504, a Suspension of Ohio Securities Salesperson License, Cease and Desist Order, against Gary Alan Vosick. Respondent is an Ohio Resident.

On November 3, 1999, the Division issued a Notice of Opportunity for Hearing and Notice of Intent to Suspend Securities Salesperson License, Division Order No. 99-462, to Gary Alan Vosick. The Division alleged that the Respondent had violated the provisions of Ohio Revised Code 1301:6-3-19(A)(19) by effecting a securities transaction not recorded on the regular books and records of the dealer that the salesman represents. Additionally, the Division alleged that the Respondent violated Revised Code 1707.44(C)(1) by selling unregistered securities. The Division alleged the Respondent's actions gave rise to a violation of R.C.1707.19(A), which permits license

suspensions. The Order alleged that the Respondent violated Revised Code section 1707.44(G), which provides that no person in selling securities shall knowingly engage in an act or practice which is, in this chapter, declared illegal, defined as fraudulent, or prohibited (namely, failing to disclose material facts in conjunction with the sales of securities). The Division's allegations stem from the Respondent's sales of promissory notes in FLIC that were purportedly partially secured by collateral that included automobile loan portfolios. The notes were not registered or claimed from exemption with the Division of Securities. The Respondent also failed to disclose to investors that several state securities regulators had issued Cease and Desist Orders against the Respondent. The Division notified the Respondent of his right to an adjudicatory hearing pursuant to Chapter 119 of the Revised Code. Upon receipt of the Order, the Division and Respondent entered into Consent Agreement, incorporating the allegations as findings. The agreement principally required the Respondent to accept a six-week period of suspension. Respondent was required to waive appeal rights in this matter and to stipulate and agree to the findings, conclusion and orders found in the Cease and Desist Order, Order No. 99-504.

### **GECKO HOLDINGS, INC.**

On December 7, 1999, the Division issued Division Order No. 99-505, a Cease and Desist Order, against Gecko Holdings, Inc. Respondent's business address is California.

On August 6, 1999, the Division issued a Notice of Opportunity for Hearing, Division Order No. 99-315, to Gecko Holdings, Inc. The Division alleged that the Respondent had violated the provisions of Revised Code sections 1707.44(C)(1) and 1707.44(G), respectively, by selling unregistered securities and failing to disclose material facts in conjunction with the sales of securities, thereby engaging in fraudulent acts as defined in Chapter 1707. The Division also alleged that Respondent violated Revised Code Section 1707.44(B)(4), which provides that no person shall knowingly make or cause to be made any false representation concerning a material and relevant fact, in any oral statement or in any prospectus, circular, description,

application or written statement for the purpose of selling securities in Ohio. The Division's allegations stem from the Respondent's acts and practices of falsely representing that Gecko Holdings, Inc. was a legitimate business that would go public, that the investors' investments would greatly increase in value shortly after the company went public, and that the Investors could expect a specific rate of return on their investment. The Division also notified the Respondent of its right to an administrative hearing pursuant to Chapter 119 of the Revised Code. Respondent failed to timely request an adjudicative hearing pursuant to Chapter 119 of the Ohio Revised Code. Therefore, the Division issued its Cease and Desist, Order No. 99-505.

### **BERNARD KENNETH WARD**

On December 7, 1999, the Division issued Division Order No. 99-506, a Cease and Desist Order, against Bernard Kenneth Ward. The Respondent is an Ohio resident.

On November 4, 1999, the Division issued a Notice of Opportunity for Hearing, Division Order No. 99-464, to Respondent pursuant to Ohio Revised Code Chapter 119. The Division alleged that the Respondent had violated the provisions of Revised Code Sections 1707.44(C)(1) and 1707.44(G), respectively, by selling unregistered securities and failing to disclose material facts in conjunction with the sales of securities, thereby engaging in acts which are declared fraudulent by Chapter 1707. The Division's allegations stem from the Respondent's sales of promissory notes in FLIC that were purportedly partially secured by collateral that included automobile loan portfolios. The notes were not registered or claimed from exemption with the Division of Securities. The Respondent also failed to disclose to investors that several state securities regulators had issued Cease and Desist orders against companies affiliated with the issuance of the notes. The Division also notified the Respondent of his right to an administrative hearing pursuant to Chapter 119 of the Revised Code. Respondent failed to timely request an administrative hearing. Therefore, the Division issued its Cease and Desist Order, Order No. 99-506.

### **KLEIN, MAUS & SHIRE, INC.**

On December 7, 1999, the Division issued Division Order No. 99-507, a Revocation of Ohio Securities Dealer License, against Klein, Maus & Shire, Inc. The Respondent is located in New York.

On June 30, 1999, the Division issued a Suspension of Ohio Securities Dealer License, Notice of Intent to Revoke Ohio Securities Dealer License, Notice of Opportunity for Hearing, to Respondent pursuant to Ohio Revised Code Chapter 119. The Division alleged that Respondent violated the provisions of Administrative Code Rule 1301:6-3-15(H)(1) and Revised Code 1707.14(B), respectively, by failing to file a financial statement within 90 days of the end of its fiscal year and neglecting to register with the SEC. The Division further alleges that these failures to comply with the above provisions permitted a license suspension pursuant to Revised Code Section 1707.19(A)(4) and (9). The Division also notified the Respondent of its right to an administrative hearing pursuant to Ohio Revised Code Chapter 119. Respondent failed to timely request an administrative hearing. Therefore, the Division issued its Revocation of Ohio Securities Dealer License, Order No. 99-507.

### **MATTHEW LANE PAINTER**

On December 15, 1999, the Division issued Division Order No. 99-516, a Cease and Desist Order, against Matthew Lane Painter. Respondent is an Ohio resident.

On October 29, 1999, the Division issued a Notice of Opportunity for Hearing to Respondent pursuant to Ohio Revised Code Chapter 119. The Division alleged that Respondent had violated Revised Code Sections 1707.44(C)(1) and 1707.44(G), respectively, by selling unregistered securities and failing to disclose material facts in conjunction with the sale of securities, thereby engaging in acts defined as fraudulent by Chapter 1707 of the Revised Code. The Division's allegations stem from the Respondent's sales of promissory notes in FLIC that were purportedly partially secured by collateral that included auto loan portfolios. The Division also notified the Respondent of his rights to an adjudicatory hearing.

Respondent did not timely request an adjudicative hearing. Therefore, the Division issued its Cease and Desist Order, Order No. 99-516.

### **JOHN FREDERICK CONYER JR.**

On December 15, 1999, the Division issued Division Order No. 99-517, a Cease and Desist Order, against John Frederick Conyer, Jr. Respondent is an Ohio resident.

On November 9, 1999, the Division issued a Notice of Opportunity for Hearing to Respondent pursuant to Ohio Revised Code Chapter 119. The Division alleged that the Respondent had violated the provisions of Revised Code Sections 1707.44(C)(1) and 1707.44(G), respectively, by selling unregistered securities and failing to disclose material facts in conjunction with the sale of securities, thereby engaging in fraudulent acts as defined in Chapter 1707. The Division's allegations stem from the Respondent's sales of promissory notes in FLIC that were purportedly partially secured by collateral that included automobile loan portfolios. The notes were not registered or claimed from exemption with the Division of Securities. The Respondent also failed to disclose to investors that several state securities regulators had issued Cease and Desist Orders against companies affiliated with the issuance of the notes. The Division also notified the Respondent of his rights to an administrative hearing pursuant to Chapter 119 of the Revised Code. Respondent failed to timely request an administrative hearing. Therefore, the Division issued its Cease and Desist Order, Order No. 99-517.

### **JAMES L. BINGE**

On December 17, 1999, the Division issued Division Order No. 99-524, a Revocation of Ohio Securities Salesperson License, against James L. Binge. The Respondent is an Ohio resident.

On September 7, 1999, the Division issued a Suspension of Ohio Securities Salesperson License and Notice of Opportunity for Hearing, Division Order No. 99-355, to the Respondent pursuant to Ohio Revised Code Chapter 119. The Division alleged that Respondent is not of

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"good business repute" as that term is defined in Ohio Administrative Code Rules 1301:6-3-19(A)(6), 1301:6-3-19(D)(1), (2), (8) and (9) and Revised Code Sections 1707.19(A)(1). Respondent also violated R.C. 1707.19(A)(9) by conducting business in violation of the Division's rules and regulations. The Division also notified the Respondent of his right to an administrative hearing pursuant to Ohio Revised Code Chapter 119. Respondent failed to timely request an administrative hearing. Therefore the Division issued its Revocation of Ohio Securities Salesperson License, Order No. 99-524.

### DONALD WAYNE OWENS

On December 28, 1999, the Division issued Division Order No. 99-533, a consented Cease and Desist Order, against Donald Wayne Owens. Respondent is an Ohio resident.

On August 25, 1999, the Division issued a Notice of Opportunity for Hearing, Division Order No. 99-341. The Division alleged the Respondent had violated the provisions of Revised Code Sections 1707.44(C)(1) and 1707.44(G), respectively, by selling unregistered securities and failing to disclose material facts in conjunction with the sale of securities, thereby engaging in fraudulent acts as defined in Chapter 1707. The Division's allegations stem from the Respondent's sales of promissory notes in FLIC that were purportedly partially secured by collateral that included automobile loan portfolios. The notes were not registered or claimed from exemption with the Division of Securities. The Respondent also failed to disclose to investors that several state securities regulators had issued Cease and Desist Orders against companies affiliated with the issuance of the notes. The Division also notified the Respondent of his right to an administrative hearing pursuant to Chapter 119 of the Revised Code. The Respondent requested an administrative hearing pursuant to Chapter 119, but later withdrew his request. The Respondent and the Division entered into a Consent agreement, and the Division issued its Cease and Desist Order, Order No. 99-533.

## SUNPOINT SECURITIES, INC.

On December 29, 1999, the Division issued Division Order No. 99-547, a Revocation of Ohio Securities Dealer License, against Sunpoint Securities, Inc. Respondent is located in Texas.

On November 23, 1999, the Division issued an Order to Suspend the Ohio Securities Dealer License, Notice of Intent to Revoke and Notice of Opportunity for Hearing, Division Order No. 99-485, to the Respondent pursuant to Ohio Revised Code Section 119. The Division alleged that Respondent is not of "good business repute" as that term is defined in Ohio Administrative Code Rules 1301:6-3-19(D)(2), (7) and (9) and Revised Code Section 1707.19(A)(1). The Division also notified the Respondent of its right to an administrative hearing pursuant to Ohio Revised Code Chapter 119. The Respondent failed to timely request an administrative hearing. Therefore, the Division issued its Revocation of Ohio Securities Dealer License.

### BRAHMAN SECURITIES, INC.

On February 18, 2000, the Division issued Division Order No. 00-039, a consented Cease and Desist Order, against Brahman Securities, Inc. Respondent is located in New York.

On December 13, 1999, the Division issued a Notice of Opportunity for Hearing, Division Order No. 99-515, to Respondent pursuant to Ohio Revised Code Section 119. The Division alleged that the Respondent violated Revised Code 1707.44(A)(1) which prohibits the unlicensed sale of securities. The Division also notified the Respondent of its right to an adjudicatory hearing. Upon receipt of the Order, the Division and Brahman Securities, Inc. entered into a Consent Agreement in which rescission was offered to the purchasers. The Division issued its Cease and Desist Order, Order No. 00-039 in conjunction with the agreement.

*Editor's note: Enforcement Section Reports of Division Orders issued or finalized later in the first quarter of 2000 will be reported in the next Ohio Securities Bulletin.*

## PROMISSORY NOTES

*Continued from page 2*

fraudulent) companies, promising interest payments far above market rates, usually between 12 and 18 percent. A major component of fraud in the sale of these notes arises when the sellers advise investors that the notes are backed by a bonding company. Typically, these bonding companies are phantom, offshore outfits that do not pay up when trouble arises with note payments to investors. Therefore, investors have no protection when payments cease on the notes.

Given the problems stemming from the sale of high-risk, short-term promissory notes that investors and regulators have encountered, those who sell them should also be wary. Sellers need to realize that these notes could be subject to the jurisdiction of state and federal regulators. Therefore, brokers, insurance agents, investment advisers and "marketing agents" who sell risky notes need to be mindful of registration and anti-fraud provisions found in the Ohio Securities Act, as well as those found in federal securities laws, and other states' securities acts.

*Desiree Shannon is an Enforcement Attorney with the Ohio Division of Securities.*

## MATURITY EXCEPTION

*Continued from page 6*

- 64 Kerr & Eisenhauer, supra note 48, at 1151.
- 65 Securities Exchange Commission v. R.G. Reynolds Enterprises, Inc., 952 F.2d 1125 (9th Cir. 1991); Holloway v. Peat, Marwick, Mitchell & Co., 879 F.2d 772 (10th Cir. 1989), vacated and remanded on other grounds, 494 U.S. 1014 (1990), aff'd, 900 F.2d 1485 (10th Cir. 1990); National Bank of Yugoslavia v. Drexel, 768 F. Supp. 1010 (S.D.N.Y. 1991); Singer v. Livoti, 741 F. Supp. 1040 (1990).
- 66 Marine Bank v. Weaver, 455 U.S. 551, 556 (1982).
- 67 494 U.S. at 61.

## Final Order Summaries

The following is a summary of recent final orders issued by the Division in response to salesman license applications. Final Orders relating to the granting or denial of salesman licenses are summarized on the chart below.

<b>PARTY</b>	<b>DECISION</b>	<b>ORDER SENT</b>	<b>ALLEGATIONS HEARING OFFICER'S RECOMMENDATION (Approved/Disapproved)</b>
William Henry Watson, III	Denied	9/24/99 No. 99-393	OAC 1707.16, OAC 1707.19, OAC 1301:6-3-19(D)(9) Findings approved
Gerard Joseph Arrigale, Jr.	Denied	10/15/99 No. 99-434	OAC 1707.16, OAC 1707.19, OAC 1301:6-3-19(D)(7) & (9) Findings approved
George Jerry Merges	Granted	10/29/99 No. 99-455	ORC 1707.16, ORC 1707.19, OAC 1301:6-3-19(D) (7) and (9) Findings approved
Robert Anthony Papariella	Denied	11/1/99 No. 99-458	OAC 1707.16, OAC 1707.19, OAC 1301:6-3-19(D)(9) Findings approved
Thomas Francis Leahy	Denied	11/1/99 No. 99-459	OAC 1707.16, OAC 1707.19, OAC 1301:6-3-19(D)(2),(7) &(9) Findings disapproved
Michael Paul Cilmi	Denied	11/19/99 99-481	OAC 1301:6-3-19(D) (7) and (9), RC 1707.19(A)(1) No hearing held
Aaron Kurt Phillips	Denied	11/19/99 99-482	OAC 1301:6-3-19(D), (2), (7) and (9), RC 1707.19(A)(1) No hearing held
William Clyde Shepherd II	Granted	11/23/99 99-486	OAC 1301:6-3-19(D) (6), (7) and (9), ORC 1707.16 and 1707.19 Findings approved
Louis Richard Lunne	Granted	12/30/99 99-534	ORC 1707.16, ORC 1707.19, OAC 1301:6-3-19(D)(9) Findings disapproved
Kevin Cline Preble	Denied	1/25/00 00-013	OAC 1301:6-3-19(D) (7) AND (9), ORC 1707.19(A)(1) No hearing held
Michael J. Zaccaro	Granted	2/9/00 00-026	ORC 1707.16, ORC 1707.19, OAC 1301:6-3-19(D) (7) and (9) Findings approved
John Andrew Pliakas	Granted	2/9/00 00-027	ORC 1707.16, ORC 1707.19, OAC 1301:6-3-19(D) (7) and (9) Findings approved
Marion Elegar Thackston, III	Granted	3/8/00 00-056	ORC 1707.16, ORC 1707.19, OAC 1301:6-3-19(D) (9) Findings approved
Alfred Ivan Lipsitz	Denied	3/8/00 00-057	ORC 1707.16, ORC 1707.19, OAC 1301:6-3-19(D) (7) and (9) Findings approved

## Division Unveils Searchable “ERNIE” Database

On May 1, the Division unveiled its new publicly searchable Exemption, Registration, Notice Interactive Electronic, or “ERNIE,” database. ERNIE, which is a new feature on the Division’s website, [www.securities.state.oh.us](http://www.securities.state.oh.us), permits the public to use the Internet to determine if a filing for a particular securities product has been made with the Division. The ERNIE name results from the fact that securities filings made with the Division are categorized as exemption, registration or notice filings.

The Division believes that ERNIE will provide an easy-to-use tool for gathering information about securities products sold in Ohio. Investors can use ERNIE to “investigate before they invest,” and attorneys and securities professionals can check for compliance and other information. ERNIE contains summary information about filings, and is searchable based on a number of different criteria including the name and address of the issuer, and the date, type and amount of the offering. Pursuant to the State record retention laws, ERNIE contains filings made for the last eight years.

Of course, not all sales of securities in Ohio require a filing with the Division, so the absence of a filing does not necessarily indicate non-compliance with the Ohio securities laws. Before searching ERNIE, users must review and acknowledge an explanation of the ERNIE database and its limitations. The Division designed ERNIE to be an important part, but not the only part, of an investigation into compliance with the Ohio securities laws.

The Division welcomes comments on the ERNIE database.

## Capital Formation Statistics\*

Filing Type	First Qtr 2000	YTD 2000
<b>Exemptions</b>		
Form 3(Q)	\$152,940,327	\$152,940,327
Form 3(W)	16,939,000	16,939,000
Form 3(X)	38,850,146,064	38,850,146,064
Form 3(Y)	1,088,000	1,088,000
<b>Registrations</b>		
Form .06	429,083,688	429,083,688
Form .09	53,350,024	53,350,024
Form .091	3,969,627,504	3,969,627,504
Form .092(C)	00	00
<b>Investment Companies</b>		
Definite	115,430,000	115,430,000
Indefinite**	790,000,000	790,000,000
<b>TOTAL</b>	<b>\$44,378,604,607</b>	<b>\$44,378,604,607</b>

\*Categories reflect amount of securities registered, offered or eligible to be sold in Ohio by issuers.

\*\*Investment companies may seek to sell an indefinite amount of securities by submitting maximum fees. Based on the maximum filing fee of \$1100, an indefinite filing represents the sale of a minimum of \$1,000,000 worth of securities, with no maximum. For purposes of calculating an aggregate capital formation amount, each indefinite filing has been assigned a value of \$1,000,000.

## Registration Statistics

The following table sets forth the number of registration, exemption, and notice filings received by the Division during the first quarter of 2000, compared to the number of filings received during the first quarter of 1999. Likewise, the table compares the year-to-date filings for 2000 and 1999.

Filing Type	1st Qtr '00	YTD 2000	1st Qtr '99	YTD 1999
1707.03(Q)*	073	073	321	321
1707.03(W)	009	009	015	015
1707.03(X)	428	428	058	058
1707.03(Y)	001	001	001	001
1707.04	000	000	000	000
1707.041	000	000	001	001
1707.06	024	024	048	048
1707.09	012	012	014	014
1707.091	029	029	026	026
1707.092(A)**	1323	1323	1117	1117
1707.092(C)***	000	000	000	000
1707.39	003	003	001	001
1707.391	034	034	027	027
<b>Total</b>	<b>1936</b>	<b>1936</b>	<b>1629</b>	<b>1629</b>

\*Statistics for the number of 3(Q) filings submitted prior to March 18, 1999 contain those pursuant to both Rule 506 and Section 4(2) of the Securities Act of 1933, whereas filings after March 18, 1999 will be represented by two different sections: RC 1707.03(Q) for Section 4(2) filings, and RC 1707.03(X) for Rule 506 offerings.

\*\* Investment company notice filings.

\*\*\*Offerings of covered securities not otherwise covered by another statutory provision in the Ohio Securities Act.

## Licensing Statistics

The table below sets out the number of Salespersons and Dealers licensed by the Division at the end of the first quarter of 2000 compared to the corresponding quarter of 1999, as well as the second, third and fourth quarters of 1999 compared to the corresponding quarters of 1998.

	End of Q1 2000	End of Q1 1999	End of Q4 1999	End of Q4 1998	End of Q3 1999	End of Q3 1998	End of Q2 1999	End of Q2 1998
Number of Salespeople Licensed:	104,326	88,727	92,788	89,152	97,483	88,796	92,226	85,526
Number of Dealers Licensed:	2,438	2,223	2,347	2,137	2,332	2,151	2,287	2,106

# OHIO SECURITIES CONFERENCE 2000

**NOVEMBER 9, 2000**

**Executive Conference and Training Center  
Vern Riffe Center  
77 South High Street  
Columbus, Ohio**

The Ohio Securities Conference is returning to an all-securities law format.

- Recent Securities Law Developments •
  - Securities Law in Cyberspace •
- Recent Securities, Corporate and Financial Services Legislation •
  - Ohio Division of Securities Update •

The meetings of the Ohio Division of Securities  
Advisory Committees will be held in conjunction with this Conference.  
In September, a Conference Brochure with detailed information and registration  
instructions will be sent to all Ohio subscribers to the *Ohio Securities Bulletin*.

## OHIO SECURITIES BULLETIN

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