OHIO SECURITIES BULLETIN

A QUARTERLY PUBLICATION OF THE OHIO DIVISION OF SECURITIES

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Governor of Ohio

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Division Proposes Rule Changes Affecting Licensees

On October 4, 2002, the Division initiated the rule promulgation process with the Legislative Service Commission and Joint Commission on Agency Rule Review by proposing two amendments to existing licensing rules. If implemented, the amendments would affect the Division's licensing processes for securities dealers and investment adviser representatives.

The first proposal pertains to amending Ohio Administrative Code 1301:6-3-15 regarding maintenance of securities dealer licenses. Currently, in order to maintain licensure, the administrative rule requires dealers to annually submit audited financial statements to the Division reflecting a threshold net capital amount. As a result of the enactment of the National Securities Markets Improvement Act of 1996 (NSMIA), both the audited financial statement requirement and threshold net capital requirement in the Division's administrative rules should be eliminated for those *dealers affiliated with the National Association of Securities Dealers, Inc. (NASD).* It should be noted that both the submission of audited financial statements and maintenance of threshold net capital amounts will continue to be required for non-NASD affiliated securities dealers in Ohio.

In order to implement these changes, the Division has proposed that language be added to applicable provisions within the rule to clarify that NASD-affiliated dealers are not subject to the specific requirements. *(For purposes of the proposed changes to OAC 1301:6-3-15, it is important to note that the Division contemplates audited finan-*

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International Securities Regulators Endorse Historic Cooperation Pact to Battle Global Money Laundering and Market Misconduct

By Robert N. Rapp

Responding to the events of September 11, 2001, which more than ever before underscored the importance of expanding cooperation among regulatory authorities in dealing with international financial activities, the International Organization of Securities Commissions (IOSCO) has taken a major step to provide resources to regulatory and law enforcement authorities in the fight against money laundering, market manipulation, insider trading and other financial market misconduct. IOSCO is a world-wide organization of securities regulators, whose 110 member agencies combine with some 60 stock exchanges, international organizations and other similar entities to develop standards of regulation and surveillance of securities markets and international securities transactions. At its 27th Annual Conference held 19-24 May, 2002 in Istanbul, IOSCO adopted the first Multilateral Memorandum of Understanding ("MOU") designed to assure cross-border mutual assistance and access to information needed to enforce or secure compliance with securities laws and regulations. With the unprecedented initiative, IOSCO becomes the first international organization to have established a broad-based arrangement to assist in combating securities violations around the world.

The IOSCO Multilateral MOU will for the first time set an international benchmark for information sharing and cross-border cooperation in law enforcement. Although the U.S. Securities and Exchange

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Rule Changes

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cial statements will not need to be filed for calendar year 2003 NASD-affiliated dealer renewals.)

Other proposed changes within OAC 1301:6-3-15 would merely clarify the effective date of cross-referenced material, e.g., United States Code or Federal Code of Regulations, or, alternatively, insert the actual text being cross-referenced in the Ohio rule rather than referencing the federal statutes or rules. These changes comport with the requirements of recently enacted S.B. 265 in Ohio.

Secondly, the Division proposes to amend OAC 1301:6-3-16.1 to require applications, renewals, and updates for investment adviser representative licensees to be submitted electronically via the Investment Adviser Registration Depository (IARD).

Readers may recall that on January 1, 2002, the Division mandated use of the IARD for all state-licensed investment advisers operating in Ohio. This was the first prong of a two-pronged initiative by the Division to not only convert to a paperless application process for licensees and notice filers, but to uniformly process—consistent with a nationwide initiative—the manner by which securities professionals can obtain and maintain licensure. In addition, the creation and uniform use of this nationwide database also expands the public's access to information about securities professionals.

As all investment advisers with whom the investment adviser representatives are employed or associated are already using the IARD, the process to transition investment adviser representatives onto the IARD by the firms will be streamlined. Investment adviser firms transitioning their agents (investment adviser representatives) onto the database should ensure that their agents do indeed satisfy the minimum competency requirements established in OAC 1301:6-3-16.1. *In other words, investment adviser representatives must have taken an applicable NASD examination or be able to demonstrate the validity of any applicable professional designations.*

Investment advisers preparing to transition *currently licensed* investment adviser representatives will receive additional information and updates from the Division regarding the transition process. Although it is proposed that this mandate become effective January 1, 2003, there will be a grace period until June 30, 2003 for transitioning.

It is extremely important to note that the time frame and grace period for transitioning currently licensed investment adviser representatives onto the IARD differs from the timeframe for initial applicants for investment adviser representative licensure. For those persons not currently licensed as an investment adviser representative, but who seek licensure as of January 1, 2003, there will be no grace period and the initial application must be submitted via the IARD. In other words, beginning January 1, 2003, initial applications for investment adviser representatives will not be accepted by the Division unless the application is electronically submitted via the IARD—paper applications will not be accepted.

PLEASE NOTE: Beginning January 1, 2003, initial applications for investment adviser representative licenses must be submitted through the IARD. There will be a $35 filing fee collected by the IARD on behalf of the Division and applicants must be able to demonstrate that they meet the minimum competency requirements for licensure by having passed one or more of the following examinations administered by the National Association of Securities Dealers, Inc. (NASD) OR by having obtained the listed professional designations:

- Investment Company and Variable Contracts Representative, **Series 6**;
- General Securities Representative, **Series 7**;
- Direct Participation Programs Representative, **Series 22**;
- General Securities Principal, **Series 24**;
- Investment Company and Variable Contracts Principal, **Series 26**;
- Direct Participation Programs Principal, **Series 39**;
- Corporate Securities Representative, **Series 62**;
- Uniform Securities Agent State Law Examination, **Series 63**;
- Uniform Investment Adviser Law Examination, **Series 65**;
- Uniform Combined State Law Examination, **Series 66**;

Ohio Securities Bulletin

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.

Ohio Division of Securities

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http://www.securities.state.oh.us

All listings are area code (614)

Receptionist	644-7381	Enforcement	466-6140
Broker-Dealer	466-3466	Registration	466-3440
Records	466-3001		

- Certified Financial Planner (**CFP**) awarded by the Certified Financial Planner Board of Standards, Inc.;
- Chartered Financial Analyst (**CFA**);
- Chartered Financial Consultant (**CFC**);
- Chartered Investment Counselor (**CIC**); or
- Certified Public Accountant with a Personal Financial Specialist designation (**CPA with PFS**).

Again, applicants must establish minimum competency via one or more of the foregoing NASD examinations or by having obtained one of the foregoing professional designations (and remaining in good standing). The Division can not waive these competency requirements.

PLEASE NOTE FURTHER: If an applicant does not have entitlement to use the WebCRD for initial filings of investment adviser representative applications, the applicant must contact the IARD Hotline at (240) 386-4848 to obtain entitlement privileges and an entitlement packet.

The proposed rules may be found on the Division's web site at www.securities.state.oh.us. In the alternative, interested readers may contact the Division directly for copies of the proposed rules. The Division anticipates an effective date in late December for both rules.

Money Laundering

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Commission pioneered the use of bilateral MOUs – those entered into between two cooperating enforcement agencies – that proved particularly useful in the investigation of insider trading cases, the IOSCO Multilateral MOU is the first providing for world-wide cross-border support and information access. When signed by IOSCO member authorities, the Multilateral MOU will allow for authorities to obtain information and documents on matters specifically including records of funds transferred into and out of bank and brokerage accounts, as well as records that identify the beneficial owner and controlling party behind securities transactions, and who owns or controls corporate or other "non-natural" persons in a particular jurisdiction. This type of information is critical in the investigation of globalized money laundering, market manipulation, and indeed the full range of criminal and terrorist activity carried out in a financial market context. The MOU additionally requires unprecedented cooperation in seeking and obtaining such information by directing that requested authorities (consistent with their lawful power) use their own laws on behalf of a requesting agency to compel statements or testimony under oath from persons within their jurisdiction, even if the type of conduct under investigation would not be a violation of laws or regulations in that country.

As with any international memorandum of understanding, the IOSCO Multilateral MOU does not create a legally binding obligation, or supercede domestic laws of the country from which assistance and information is sought. Moreover, a key qualification to be a part to the Multilateral MOU is that laws of the participating country do not prevent the collection and sharing of information, and that the extent of participation by a regulatory agency in the process is consistent with its legal authority. Nevertheless, because of significant inroads already made in regard to blocking laws and other similar regulations, it is anticipated that there will be few major impediments to widespread acceptance of the MOU by IOSCO members. To be applicable in the U.S., the MOU will have to be signed by the U.S. Securities and Exchange Commission (the U.S. member of IOSCO), and may also be signed by U.S. "associate" members of IOSCO that include the U.S. Commodities Futures Trading Commission and the North American Securities Administrators Association (NASAA). Once signed by an IOSCO regulatory authority, the MOU prescribes a procedure for requesting and obtaining information and documents, and prescribes the extent to which that information may be utilized. The scope of use of information is defined generally in terms of any purpose within the general framework of conducting surveillance or enforcement activities, or conducting an investigation for any general charge pertaining to the violation of the laws and regulations administered by the requesting authority. There are confidentiality protections built into these mechanisms, but the authority and use provisions are nonetheless broad.

The IOSCO MOU comes with the recognition of the reality of global criminal activity, terrorism and the use of financial markets in that context, and that there must be a quantum increase in the level of cooperation and information sharing by market regulators. It is an historic step that will subject not only multi-national companies and financial institutions to scrutiny, but will provide the tools for regulators around the world to access previously walled-off domestic firms and organizations in the search for international illegal conduct. The shock of September 11, 2001 was global, and it is altogether fitting the IOSCO seized the initiative in providing securities regulators around the world with a critical first tool needed to police global misconduct on a truly global basis. A report on progress in the adoption and implementation of the IOSCO MOU by member authorities is expected by May 2003.

Editor's Note: Mr. Rapp is a partner at Calfee, Halter & Griswold LLP in Cleveland, Ohio. Mr. Rapp, an author and attorney concentrating in the area of financial market regulation, was a United States observer at the 27th Annual Conference of the International Organization of Securities Commissions held in May 2002 in Istanbul, Turkey. He is a member and past Public Chair of the Enforcement Advisory Committee of the Ohio Division of Securities.

Reason to Know: When Investors' Knowledge of Facts Giving Rise to Violations of the Ohio Securities Act Limit the Right to Recission

By Desiree T. Shannon

Like most states, Ohio allows investors a private right of action to reclaim money invested in securities that are the subject matter of sales made in violation of the Ohio Securities Act. R.C. 1707.43 states that sales made in violation of Chapter 1707 are voidable at the election of the purchaser and that the seller, along with those participating in or aiding the seller, are jointly and severally liable to the purchaser in an action at law. However, the statute goes on to say that

> (n)o action for the recovery of the purchase price as provided for in this section, and no other action for any recovery based upon or arising out of a sale or contract for sale made in violation of Chapter 1707 of the Revised Code, *shall be brought more than two years after the plaintiff know, or had reason to know, of the facts by reason of which the actions of the person or director were unlawful,* or more than four years from the date of such sale or contract for sale, whichever is the shorter period. (Emphasis added).

The time restrictions outlined above serve as a statute of limitations for bringing recission actions based on R.C. 1707.43. Investors seeking recission either have two or four years to file claims against the securities sellers who wronged them, depending upon the plaintiff-investor's knowlege of facts that should have alerted him or her to unlawful activity.

The two-year statutory time limit is most problematic, because its calculation is predicated upon the plaintiff-investor discovering the facts that gave rise to the unlawful sales. If the investor fails to bring a recission action against the seller within two years of obtaining knowledge of factual circumstances giving rise to unlawful acts, or, more significantly, had reason to know of them, he loses his right to invoke the remedy. Ohio's state courts, as well as federal courts attempting to interpret similar time limits found in analogous federal statutes, have generated case law addressing this issue that outlines what types of factual situations might put a reasonable investor on notice when a seller has incurred a violation of securities laws.

Knowledge of Facts Indicating Unregistered or Unlicensed Sale of Securities

Individuals and entities who violate securities laws, both at the state or federal level, frequently incur these violations because they are either selling securities without benefit of licensure, or have not registered their securities in accordance with state or federal laws. Indeed, many sellers are emboldened enough to disclose the fact that the securities they sell are not registered in accordance with state or federal law. Would so blatant an admission of sales not conforming to requirements set down by the law be enough to alert the reasonable investor that unlawful activity is afoot? An Ohio appellate court ruled in J J Enterprises v. Hawk Energy Co., (January 28, 1987) Ninth Appellate District Case No. CA-12589, that where a prospectus notes that the securities being sold are not registered, an investor is henceforth on notice of the existence of facts surrounding the transaction indicating the unlawful sales of securities. In this case, the plaintiff received a prospectus that noted on its cover page that the offered securities were not registered. The court noted that the two-year statute began to run when the investor received the prospectus shortly after the sale. Id. at pp.5,6. The case also applied the two-year limitation to the issue as to when the investor was charged with knowing the seller was unlicensed. The court treated this issue as a separate violation in which the investor might have qualified for the R.C. 1707.43 recisssion remedy (the court ultimately decided that the investor missed the two-year statute of limitation on both the registration and the unlicensed sales issue). Id.

Again, it should be noted that J.J. Enterprises v. Hawk Energy Co. treated unlicensed sales and unregistered sales as separate grounds for applying the two-year statute of limitations. An investor's knowledge of facts surrounding the sale of securities that might alert him or her to the seller's unlawful activity relating to either of these issues could trigger the running of the two-year time limit. But an investor's knowledge of facts regarding unlawful activity surrounding one violation will not give rise to the assumption that he or she has knowledge of another violation. In Crater v. International Resources, Inc., 92 Ohio App. 3rd 18 (1993), the court noted that, where a recission action involved two distinct causes of action—unregistered sales and unlicensed sales in violation of R.C. 1707.44 (A) and R.C. 1707.44 (C)(1)—their limitations periods run separately. Therefore, information in a prospectus alerting the investor that she was purchasing unregistered securities would not necessarily have alerted her to the fact that the seller was not licensed to sell securities, thus allowing her to meet the statutory deadline for filing a claim on that issue, regardless of whether a claim for unregistered sales would have met the deadline. Id at p. 24. The separate cause of action/separate statute of limitations rule could also apply in cases where there are individual claims of unregistered securities and fraud. In Seuffert v. Mobile Health Scan, Inc., 1989 WL 107039, Ohio's Eighth Appellate District Court noted that:

> ... knowledge of possible fraud with regard to the security in question does not provide the plaintiff with reason to know that the security is unregistered....

Courts have addressed other factual situations dealing with the issue of unregistered securities (and the unlicensed sales thereof) pursuant to the Ohio Securities Act that impact the application of the statute of limitations for purposes of recission. Official action by the Division declaring a seller's activities as unlawful can give an investor reason to know of facts that would indicate unlawful acts. This occurs

in situations where the Ohio Division of Securities has issued a Cease and Desist Order and requires an issuer who has violated the Ohio Securities Act to send a letter offering investors recission. The letter operates as notice of unlawful acts and will impute knowlege of such to an investor seeking recission, thus commencing the two-year run of the statute of limitations. St. Clair v. Structured Shelters, 1985 WL 4672. Ohio's Tenth Appellate District Court has ruled that a shareholder who also serves as an officer of an issuing corporation will not automatically be assumed to possess knowledge of facts that would alert him or her to unlawful acts regarding the sale of securities. Eastman v. Benchmark Minerals, Inc., 34 Ohio App. 255 (1986).

Knowledge of Facts Involving Fraud

Cases involving fraud, misrepresentation and omission are much dicier to analyze in respect to the types of fact patterns that would charge an investor with enough knowledge that would commence the running of the statute of limitations. Investors in Ohio's Eighth Appellate District Court had best beware when they buy securities which are accompanied by investment literature warning of the securities' high risks. The court in Kondrat v. Morris, (January 16, 1997) 8th Appellate Dist. Case No. CV-282903, held that the plaintiff-investors' recission claim based partially on misrepresentation in the sale of securities was time-barred under R.C. 1707.43. The court noted that the plaintiffs were basing their misrepresentation claim mostly on the fact that they had been told they would receive a 2-to-1 ratio of return on their investment. Id. at p.9. The court noted that, despite these representations, the plaintiff was given written materials that clearly outlined the risky nature of the investment at the time of purchase, and that this notice was enough to commence the statute's two-year run. Id. (Since the court determined that the plaintiffs had purchased the securities more than four years before filing their claim, they could not have recovered anyway). Id. at p. 12.

Ohio courts have applied the statute of limitations imposed by section R.C. 1707.43 in instances where the investor has sued under a legal theory found outside the Ohio Securities Act. Such was the case in Ware v. Kowars, 2001 WL 58731 (10th Dist. Ct. App. 2001), where the court held that, even though an investor framed a suit involving securities fraud primarily under a breach of contact theory, her "allegations are inextricably interwoven with the sale of securities, and, therefore, controlled by the limitations period contained in R.C. 1707.43" as opposed to the longer statute of limitations period allowed for actions brought under breach of contract. Despite this, courts can allow investors to avoid the statute of limitations found in the Ohio Securities Act by employing the doctrine of equitable estoppel. In the case of Helman v. EPL Prolong, Inc., 2000 WL 1670683, (7th Dist. Ct. App. 2000), the court noted that, while the statute of limitations period found in R.C. 1707.43 applied in a suit concerning the fraudulent sale of securities, the case should be remanded to trial court to determine if the defendants should be equitably estopped from demanding its application, since there was evidence that some of the defendants made false assurances to plaintiffs which caused them to forebear from suing.

A review of federal court cases, which involve statutes that impose time limits similar to the one found in R.C. 1707.43, show courts' difficulty in deciding what kinds of factual situations constitute reasonable notice to investors that fraud was present when they purchased their securities. Many federal actions relating to fraud are brought under the SEC's Rule 10b-5, which has a corresponding statute of limitations of one year, with a three-year statute of repose. A review of these cases is useful even in instances where courts have used federal statute of limitations instead of borrowing state statutes such as R.C. 1707.43. Generally, in cases where plaintiffs bring a cause of action that is implied under a federal statute which has its own statute of limitations, the federal time limit should be used. Otherwise, it is allowable for federal courts to invoke the well-established practice of "borrowing" the analogous local state statute in applying a statute of limitations for such claims. Lampf, Pleva, Lipkind, Purpis & Petigrow v. Gilbertson., 501 U.S. 350 (1991). Whether a federal court is using a state statute of limitations such as the one found in Ohio Revised Code Chapter 1707, or a similar federal statute, it is useful to consider guidelines set down by federal courts regarding what may be deemed notice of unlawful activity. Since the federal statutes of limitation are so similar to that of Ohio's, and federal courts may need to "borrow" Ohio's statute beacause an analagous federal statute is unavailable, outcomes in federal courts could be highly indicative of future interpretations of Ohio statute of limitations found in R.C. 1707.43.

Despite the difficulty of defining when an investor has reason to know of unlawful violations, federal courts have managed to set down some general rules. In analyzing a federal statute that places a one-year time limit on filing claims from the time fraud is discovered, Ohio's Southern District, in considering a motion for summary judgment for plaintiff-investors, has held that "(g)enerally the question of when a party discovered fraudulent conduct or when he should have discovered it by exercising diligence is a factual inquiry." Roger v. Lehman Brothers Kuhn Loeb, Inc., 604 F. Supp. 222 (S.D. Ohio 1984).

Despite this, other federal courts have not been reticent to pass on the facts surrounding investors' claims. The U.S. Court of Appeals, Second Circuit did so in the case of In re Ames Department Stores, Inc. Note Litigation, 991 F. 2d 968 (2nd Cir. 1993). The court held that the one-year federal statute of limitations under consideration in the case would begin running when the investor received constructive notice of possible fraud: "where the circumstances are such to suggest to a person of ordinary intelligence the probability that he has been defrauded." (Here the court was quoting another federal case, Armstrong v. McAlpin, 699 F.2d 79 (2nd Cir. 1983)). The suit was based on misleading financial projections that were included in investors' prospectuses. The court decided that the plaintiff-investors would not have known the information they received was misleading until it was announced that the company had sustained significant losses for the previous year (the defendant allegedly had internal data that would have shown it was losing money at the time the plaintiff-investors purchased notes issued by the company). The court noted mere "storm warnings" that the company was in trouble, such as media

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Buckeye Energy Corporation

On September 20, 2002, the Division issued Division Order No. 02-309, a consented Cease and Desist Order, to Buckeye Energy Corporation of Byrdstown, Tennessee, and Vermilion, Ohio.

On April 4, 2002, the Division issued a Notice of Opportunity for Hearing, Division Order No. 02-109, to the Respondent. The Division alleged that the Respondent violated Revised Code sections 1707.44(B)(4) and 1707.44(C)(1) by, respectively, misrepresenting facts in connection with the sale of an oil lease interest to an Ohio resident and selling an unregistered oil lease interest to an Ohio resident. The Division also notified Buckeye Energy Corporation of its right to an administrative hearing pursuant to Chapter 119 of the Revised Code. Buckeye Energy Corporation requested an administrative hearing pursuant to Chapter 119, but withdrew its request upon consenting to the issuance of Cease and Desist Order No. 02-309 by the Division.

Phillip D. Bliss

On July 9, 2002, the Division issued Division Order No. 02-178, a Cease and Desist Order, to Phillip D. Bliss of Ashtabula, Ohio.

The Division found that Bliss, an Ohio-licensed insurance agent, violated the provisions of Revised Code sections 1707.44(A)(1) and 1707.44(C)(1) by selling unregistered securities in the form of pay telephone and related service agreements for National Communications Marketing, Inc. and Communications Marketing Associates, Inc. while he was unlicensed as a securities salesperson. The Division found that the salespeople were paid commissions of 10% to 14% for selling the securities. ETS Payphones, Inc. was the exclusive supplier of the customer-owned coin-operated telephones. The Securities and Exchange Commission obtained a permanent injunction against ETS for securities law violations.

On June 6, 2002, the Division issued a Notice of Opportunity for Hearing, Division Order 02-160, to Bliss.The Division notified Bliss of his right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was not requested and the Cease and Desist Order was issued on July 9, 2002.

Clarin D. Davis

On July 9, 2002, the Division issued Division Order No. 02-179, a Cease and Desist Order to Clarin D. Davis of Southington, Ohio.

The Division found that Davis violated the provisions of Revised Code sections 1707.44(A)(1) and 1707.44(C)(1) by selling unregistered securities in the form of pay telephone and related service agreements for National Communications Marketing, Inc. and Communications Marketing Associates, Inc. while he was unlicensed as a securities salesperson. The Division found that the salespeople were paid commissions of 10% to 14% for selling the securities. ETS Payphones, Inc. was the exclusive supplier of the customer-owned coin-operated telephones. The Securities and Exchange Commission obtained a permanent injunction against ETS for securities law violations.

On June 3, 2002, the Division issued a Notice of Opportunity for Hearing, Division Order 02-150, to Davis.The Division notified Davis of his right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was not requested and the Cease and Desist Order was issued on July 9, 2002.

Michael R. Corcoran

On July 17, 2002, the Division issued Division Order No. 02-226, a Cease and Desist Order, to Michael R. Corcoran of Marion, Ohio.

The Division found that Corcoran, an Ohio-licensed insurance agent, violated the provisions of Revised Code sections 1707.44(A)(1) and 1707.44(C)(1) by selling unregistered securities in the form of pay telephone and related service agreements for National Communications Marketing, Inc. and Communications Marketing Associates, Inc. while he was unlicensed as a securities salesperson. The Division found that the salespeople were paid commissions of 10% to 14% for selling the securities. ETS Payphones, Inc. was the exclusive supplier of the customer-owned coin-operated telephones. The Securities and Exchange Commission obtained a permanent injunction against ETS for securities law violations.

On June 13, 2002, the Division issued a Notice of Opportunity for Hearing, Division Order 02-165, to Corcoran.The Division notified Corcoran of his right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was not requested and the Cease and Desist Order was issued on July 17, 2002.

Scott A. Herman

On August 13, 2002, the Division issued Division Order No. 02-260, a Cease and Desist Order to Scott A. Herman of Dayton, Ohio.

The Division found that Herman, an Ohio-licensed insurance agent, violated the provisions of Revised Code sections 1707.44(A)(1) and 1707.44(C)(1) by selling unregistered securities in the form of pay telephone and related service agreements for National Communications Marketing, Inc. and Communications Marketing Associates, Inc. while he was unlicensed as a securities salesperson. The Division found that the salespeople were paid commissions of 10% to 14% for selling the securities. ETS Payphones, Inc. was the exclusive supplier of the customer-owned coin-operated telephones. The Securities and Exchange Commission obtained a permanent injunction against ETS for securities law violations.

On July 3, 2002, the Division issued a Notice of Opportunity for Hearing, Division Order 02-175, to Herman.The Division notified Herman of his right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was not requested and the Cease and Desist Order was issued on August 13, 2002.

Robert L. Scott

On August 29, 2002, the Division issued Division Order No. 02-295, a Cease and Desist Order, to Robert L. Scott of Galion, Ohio.

The Division found that Scott, an Ohio-licensed insurance agent, violated the provisions of Revised Code sections 1707.44(A)(1) and 1707.44(C)(1) by selling unregistered securities in the form of pay telephone and related service agreements for National Communications Marketing, Inc. and Communications Marketing Associates, Inc. while he was unlicensed as a securities salesperson. The Division found that the salespeople were paid commissions of 10% to 14% for selling the securities. ETS Payphones, Inc. was the exclusive supplier of the customer-owned coin-operated telephones. The Securities and Exchange Commission obtained a permanent injunction against ETS for securities law violations.

On July 25, 2002, the Division issued a Notice of Opportunity for Hearing, Division Order 02-235, to Scott.The Division notified Scott of his right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was not requested and the Cease and Desist Order was issued on August 29, 2002.

Richard D. Wetzel, Jr.

On September 20, 2002, the Division issued a Cease and Desist Order with Consent Agreement, Division Order No. 02-308, to Richard D. Wetzel, Jr. of Columbus, Ohio.

The Division found that Wetzel violated the provisions of Revised Code sections 1707.44(A)(1) and 1707.44(C)(1) by selling unregistered viatical settlements of Beneficial Assistance and Imtek Funding Corporation while unlicensed as a securities dealer. The Division found that commissions of 7%, plus a 1% bonus, were paid to Wetzel for the sales of the securities. On September 3, 2002, the Division issued a Notice of Opportunity for Hearing, Division Order 02-296, to Wetzel.

The Division notified Wetzel of his right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. Wetzel entered into a Consent Agreement with the Division that was incorporated into the Cease and Desist Order issued on September 20, 2002.

Steven L. Kyer

On July 1, 2002, Steven Kyer entered into a Consent Agreement with the Division and consented to the issuance of a Cease and Desist Order, Division Order No. 02-174.

The Division found that the Respondent violated the provisions of Revised Code Sections 1707.44(A)(1) and (C)(1) by selling Chemical Trust promissory notes, Alpha Telcom payphones and Phoenix Telecom payphones that had not been registered as securities and without being licensed as a securities dealer. Mr. Kyer waived his right to the issuance of a Notice of Opportunity for Hearing and his right to an administrative hearing pursuant to Chapter 119 of the Revised Code in the Consent Order. The Final Order to Cease and Desist was issued on July 1, 2002.

Melvin W. Mitchell; Real Estate Consultants Investment Corporation

On August 20, 2002, the Division issued Order No. 02-288, a Cease and Desist Order, against Melvin W. Mitchell and Real Estate Consultants Investment Corp. of Fairview Park, Ohio.

On July 17, 2002, the Division issued Order No. 02-227, a Notice of Opportunity for Hearing against Melvin W. Mitchell and Real Estate Consultants Investment Corp. The Division alleged that the Respondents violated Revised Code Section 1707.44(C)(1), the unregistered sale of securities, when they sold promissory notes to investors. It was further alleged that the Respondents violated Revised Code Section 1707.44(G) when they failed to disclose to investors a previous Cease and Desist order issued against Mitchell (Division Order No. 96-092) and that Mitchell was previously convicted of a felony in September 1994. The order notified the Respondents of the Division's intent to issue a final Cease and Desist Order. The Respondents failed to timely request a hearing pursuant to Chapter 119 of the Revised Code, thereby allowing the Division to issue its Cease and Desist Order, Order No. 02-288, incorporating the allegations set forth in the Notice of Opportunity for Hearing.

BidBay.com, Inc.

On August 13, 2002, the Division issued Division Order No. 02-261, a Cease and Desist Order, to BidBay.com, Inc. of Tujunga, California.

On July 9, 2002, the Division issued a Notice of Opportunity for Hearing, Division Order No. 02-180, to BidBay pursuant to Revised Code Chapter 119. The Division alleged that BidBay violated Revised Code section 1707.44(C)(1) by selling or causing to be sold unregistered securities in the form of shares of stock in BidBay to Ohio residents. The Division also notified BidBay of its right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was not requested and a final Cease and Desist Order was issued on August 13, 2002.

Criminal Updates

On July 9, 2002, **Gary Nelson Burg** was sentenced in Cuyahoga County Common Pleas Court to four years probation and ordered to pay restitution and a fine of $1500. Burg pled guilty to four counts of selling securities without a license and two counts of attempted sale of securities without a license resulting from his involvement in the sale of promissory notes issued by Serengeti Diamonds USA and Lomas de la Barra Development to Ohio residents.

On July 9, 2002, **John R. Rodeman** was sentenced in U.S. District Court in Akron to two years in prison, three years probation, and ordered to pay restitution of $1,380, 039. Rodeman previously pled guilty on April 16, 2002, to a four- count Information including conspiracy, securities fraud, mail fraud, and filing a false income tax return. Rodeman is a former salesman and participant in **Andrew P. Bodnar's** $41 million Ponzi scheme.

On July 18, 2002, **William LaSelle** was indicted in Hamilton County Com-

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Enforcement Reports

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mon Pleas Court on two counts each of making misrepresentations in the sale of securities, securities fraud, and theft. It is alleged that LaSelle led two Ohio investors to believe that they were providing start-up funds for LaSelle's company, **The Travel Group**, when instead the funds were used for LaSelle's personal expenses. Additionally, it is alleged that LaSelle represented that The Travel Group had a net worth of one to ten million dollars. The Travel Group's real net value was less than $5,000.

On August 8, 2002, **Kenneth E. Bailey, Jr.** entered into a plea agreement with Fairfield County Common Pleas Court whereby he pled no contest to two counts of aggravated theft and nine counts of issuing false statements. Bailey was indicted on October 12, 2001, by a Fairfield County Grand Jury on 58 felony counts in connection with his running of **Trendsetter Investments, Ltd**. Bailey sold limited partnership interests to approximately 90 investors for a total of $2.5 million from July 1998 through early 2001.

On September 20, 2002, **William C. Davis** and **Wells Investment** were indicted in Lucas County on one count each of selling unregistered securities, making false representations in connection with the sale of securities, securities fraud, and theft.

On September 25, 2002, **Gregory J. Best** was indicted in U.S. District Court in Akron on 22 counts, including one count of conspiracy, nine counts of securities fraud, four counts of interstate transportation of stolen property, and seven counts of money laundering. Best was a former business associate of **Andrew Paul Bodnar**. Best is currently a resident of South Carolina.

Reason to Know

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speculation about the company's position or negative assessments by analysts of the acquisition underpinning the offering, were not enough to alert investors to possible fraud. The Seventh Circuit also weighed in with an opinion regarding the significance of "storm warnings" found in prospectuses. In utilizing California's statute of limitations in deciding the case of Eckstein v. Balcor Film Investors, 8 F.3rd 112 (7th Cir. 1993) the court noted that such warnings only put investors on notice that "things may not go as hoped in the future; they do not put investors on notice that statements made in the prospectus are untrue at the time, or that important facts have been left out." Id. at 1127.

The Second Circuit in another case considered inherent investment knowledge possessed by "sophisticated" or accredited investors. The court held that such investors were on constructive notice that the limited partnership interests they purchased were high risk and designed more as tax shelters rather than investments for profit. The court noted that the prospectuses provided to the investors, along with their knowledge and sophistication, would have disclosed as much. Block v. First Blood Associates, 988 F. 2d 344 (2nd Cir. 1993).

A line of Seventh Circuit cases has adopted the concept of "inquiry notice" in evaluating federal statutes of limitations applicable to securities claims which assume notice of a violation on the part of investors. This doctrine holds that the federal statute of limitations applicable to Rule 10b-5 actions "begins to run not when the fraud occurs, and not when the fraud is discovered, but when....the plaintiff learns, or should have learned through the exercise of ordinary diligence in the protection of one's legal rights, enough facts to enable him by such further investigation as the facts would induce in a reasonable person to sue within a year." Law v. Medco Research, Inc, 113 F. 3rd 781,785 (7th Cir. 1997). Thus in the case of Whirlpool Financial Corporation v. GN Holdings, Inc., 67 F. 3rd 605 (7th Cir. 1995), the court determined that the plaintiff-investor's fraud claim was time-barred because it failed to act earlier in investigating significant discrepancies between financial reports and the private placement memorandum initially provided by the issuer. The court noted that a "reasonable investor would have believed fraud was a possible explanation" for the discrepancies. Id. at p. 610.

A fine-tuning of the doctrine of "inquiry notice" necessitates that courts take into consideration the timing of investors' notice that they might be victims of fraud. In the case of Fujisawa Pharmaceutical Company, Ltd. v. Kapoor, 115 F. 3rd 1332 (7th Cir. 1997), the court noted that a fraud victim's status in regard to possessing inquiry notice "may depend on the victim's access to the information that he will need in order to be able to plead a reasonably well substantiated and adequately particularized case of securities fraud...the better his access, the less time he needs." Id. at p. 1335. Thus the court deemed the plaintiff, which argued that it had no notice of fraud until the FDA began to investigate the defendant regarding matters relating to the fraud, was on inquiry notice even before the FDA's inquiry. The court reasoned that the plaintiff had "better access to the relevant documents than the FDA and a greater incentive...to find in them evidence that (defendant) had concealed information..." Id.

Conclusion

In conclusion, an investor considering bringing an action under R.C. 1707.43 for recission must take care that their claim is not doomed because they did not file their claim within the two-year statute of limitations, assuming the investor is in a situation where it is triggered in the first place (as opposed to the longer four-year period of repose). Of course, investors should carefully review offering materials for red flags before they purchase securities. If an investor has knowledge of any facts that would indicate unlawful activity, he or she should immediately investigate and evaluate them as evidence that might support a recission claim. Otherwise, a court could impose the time-honored "you snooze, you lose" doctrine on the unfortunate investor.

Editor's Note: This article was originally published in OSB 98:1. It has been updated.

Ms. Shannon is an Enforcement Staff Attorney with the Ohio Division of Securities and Editor of the Ohio Securities Bulletin.

OHIO SECURITIES CONFERENCE 2002

NOVEMBER 22, 2002

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Investment Adviser Update
Securities Law in Cyberspace
Ohio Control Share Acquisition Act: Northrop Grumman v.TRW
Private Placements
Sarbanes-Oxley Act Overview
Ohio Division of Securities Panel

presented by
The Ohio Division of Securities
The Cybersecurities Law Institute at the University of Toledo College of Law

The meetings of the Ohio Division of Securities Advisory Committees

Capital Formation Statistics*

Because the Division's mission includes enhancing capital formation, the Division tabulates the aggregate dollar amount of securities to be sold in Ohio pursuant to filings made with the Division. As indicated in the notes to the table, the aggregate dollar amount includes a value of $1,000,000 for each "indefinite" investment company filing. However, the table does not reflect the value of securities sold pursuant to "self-executing exemptions" like the "exchange listed" exemption in R.C. 1707.02(E) and the "limited offering" exemption in R.C. 1707.03(O). Nonetheless, the Division believes that the statistics set out in the table are representative of the amount of capital formation taking place in Ohio.

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. Consequently, for purposes of calculating an aggregate capital formation amount, each indefinite filing has been assigned a value of $1,000,000.*

Filing Type	Third Qtr 2002	YTD 2002
Exemptions		
Form 3(Q)	$311,239,068	$697,671,003
Form 3(W)	3,000,000	25,494,580
Form 3(X)	42,347,552,568	222,037,885,600
Form 3(Y)	10,750,000	420,501,000
Registrations		
Form .06	1,357,334,482	1,803,260,344
Form .09/.091	5,319,589,483	22,311,306,699
Investment Companies		
Definite	1,097,148,999	3,308,259,798
Indefinite**	555,000,000	1,690,000,000
TOTAL	**$51,001,614,600**	**$252,294,379,024**

Registration Statistics

The following table sets forth the number of registration, exemption, and notice filings received by the Division during the third quarter of 2002, compared to the number of filings received during the third quarter of 2001. Likewise, the table compares the year-to-date filings for 2002 and 2001.

Filing Type	3rd Qtr '02	YTD '02	3rd Qtr '01	YTD '01
1707.03(Q)	31	99	25	105
1707.03(W)	2	14	5	16
1707.03(X)	257	781	255	819
1707.03(Y)	4	9	8	13
1707.04/.041	1	5	1	2
1707.06	15	63	26	66
1707.09/.091	49	134	39	123
Form NF	1125	3350	1097	3614
1707.39/.391	10	34	11	34
Total	1494	4489	1467	4792

Licensing Statistics

License Type	YTD 2001
Dealer	2,335
Salespersons	125,418
Investment Adviser/Notice Filers	1,575
Investment Adviser Representative	8,957

Ohio Securities Bulletin

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