

OHIO SECURITIES BULLETIN

A QUARTERLY PUBLICATION OF THE OHIO DIVISION OF SECURITIES

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Division Action Spurs Injunction Against Hopkins and Related Companies

On September 30, 2004, the Summit County Common Pleas Court issued a preliminary injunction against Harold H. Hopkins and his wife, Linda C. Hopkins, as well as four companies controlled by Hopkins and his family members. The Court also appointed a Special Master to oversee operations of the businesses. In a related action, on October 12, 2004, the Division suspended Hopkins' salesperson's license.

Judge Marvin A. Shapiro issued the preliminary injunction against Harold Hopkins, Linda Hopkins, Vista Financial Group, Vista Financial Services Corporation, Horizon Benefit Administration Corporation and Flagship Administration, Ltd. The companies are located in Hudson, Ohio.

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Ohio Supreme Court Adopts Federal Promissory Note Test

On September 8, 2004, the Supreme Court of Ohio released a significant securities-related decision. In *Perrysburg Twp. V. Rossford*, 103 Ohio St.3d 79, 2004-Ohio-4362, the Court adopted a nationally recognized test for determining whether a particular promissory note is a security. The test is known as the *Reves* test and was first set forth in a 1990 U.S. Supreme Court case, *Reves v. Ernst & Young*. The *Reves* test has since been widely applied by federal courts throughout the

country and adopted by numerous other states.

Perrysburg involved a proposal by the Rossford Arena Amphitheater Authority ("RAAA") established by the city of Rossford to build a new sports arena and amphitheater. Perrysburg Township agreed to contribute \$5 million to RAAA, which was to be repaid by RAAA, plus eight percent interest over two years. The arena/amphitheater project was never built, and RAAA defaulted on the agreement.

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Hopkins

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The Court action enjoins the defendant individuals and companies, named employees and family members from entering the defendant companies' business premises in Hudson, Ohio. It also bars the same from disposing of funds, securities and business assets overseen or controlled by the defendant companies. Additionally, the defendants cannot hire or fire employees or incur new business debt.

The Special Master will establish court-approved policies and procedures, which could permit the transfer of employee pension plan contributions in frozen accounts. Marc B. Merklin, of the Akron law firm of Brouse McDowell, was appointed Special Master in the case. The injunctive action was the result of a Division investigation of Hopkins and his companies that was coordinated with the Ohio Bureau of Criminal Identification and Information and the U.S. Department of Labor's Employee Benefits Security Administration.

The Division originally filed and obtained a Temporary Restraining Order on September 23, 2004. The Division alleged that Harold Hopkins, Flagship Administration and its predecessor, Horizon Benefit Administration, misappropriated more than \$300,000 in employee pen-

sion contributions for his companies' business expenses. The Division also alleged that Flagship sent participating employees false statements that understated the actual quarterly performance of some mutual funds. Additionally, the Division alleged that Harold Hopkins fraudulently sold more than \$700,000 in stock issued by Vista Financial Group and Flagship Benefit Administration stock while it failed to disclose the degree of risk and lack of liquidity of the stock to at least 51 investors.

In addition to the civil action outlined above, the Division also suspended Harold Hopkins' salesperson's license. The Division issued its Notice of Opportunity for Hearing/Notice of

Intent to Revoke Ohio Salesperson License/Suspension of Salesperson License on October 12, 2004. In the Order, the Division alleges that Hopkins violated R.C. sections 1707.44(B)(4), 1707.44(G) and 1707.44(C)(1). These sections deal with fraudulent representations or omissions in the sale of securities, as well as the unregistered sale of securities. The factual basis for these violations were the same as that used to support the injunction. The Division also found that Hopkins was not of "good business repute" as that term is used in R.C. 1707.19 and Ohio Administrative Code Rule 1301:6-03-19(D), supported by his violations of code sections falling under R.C. 1707.19(A).

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.

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Promissory Note Test

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Perrysburg Township sued RAAA, Rossford, and Rossford's mayor, claiming violations of the Ohio Securities Act. The Wood County Common Pleas Court held that the financial instrument at issue was not a security under R.C. 1707.01(B), and dismissed the securities-violations claims. Perrysburg Township appealed, and the 6th District Court of Appeals reversed the trial court's dismissal of the securities related claims. Perrysburg Township appealed the appellate court's judgment in its favor, as it was not satisfied with the court's reasoning. RAAA cross-appealed and the Ohio Attorney General filed an amicus brief, requesting the Court to adopt the *Reves* test.

The Court in *Perrysburg* ruled that the agreement for RAAA to repay Perrysburg Township was a promissory note, and held that it was presumptively a security, along with each of the other certificates and instruments listed in the second sentence of the definition of a "security" found at R.C. 1707.01(B). The Court then went on to adopt the test set forth in

Reves to determine whether a particular note is a security. The *Reves* test begins with a presumption that every note is a security, which the *Perrysburg* Court noted was consistent with their holding that the items listed in the second sentence of R.C. 1707.01(B) are presumed to be securities. The Court stated that, "the *Reves* test next recognizes that certain instruments that are commonly called 'notes' are not securities." "The 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 by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business." It was found that the note in *Perrysburg* was not one of these listed exceptions.

The Court then applied the next part of the *Reves* test, the four-part "family-resemblance" test to determine whether the note in question closely re-

sembles the notes from the list that are not securities. The Court noted that the family-resemblance test "was designed to ascertain the economic realities of the instrument in question."

The family resemblance test examines the following four factors: (1) the transaction is examined to determine the motivations of the parties entering into the agreement; (2) the plan of distribution of the instrument is examined; (3) the reasonable expectations of the investing public are considered; and (4) it is determined whether there are any factors that reduce the risk of the instrument, thereby rendering securities protections unnecessary. Based on the family-resemblance test, the Court found that the agreement between Perrysburg Township and RAAA did not closely resemble the list of notes that are not securities. The Court thus concluded that, "the presumption that the note is a security holds." *Reves* provides a practical test for Ohio courts in distinguishing between promissory notes that meet the definition of a security under 1707.01(B) and those notes that are merely part of a commercial transaction.

Enforcement Section Reports

James T. Johnson

On July 20, 2004, the Division issued Order No. 04-145, a Cease and Desist Order, against James T. Johnson. Johnson sold payphones to an Ohio resident on behalf of American Telecommunications Company, Inc. These payphones were investment contracts and, therefore, securities under the Ohio Securities Act but were not registered with the Division. Furthermore, Johnson sold these payphones without the transactions being recorded on the books or records of his broker/dealer, nor were the transactions authorized by his broker/dealer in writing prior to the transaction. Therefore, on June 15, 2004, the Division issued Order No. 04-133, a Notice of Opportunity for Hearing, against Johnson for allegedly violating Revised Code Section 1707.44(C)(1), the unregistered sale of securities, along with Ohio Administrative Code Section 1301:6-3-19(A)(19), "selling away". The Respondent did not request a hearing pursuant to Chapter 119 of the Ohio Revised Code, thereby allowing the Division to issue its Cease and Desist Order No. 04-145, which incorporated the allegations set forth in the Notice of Opportunity for Hearing.

John F. Conyers

On July 20, 2004, the Division issued Order No. 04-145, a Cease and Desist Order, against John F. Conyers. Conyers sold payphones to an Ohio resident on behalf of American Telecommunications Company, Inc. These payphones were investment contracts and, therefore, securities under the Ohio Securities Act but were not registered with the Division. On June 15, 2004, the Division issued Order No. 04-133, a Notice of Opportunity for Hearing, against Conyers for allegedly violating Revised Code Section 1707.44(C)(1), the unregistered sale of securities. The Respondent did not request a hearing pursuant to Chapter 119 of the Ohio Revised Code, thereby allowing the Division to issue its Cease and Desist Order No. 04-145, which incorporated the allegations set forth in the Notice of Opportunity for Hearing.

David S. Gale

On August 2, 2004, the Division issued a Cease and Desist Order, Division Order No. 04-146, against David S. Gale of Marion, Ohio.

The Division found that Gale violated the provisions of Revised Code sections 1707.44(A)(1), 1707.44(B)(4) and 1707.44(G) by selling securities while unli-

censed as a securities salesperson, making false representations in the sale of securities and engaging in fraudulent securities activity. The Division found that Gale posed as a securities salesperson for Merrill Lynch and sold approximately \$154,000 in stock issued by Krispy Kreme Doughnuts to a Dublin, Ohio investor. While not affiliated with Merrill Lynch and not licensed to sell securities, Gale did not disclose to the investor that he had a criminal history. In addition, Gale guaranteed the investor at least a fifty percent profit on the purchase price in event of a sudden loss of the stock's value.

Between July 2001 and February 2002, Gale sold the investor stock in nine separate transactions. Gale failed to disclose to the investor that he hadn't purchased shares to fulfill the purchase orders, and he converted the investment funds for his own use.

On June 30, 2004, the Division issued a Notice of Opportunity for Hearing, Division Order 04-142, to Gale. The Division notified David S. Gale 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 2, 2004.

Criminal Updates

On July 8, 2004, **Paul Rendina** was indicted by a federal grand jury in Cleveland on 13 counts of mail fraud, three counts of mailing threatening letters, three counts of tax evasion, four counts of failure to file tax returns, one count of bank fraud, and two counts of use of fire to commit mail fraud. Rendina, of Willoughby Hills, is a C.P.A. and is accused of siphoning more than one million dollars from investors, trying to extort life insurance proceeds from a client, lying to a Catholic school so that he could get a break on tuition and torching two homes to collect insurance money. The indictment describes interconnected financial schemes to fleece clients and businesses over a period of 14 years. Rendina had been indicted by a Lake County grand jury on November 13, 2002, on three counts of securities fraud, three counts of misrepresentations in the sale of securities, three counts of the sale of unregistered securities, six counts of grand theft, and two counts of aggravated theft.

On July 30, 2004, a Bill of Information was filed in the Franklin County Court of Common Pleas alleging that **David Scott Gale** sold securities while

unlicensed to sell securities, made false representations while selling securities and committed theft. All three of these violations are third degree felonies. A Waiver of Indictment was also executed by Gale's attorney and filed with the Bill of Information. Gale is scheduled to enter a plea on December 7, 2004.

On August 16, 2004, **George Fiorini** pleaded guilty to federal charges of mail fraud, interstate transportation of stolen property and filing false income tax returns in U.S. District Court in Dayton, Ohio.

The case resulted from an investigation conducted by the Division, FBI, and IRS. The Division previously obtained both a Cease and Desist Order and a permanent injunction against Fiorini for his sale of the 10% Income Plus Plan in the Cincinnati area. No sentencing date has yet been set.

On October 8, 2004, **Stanley Cox** was sentenced to four years in prison and ordered to pay \$1.5 million dollars in restitution to investors. The sentence was the result of his earlier guilty plea to one

count each of the false reporting of securities transactions, the selling of unregistered securities, securities fraud and aggravated theft. Cox begins his sentence on December 8, 2004. The plea was entered before Judge Norbert Nadel in Hamilton County Common Pleas Court.

Federal Civil Action: Bradley T. Smith and Bancshareholders of America

On August 11, 2004, the Securities and Exchange Commission, with the assistance of the Division of Securities, filed a Temporary Restraining Order and Order for Emergency Relief against Bradley T. Smith, Continental Midwest Financial, Inc., Bankstock Investment Partners Series #1, LP, Scioto National, Inc. and Bancshareholders of America, Inc., in the United States District Court for the Southern District of Ohio, Eastern Division. The filing alleged that Smith, by and through his entities, has engaged, is engaged, and is about to engage in acts that constitute a violation of the Securities Act of 1933 and the Investment Advisors Act of 1940. Specifically, Smith obtained money or property by means of untrue statements of material facts or omissions of material facts in order to operate

a business as a fraud or deceit upon purchasers of high yield securities offered for private placement.

The TRO requested that all the assets of the companies be frozen. The pleading filed with the Court alleges that Smith held himself out to investors as a specialist in small bank stocks. Smith's business consists primarily of establishing and operating private companies whose stated purpose is to serve as vehicles for investors to buy small community bank stock. Since 2002, it is alleged that Smith has established four new businesses which have made private offerings of securities. These four entities controlled by Smith have raised approximately \$3.3 million through these four private securities offerings. Contrary to the representations

in the private placement memorandums, it is alleged that Smith did not use the proceeds from investors as stated, but instead had used a large portion of investor funds to pay for personal expenses.

On August 17, 2004, the parties entered into an Agreed Order of Preliminary Injunction and other relief in that certain assets were frozen and other assets were restricted in their use, an accounting of the businesses was ordered and discovery expedited. On October 1, 2004, Smith filed a motion requesting that the Court modify and partially release the assets. The SEC filed a motion in response to this request on October 22. On November 2, 2004 the Judge denied Smith's request to unfreeze the assets and release the funds, and the case is still pending.

Licensing Statistics

License Type	YTD 2004
Dealers	2,331
Salespersons	127,057
Investment Adviser/Notice Filers	1,797
Investment Adviser Representatives	10,220

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	3rd Qtr 2004	YTD 2004
Exemptions		
Form 3(Q)	\$572,428,918	\$1,216,191,930
Form 3(W)	6,200,000	15,750,000
Form 3(X)	114,200,566,947	244,389,717,114
Form 3(Y)	-0-	8,790,000
Registrations		
Form .06	1,045,378,700	2,834,295,861
Form .09/.091	12,393,798,806	60,336,407,359
Investment Companies		
Definite	108,250,500	315,711,700
Indefinite**	481,000,000	1,572,000,000
TOTAL	\$128,807,623,871	\$310,688,863,964

Registration Statistics

The following table sets forth the number of registration, exemption, and notice filings received by the Division during the third quarter of 2004, compared to the number of filings received during the third quarter of 2003. Likewise, the table compares the year-to-date filings for 2004 and 2003.

Filing Type	3rd Qtr '04	YTD '04	3rd Qtr '03	YTD '03
1707.03(Q)	23	80	33	100
1707.03(W)	2	10	2	13
1707.03(X)	405	1113	307	809
1707.03(Y)	0	5	1	4
1707.04/.041	0	1	3	4
1707.06	14	61	15	63
1707.09/.091	39	135	54	130
Form NF	1079	3303	1098	3292
Total	1562	4708	1513	4415

Recent Ohio Investor Education Initiatives

The Ohio Division of Securities has joined other agencies within the Ohio Department of Commerce to hold free informational seminars on financial literacy around the state. Titled “Buy Smart, Borrow Smart, and Invest Smart,” the educational events are promoted in the community and last approximately two hours with speakers from the various agencies providing presentations. The agency also provided 9000 educational brochures for the State Treasurer’s Office for seven “Women and Money” conferences held at Ohio colleges and universities. In addition, the Division participated in the “Scam Jam” held at the University of Dayton by providing investor education information to the participants.

The Division sent letters to Ohio teachers, civic groups and senior citizen centers informing them of the availability of speakers from the agency that resulted in a total of 3,423 Ohioan attendees being reached by 74 presentations, with more planned for the future. Presentations were made by agency staff employees who have other full-time duties, but volunteer to assist with presentations. One such presentation included an assembly of 900 high-school seniors at a larger central Ohio school system. Educational information was distributed and displayed, as well.

A proclamation was issued by Governor Bob Taft for the month of April 2004 declaring it “Saving and Investing Education Month.” The agency also recently released two new publications, the “Check Before You Invest” checklist and “Don’t be Misled by Viatical Settlements: What Every Investor Should Know.” These publications can also be accessed on the agency’s Web site at www.securities.state.oh.us.

The Division worked at educating its citizens by spreading its saving and investing messages to Ohioans through the media during the month of April. A total of five educational media releases were issued during the month. Twelve radio interviews were conducted and numerous newspaper articles ran in Ohio newspapers. In addition, media releases have been issued on many significant enforcement cases in hopes of media providing the information to educate investors. These media releases can also be found on the Division’s Web site.

An educational article was submitted by the agency for the monthly senior newsletter of the Ohio Department of Aging to help combat investment fraud against seniors. The Division also displayed investor education information at the summer 2004 Ohio State Fair in which 850,218 Ohioans attended. The agency planned and held its educational *Ohio Securities Conference* in October. In addition, the Division held a *Securities Law Seminar for Ohio Prosecutors and Law Enforcement* in November.