

OHIO SECURITIES BULLETIN

A QUARTERLY PUBLICATION OF THE OHIO DIVISION OF SECURITIES

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CLEARING EXEMPTION HURDLE DOES NOT ALLOW ESCAPE FROM ANTI-FRAUD PROVISIONS

By Desiree T. Shannon

There are many areas of law that are presumed so basic, they are rarely questioned. Such is the case with the legal reasoning behind the Division of Securities' policy of pursuing cases against issuers and agents who have sold securities in violation of the Ohio Securities Act's anti-fraud provisions notwithstanding a valid claim of exemption for the same. There is presently some confusion among securities law practitioners as to whether this policy is grounded in an accurate reading of the Ohio Securities Act. A review of the structure of the Ohio Securities Act, as well as an overview of the code sections dealing with exemptions, might clarify the Division's jurisdiction under the Act.

There are two sections of the Ohio Revised Code that deal with registration exemptions: R.C. section 1707.02, which enumerates exempt securities, and R.C. section 1707.03, which enumerates exempt transactions. Each of these sections has companion rules in Ohio Administrative Code sections 1301:6-

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DIVISION OBTAINS INJUNCTION AGAINST WESTHAVEN GROUP AND A RECEIVER IS APPOINTED

The Lucas County Common Pleas Court appointed a Receiver and issued a preliminary injunction against Westhaven Group, LLC, Haven Holdings, LLC and John F. Ulmer on December 14, 2005. These actions resulted from a complaint filed by the Ohio Division of Securities on the same day.

The Division alleged that the defendants violated the Ohio Securities Act by sell-

ing unregistered securities, making false representations in the sale of securities and committing securities fraud. The companies are in the business of buying, rehabbing, selling and leasing real estate. Judge Thomas J. Osowik appointed Toledo attorney Gerald R. Kowalski as Receiver. His duties will include taking possession of all assets and records of Westhaven

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Clearing Exemption Hurdle

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3-02 and 1301:6-3-03 that expand upon the main statutory provisions. It should be noted that R.C. section 1707.01, which defines "security," underpins these sections in that the securities and transactions discussed in the exemption sections are (or derive from) the broad categories of instruments listed in the definitional section.

R.C. section 1707.02(A) states that "exempt" as used in this section means exempt from sections 1707.08 to 1707.11 and 1707.39 of the Revised Code." These code sections generally deal with the various forms of registration and curative registration filings. Note that this section does not mention any exemption from the anti-fraud provisions of the Act found in R.C. section 1707.44, which provides impetus for many of the Division's enforcement actions. Indeed, the legislative committee charged with drafting the original version of Ohio's blue sky law saw fit to note in their comments that, "while these securities are exempt from the registration and qualification provisions of the Act, they are still included in the general fraud provisions." The other subsections of R.C. section 1707.02 list various types of securities which don't have to be registered, such as commercial paper not offered

directly or indirectly for sale to the public (the section's companion rule further expounds on when a security will be deemed offered for sale directly or indirectly to the public) and securities issued by financial institutions.

R.C. section 1707.03(A) reads in part, "...(a)s used in this section, 'exempt' means that...transactions in securities may be carried on and completed without compliance with sections 1707.08 through 1707.11." The pertinent language regarding the scope of the exemption is similar to that found in R.C. section 1707.02, except this section and its companion rule deal with transactions related to securities rather than the securities themselves. Securities transactions listed as exempt under this section include the sale of

equity securities under certain circumstances and the sale of instruments secured by a mortgage.

The language of the statutes would appear to be straightforward in limiting exemptions to registration issues. However, one should also consider the fact that the Ohio Securities Act attempts to expressly limit the Division's overall jurisdiction with regards to certain types of securities. This is the case with R.C. section 1707.32, which gives the Department of Insurance jurisdiction over "insurance securities." It is noteworthy that the legislature saw fit to devote a separate code section in the Ohio Securities Act to set apart a specific type of security for regulation by an agency that is not governed by Chapter 1707. Some states

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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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simply provide an exemption from registration for these types of securities, but retain jurisdiction for anti-fraud purposes. However, in Ohio, insurance securities are excluded from the jurisdiction of the Act instead of merely being exempt from specific provisions of the same.

In summary, the Ohio Securities Act expressly grants

the Division jurisdiction to investigate issuers and sellers of securities who clear the agency's registration hurdles unscathed. An exemption from narrow areas of statutory regulation is not the same as a complete exception from regulation altogether. Securities law practitioners should warn their clients that claiming an exemption from

registration does not mean they will escape the Division's scrutiny regarding possible fraudulent practices, as well as other areas of non-compliance with the Ohio Securities Act.

DIVISION OBTAINS INJUNCTION AGAINST WESTHAVEN

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and Haven Holdings, as well as to manage and operate the companies on behalf of investors. Doug White, Director of the Department of Commerce noted that it was the Division's intention "...to seek the return of as much money as possible to the affected investors."

In its filings, the Division alleged that Westhaven sold at least 336 promissory notes worth approximately \$19.3 million to 169 investors between November 2002 and June 2005. Westhaven sold the notes, and Haven Holdings was established to assign real estate mortgages in the investors' name. Ulmer, a Toledo

resident, is the founder and sole owner of Westhaven and Haven Holdings. The Division alleges, that in selling the notes, the defendants misrepresented to investors that the investments were secured by real estate. This was not true in some cases because 77 of the notes were not secured by real estate and 53 were not properly recorded with the appropriate county recorder's office. Also, 48 notes were assigned mortgages valued at less than the face amount of the note. The Division alleged that, despite these facts, Westhaven's marketing literature claimed the notes were "supersafe investments."

The defendants cooperated with the issuance of the injunction and appointment of the Receiver. The injunction bars the defendants and their agents from selling or disposing of securities without court approval; buying, selling, encumbering or transferring any real estate without the court's approval; engaging in deceptive, fraudulent or manipulative acts and destroying, disposing or altering records.

Licensing Statistics

License Type	YTD 2005
Dealers	2,332
Salespersons	131,130
Investment Adviser/Notice Filers	1,818
Investment Adviser Representatives	11,289

Registration and Exemption Advisory Committee Minutes

The Registration and Exemption Advisory Committee held its meeting at the Ohio Securities Conference on October 21, 2005. The meeting was well attended by securities practitioners from throughout the state of Ohio. The attendees were interested in recent developments at the Division and therefore the topics addressed were updates of issues and matters experienced by the registration and exemption section of the Division. The Division always encourages comments from practitioners concerning statutory provisions, rules, guidelines or procedures.

The Division commented that a number of Form D's are sent to the enforcement section. Only a small percentage of the total number of Form D's received by the Division are referred to enforcement. The enforcement section issued an order for Enterra Energy, LLC and other Respondents, Order No. 05-119 for a false statement in a Form D under the recently adopted R.C. section 1707.44(B)(6). The false statement was that the offering was exempt pursuant to Rule 506 of Regulation D as indicated on the Form D. The Division brought an action for a violation of R.C. section 1707.44(C)(1), which prohibits the sale of unregistered securities, as well. An attendee questioned whether the unregistered violation of this provision was

sufficient. The Division believed that based upon the egregiousness of the violation and the respondents history of violations and other securities offerings, that marking Rule 506 of Regulation D and filing the Form D with the Division was a serious false statement warranting this action. The Division further stated that a number of oil and gas syndications appear to file Form D's and disregard compliance with Rule 502(c). Other problems in Form D filings have included excessive front-end expenses and commissions up to 40%, mandatory arbitration for security holder disputes with the issuer, and the denial of access to books and records after the offering. The Division is prevented from commenting on these terms due to the National Securities Market Improvement Act. The Division has advised the NASD of the excessive commissions. Finders continue to be a licensing problem. NSMIA does not preempt licensing requirements on a Form D. Securities practitioners within the American Bar Association have conducted extensive work on finders¹ that provides an overview of state and federal licensing issues. The Division advised attendees to stay alert for Form D revisions. Staff² of the U.S. Securities and Exchange Commission has suggested informally that there may be revisions coming to the Form D and that the Form D may even-

tually be filed electronically with the SEC.

Other enforcement initiatives arising from the registration and exemption section included a refusal and suspension of Four House Limited, Order no. 05-076. The problems alleged included the potential issuance of unauthorized securities, selling beyond an allowable effective period, and significant disclosure problems. Disclosure problems included material omissions of risks and financial information. Further assertions in the order included the principal failing to disclose a conviction, sentence and disbarment for using false social security numbers. See: Disciplinary Counsel v. Manogg, 74 OS3rd 213 (1995). The Division alleged the principal also falsely stated certain real estate licensing information. The Form 6 application was withdrawn.

The registration section referred to the enforcement section an issuer that relied on an exemption not contained in the Ohio Securities Act. Cornerstone Ministries Investments, Inc., Order no. 05-146, relied on a "senior security"-type exemption for securities listed on the Chicago Stock Exchange. The underlying securities never became listed and the Ohio Securities Act does not have an exemption for securities listed on this exchange.

Registration personnel assisted the enforcement section and the Ohio Attorney General's office in an administrative action against The Thaxton Group, Inc., Order No. 02-237. Allegations included false statements in a filing. The Division alleged unlicensed sales practices and violations of suitability standards, as further explained in the order. The matter has gone to an administrative hearing.

The registration and exemption section welcomes comments on the secondary trading of SPAC's (Special Purpose Acquisition Corporations.) The primary offerings do not comply with R.C. section 1707.131(B) or blind pool or use of proceeds guidelines of the Division. However, certain SPAC's may be entering the secondary market in Ohio based upon NSMIA preemption pursuant to section 4(3), '34 Exchange Act filings and notice filings with the Division pursuant to R.C. section 1707.092. The Division is working with NASAA and other states to watch these offerings closely.

The Division has historically followed NASAA guideline economic suitability provisions in DPP offerings. Generally, the Division has not increased suitability to waive guidelines or to address the risk within the offering. The provisions require that investors have

either: (a) a net income of \$45,000 and a net worth of \$45,000; or (b) a net worth of \$150,000. These are commonly known as the "45/45/150" standard. The provisions have not been increased for over 15 years. The Division is adjusting the suitability threshold for inflation to "70/70/250." Certain offerings have timing difficulties in implementing the new suitability provisions and the Division is working to assist such issuers with the implementation. The Division notes that the suitability standards are in addition to a restriction that the investment not exceed 10% of the investor's liquid net worth. The Division has received few comments objecting to this inflationary adjustment.

Alternative investment filings have significantly increased. The Division is seeing new sponsors of commodity pool limited partnerships and REIT's. Additionally, the filing of sales literature has increased with the Division. Applicants frequently request meetings and conference calls. These new filings and the above-referenced enforcement referrals have stretched the resources of the registration section. The timing of our review for comments may be longer than in prior years.

The Division noted that additional information is available online from the web site of the Division. This includes forms, merit guidelines, administrative

rules, and an introduction to the Ohio Securities Act for start-up businesses. The Division should consider revisions to direct the practitioner to relevant sections of the web site. The Division concluded the meeting by noting that the registration section is available for telephone or e-mail inquiries.

(Endnotes)

¹ Report and Recommendations of the Task Force on Private Placement Broker Dealers, June 20, 2005, Task Force: Mary M. Sjoquist (Chair). American Bar Association, Section of Business Law, Committees on Small Business, Federal Regulation of Securities, Negotiated Acquisitions, and State Regulation of Securities. The views expressed in the Report and Recommendations have not been approved by the Section of Business Law, The House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be considered as representing the policy of the American Bar Association.

² This is not the official position of the U.S. Securities and Exchange Commission as known to the Ohio Division of Securities. Comments from Gerald J. Laporte, Chief, Office of Small Business Policy, Division of Corporation Finance, United States Securities and Exchange Commission at the 2005 NASAA Annual Fall Conference, Minneapolis, MN, September 2005.

Takeover Advisory Committee Minutes

The Division's Takeover Advisory Committee held its annual meeting at the 2005 Ohio Securities Conference on October 21, 2005. David Zagore, Co-Chair of the Takeover Advisory Committee, and Michael Miglets of the Division prepared the agenda and served as moderators for the meeting.

The Division reported on the progress of the proposed amendment to R.C. 1707.041 that would create a three-day review period for material amendments of control bids. The proposed legislation would require an offeror to file material amendments to a control bid, including changes in the consideration offered, increases or decreases in the percentage of the class of securities to be acquired, or changes in the dealer's soliciting fee, with the Division. The Division would then have three days to review the amendment. If the disclosure was inadequate, the Division could then suspend the tender offer. Following the suspension, the Di-

vision would be required to schedule a hearing within three days. A final ruling on the suspension must be issued within three days. If the offeror amended the disclosure, the suspension could be lifted at any time. The nine-day period for Division action is designed not to conflict with the ten-day period specified in Rule 14d-4(d)(2)(ii).

The proposed amendment to R.C. 1707.41 was included in H.B. 301 introduced by Representative Seitz. Hearings have been held by the House Judiciary Committee, but the Senate has not taken any action on H.B. 301.

On December 14, 2005 the Securities and Exchange Commission ("SEC") voted to publish for comment proposed revisions to the best-price rule for tender offers. The tender offer best-price rule requires that all security holders tendering shares or other securities to be treated equally. The SEC's proposal would: (1)

clarify that the best-price rule applies only to the consideration paid for securities; (2) exempt certain compensation, severance and employee benefits from the tender offer best-price rule; and (3) provide a safe harbor for the exemption from the tender offer best-price rule for certain compensation, severance and employee benefit arrangements. Comments on the proposed amendments to the tender offer best-price rule must be submitted to the SEC by February 21, 2006.

The SEC's proposed amendments to the tender offer best-price rule appear to be consistent with the requirements in R.C. 1707.041(B)(1) that the offer to security holders in the State of Ohio be on the same terms as offered to security holders in any other state. The Takeover Advisory Committee planned to discuss the SEC's proposal with the Tender Offer Subcommittee at the January 14, 2006 meeting of the Corporation Law Committee of Ohio State Bar Association.

Criminal Updates

On October 28, 2005, criminal complaints on two felony securities counts were filed against **Martin R. Hershner** of Lexington, Ohio, in Mansfield Municipal Court. The counts include securities fraud and false representations in the sale of securities, both third-degree felonies. While licensed as a securities salesperson and investment adviser representative, Hershner allegedly failed to invest more than \$5,000 of a Mansfield investor's funds as he had represented and converted the funds to his own personal use. Hershner was arrested on October 29, 2005, on the charges. A hearing was held on November 1, 2005, at which time Hershner was placed on pretrial supervision and he then posted a \$50,000 personal recognizance bond. Hershner waived a preliminary hearing.

Philip A. Regano was sentenced on December 22, 2005 by U.S. District Judge Ann Aldrich in Cleveland to 63 months incarceration, three years of supervised release and ordered to pay restitution of over \$2.5 million to investors. Regano was indicted by a Pittsburgh federal grand jury in U.S. District Court in the Western District of Pennsylvania on August 4, 2005 on one count of mail fraud. He sold clients, including Ohio residents, a gold product scheme in which he promised high rates of return and issued promissory notes. Regano converted the investors' funds to his own use. Regano was arraigned in Cleveland on October 5, 2005, at which time he entered a guilty plea. The Division had previously issued a Cease and Desist Order against Regano, who lives in Boardman, Ohio, on August 2,

2005 for securities fraud, false representations in the sale of securities and selling products not authorized by his securities dealer.

On December 9, 2005, **Allen O. Snyder** of Indianapolis, Indiana, was indicted in Sandusky County Common Pleas Court on nine felony counts, including three counts of grand theft, two counts of securities fraud, two counts of making false representations in the sale of securities, and two counts of issuing false reports of securities transactions. Snyder is accused of luring Ohio investors to place their funds in a qualified IRA custodian fund with his company, HiTech Accounting Services, in order to purchase government bonds. Instead, Snyder allegedly converted the funds to his own personal use and provided investors with fraudulent account statements.

Enforcement Section Reports

Dan P. Creviston

The Division of Securities issued a Cease and Desist Order on October 18, 2005, against Dan P. Creviston of Chagrin Falls, Ohio for the following violations of the Ohio Securities Act: R.C. 1707.44(A)(2), 1707.44(K), and 1707.44(M)(1)(b). Creviston held himself out as an investment adviser even though he was not licensed as such. Creviston represented to Ohio investors that he would manage their money and earn a 20 percent minimum annual

return with very little risk by investing in stocks and options. In response to his representations, at least twelve investors transferred \$1,197,081 to Creviston from 1998 to 2002. Creviston failed to return investor money as promised. He placed investor money in his personal accounts and commingled investor funds with his own. Additionally, he converted a portion of investor funds for his own personal use.

Moreover, on March 10, 2005, Creviston was convicted in

U.S. District Court for the Northern District of Ohio of mail fraud for his misdealings with investors and sentenced to 55 months imprisonment and ordered to pay restitution of \$1,011,446.

The Division notified Creviston of his right to an administrative hearing pursuant to a Notice of Opportunity for Hearing Order on September 7, 2005. He did not request a hearing in a timely manner resulting in the issuance of the Cease and Desist Order.

Phillip Ray Smith/United Financial Solutions Group, LLC

On November 29, 2005, the Division issued a Cease and Desist Order, Division Order No. 05-205, to Phillip Ray Smith and United Financial Solutions Group, LLC, of New Paris, Ohio.

Beginning in 2002, Smith and his company, United Financial Solutions Group, LLC, sold securities issued by Wellspring Capital Group, Inc. of Connecticut and Vermont, both directly and through a marketing agent, Shared Profit City LLC, aka Shared Profit City of Dayton and Shared Profit City of East Dayton.

Both Smith and Blake Prater, the president of Wellspring, have criminal records that were not disclosed to investors. Smith had been convicted in 1999 of a fourth-degree felony theft offense and served six months in prison. He and United Financial Solutions also were aware that Prater has an extensive criminal history, including a conviction in 1993 for fraud in Michigan and 1992 convictions for forgery and theft in Washington, for which he served prison terms of four and a half years, five months, and nine months, respectively.

By failing to disclose the criminal history of himself and

Prater, Smith and United Financial Solutions knowingly failed to disclose material information to investors in violation of Revised Code 1707.44(G).

In addition, neither Smith nor United Financial Solutions was licensed to sell securities in Ohio as required by Revised Code 1707.44(A)(1), and the investment contracts and "programs" they were selling were not registered to be sold in Ohio as required by Revised Code 1707.44(C)(1).

The Division notified Respondents of their right to an administrative hearing pursuant to Chapter 119 of the Revised Code with the issuance of a Notice of Opportunity for Hearing on February 2, 2004. Respondents first requested a hearing, then withdrew the request.

J.L.B., Inc./ Desert Daily Dose, Ltd.

On November 29, 2005, the Division issued a Cease and Desist Order, Division Order No. 05-204, to J.L.B., Inc. and Desert Daily Dose, Ltd. of Los Angeles, California.

J.L.B., Inc. offered limited partnership interests in Desert Daily Dose, Ltd. for \$1000 per unit. The capital raised in the offering was to be used for an

expansion of 15 Papa John's Pizza restaurants. An Ohio investor was cold called and solicited to invest, and he purchased one unit for \$1000. However, after he invested, the company's phone was disconnected and nobody from Desert Daily Dose could be contacted. The sale was unregistered and a violation of 1707.44(C)(1). Also, in paperwork given to the Ohio investor, Desert Daily Dose states that it is a California limited partnership. According to the California Secretary of State, it has never been registered as such. This misrepresentation was a violation of 1707.44(B)(4).

The Division notified J.L.B., Inc. and Desert Daily Dose of their right to an administrative hearing pursuant to Chapter 119 of the Ohio Revised Code with the issuance of a Notice of Opportunity for Hearing on June 10, 2005. J.L.B., Inc. and Desert Daily Dose did not request a hearing in a timely matter, resulting in the issuance of the Cease and Desist Order.

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	4th Qtr 2005	YTD 2005
Exemptions		
Form 3(Q)	\$58,472,591	\$205,178,284
Form 3(W)	3,100,000	9,895,000
Form 3(X)	116,815,650,612	368,258,283,687
Form 3(Y)	1,240,000	8,133,000
Registrations		
Form .06	304,654,078	2,690,369,495
Form .09/.091	17,133,428,457	57,309,306,108
Investment Companies		
Definite	111,816,000	456,705,500
Indefinite**	538,000,000	2,120,000,000
TOTAL	\$134,966,361,738	\$431,057,871,074

Registration Statistics

The following table sets forth the number of registration, exemption, and notice filings received by the Division during the fourth quarter of 2005, compared to the number of filings received during the fourth quarter of 2004. Likewise, the table compares the year-to-date filings for 2004 and 2005.

Filing Type	4th Qtr '05	YTD '05	4th Qtr '04	YTD '04
1707.03(Q)	25	118	18	98
1707.03(W)	3	10	5	15
1707.03(X)	429	1614	340	1453
1707.03(Y)	1	9	4	9
1707.04/.041	0	1	0	1
1707.06	10	65	17	78
1707.09/.091	50	154	47	182
Form NF	1214	4835	1117	5420
Total	1732	6806	1548	7256