

OHIO SECURITIES BULLETIN

Ted Strickland
Governor of Ohio

Kimberly Zurz
Director of Commerce

Brian Misencik
Acting Commissioner of Securities

OHIO DEPARTMENT OF COMMERCE OBTAINS APPOINTMENT OF A RECEIVER AND AN INJUNCTION AGAINST JERRY RAY ROSE, OF HAMILTON, AND HIS COMPANIES

Following a complaint filed by the Ohio Department of Commerce's Division of Securities, the Butler County Common Pleas Court appointed a Receiver and issued a preliminary injunction on July 6, 2007, against Jerry Ray Rose (also known as J.R. Rose) of Hamilton and his 10 business entities.

OHIO

DEPARTMENT OF

COMMERCE

DIVISION OF

SECURITIES

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Judge Keith M. Spaeth appointed Rupert E. Ruppert of Ruppert, Bronson & Ruppert Co. LPA as Receiver to take possession of all assets and records of Rose and his business entities. The court granted the receiver exclusive authority to manage and operate Rose's business entities and to wind up Rose's affairs.

Rose had been a licensed insurance agent in Ohio but was not licensed as a securities salesperson. The Division's complaint stated that Rose admitted that approximately \$10 million in investments have been under his control since he began trading securities. He also admitted to the Division that he is short approximately \$4 million to \$5 million from fully reimbursing investors.

Rose established bank and brokerage accounts – under his name and direct control – to pool money received from investors, most of whom resided in Butler County. In the complaint filed in court, the Division alleged that Rose commingled investor funds with those of his own and paid personal expenses out of the accounts. The Division said Rose was dependent on deposits from new investors to continue to paying existing investors.

“By obtaining the injunction and with the appointment of the Receiver, the Ohio Department of Commerce is seeking the return of as much money as possible to the affected investors,” said Director of Commerce Kimberly Zurz.

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Acting Securities Commissioner Named

Brian Misencik, of Columbus, was named Acting Commissioner of Securities on August 7, 2007. Misencik is also the Deputy Director of Administration for the Department of Commerce. Misencik's prior experience includes a decade of service with the Ohio Legislature in both the House and Senate. Most recently he served six years as Minority Deputy Chief of Staff for the Ohio Senate. Misencik holds a bachelor's degree from Capital University.

Rose case continued...

The preliminary injunction bars Rose and his agents from:

- selling, offering to sell, or transferring any securities;
- buying, selling or transferring any real estate without the court's prior approval;
- engaging in any deceptive, fraudulent or manipulative act; and
- destroying, disposing or altering records.

The judge ordered that Rose cannot have any contact with his insurance agency clients or any person who invested with him in the past 10 years. Rose surrendered his insurance license to the Ohio Department of Insurance.

Editor's Note: Please see the Criminal Reports section in this issue of the Bulletin for information regarding a related criminal case involving Rose.

The following table sets forth the number of registration, exemption and notice filings received by the Division during the first and second quarters of 2007, and the year-to-date totals for all types of filings.

	3Q	3W	3X	3Y	04/041	06	9/91/92	NF
1 st Quarter	14	4	441	2	0	18	23	1,435
2 nd Quarter	19	1	488	2	1	12	38	1,478
YTD 2007	33	5	929	4	1	30	61	2,913

OHIO SECURITIES BULLETIN

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 Karen Bowman at karen.bowman@com.state.oh.us for editorial guidelines and publication deadlines. The Division reserves the right to edit articles submitted for publication.

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HAROLD HOPKINS PLEADS GUILTY TO SECURITIES LAW VIOLATIONS

Harold Hopkins, formerly of Aurora, pleaded guilty in Summit County Common Pleas Court on August 28, 2007, to 39 counts of selling unregistered securities following an investigation and criminal referral by the Ohio Department of Commerce's Division of Securities. The 39 counts cover 39 victims who invested and lost approximately \$500,000. Most of the victims were from northeast Ohio.

Hopkins, who was indicted in August 2005 on 56 counts of securities law violations, was scheduled to go on trial on September 10, 2007. Brad Gessner of the Summit County Prosecutor's Office prosecuted the case. The sentencing hearing will be held at 9:00 a.m. on November 19, 2007.

In 2005, the Division's investigation led to a civil injunctive action in Summit County Common Pleas Court that resulted in a preliminary injunction against Hopkins and his four companies in Hudson, Ohio, as well as the appointment of a Special Master to oversee the operations of the companies. Hopkins had been the controlling officer of Vista Financial Group, Flagship Administration Ltd., Vista Financial Services Corp. and Horizon Benefit Administration Corp.

In the civil action, the Division alleged that Hopkins sold unregistered securities and fraudulently sold stock to investors by misrepresenting the degree of risk and the liquidity of the stock. Hopkins prepared a private placement memorandum describing the investments as high risk and nonliquid – meaning the stock had no trading or resale market. However, the Division discovered that Hopkins had failed to provide copies of the private placement memorandum prior to sale and that he had told the investors that the stock was low risk and liquid.

In investigating the criminal case, the Division of Securities worked in cooperation with the Summit County Prosecutor's Office, the Ohio Bureau of Criminal Identification and Investigation, the U.S. Department of Labor's Employee Benefits Security Administration, and the Hudson, Aurora and Stow police departments.

The following is a chronology of Hopkins-related events:

9-23-04 – Temporary restraining order issued against Harold Hopkins, his wife Linda C. Hopkins and four of his companies. The court froze the assets and bank accounts of the four companies.

9-30-04 – The Summit County Common Pleas Court issued a preliminary injunction against Harold Hopkins, Linda C. Hopkins, and four of his companies. The court appointed Akron attorney Marc B. Merklin as Special Master to oversee the operations of the businesses.

10-12-04 – Ohio Division of Securities suspends Harold Hopkins' securities salesperson license.

2-18-05 – Ohio Division of Securities suspends Harold Hopkins' securities salesperson license.

8-30-05 – Summit County grand jury hands down 56-count secret indictment against Harold Hopkins.

8-28-07 – Harold Hopkins pleads guilty to 39 counts of selling unregistered securities.

The Division of Securities Adopts Administrative Rules Incorporating Federal Regulations “As Amended”

by Michael Miglets

The Ohio Securities Act (“OSA”) and the Division’s administrative rules have incorporated a number of federal securities laws and rules over the years to enable issuers, securities dealers and investment advisers to limit compliance costs and the regulatory burden on securities transactions. Incorporation by reference has included: securities registration and exemption, securities dealer and investment adviser regulations and case law defining fraudulent securities practices.

In 1992, the Ohio Supreme Court held that there was an Ohio constitutional issue with adopting federal statutes with the provision “as amended.” *State v. Gill*, 63 Ohio St. 3d 53 (1992). *Gill* was an appeal of criminal conviction for violation of a state statute that incorporated a federal food stamp statute. The Court held that the Ohio General Assembly may adopt only the federal statute or regulation that was in effect at the time the state legislation was enacted. The incorporation of future federal amendments appeared to the Court to be an unconstitutional delegation of state legislative authority. The *Gill* decision raised serious questions about the incorporation of the federal securities laws and regulations in the OSA.

The *Gill* decision created additional problems in 1996 when Congress added a uniformity mandate to state and federal securities regulation by enacting the National Securities Markets Improvement Act (NSMIA). NSMIA created uniform state securities exemptions by creating “covered securities” in section 18 of the Securities Act of 1933. States were also precluded from adopting securities dealer requirements that differ from federal law or add additional restrictions.

However, the Ohio Supreme Court in a 1996 decision held that the incorporation of federal securities laws and cases developed after the enactment of amendments to the Ohio Securities Act were permitted. *In re Columbus Skyline Securities Inc.*, Ohio State 3d 495 (1996). In *Columbus Skyline*, the Court upheld the definition of fraud in R.C. 1707.01(J) without referring to *Gill* or the issue of the unconstitutional delegation of state legislative authority. The Court recognized the goal of uniformity for securities law and the extensive number of federal cases, statutes and regulations defining securities fraud.

H.B. 301, effective on October 12, 2006, included a key amendment to the Ohio securities laws covering incorporation by reference of federal securities statutes and regulations. Under R.C. 1707.20(A), the Ohio Securities Act may incorporate federal laws and regulations “as amended” instead of incorporation as of a specific date.

To clarify any potential inconsistencies between the *Gill* and *Columbus Skyline* decisions, R.C. 1707.20(A)(2) was amended to specifically permit the Division to adopt rules that incorporate future amendments to federal securities laws, rules, regulations and forms in the Division’s administrative rules. This insures that the uniformity mandate of NSMIA will be met and that the regulatory costs and burdens on the securities industry will be limited.

Effective August 5, 2007, all of the Division’s administrative rules have been amended to incorporate federal laws, regulations and forms “as amended.” Any federal amendments will be incorporated automatically into the Division’s administrative rules.

H.B 301 also amended the Ohio Securities Act to clarify that all licensed securities dealers are subject to the books and records requirements of Sections 15 and 17 of the Securities Exchange Act of 1934 and rules promulgated by the Securities and Exchange Commission (“SEC”). A document filed with the SEC is deemed filed with the Division. See R.C. 1707.14.2. The Division is authorized to take action against licensed dealers for violations of the federal laws and regulations.

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Criminal Reports

Clarke T. Blizzard was sentenced on May 3, 2007, in U.S. District Court in Cleveland to three years in prison on one count of conspiring to bribe a public official. Blizzard was also sentenced in Franklin County to three years on one count of money laundering. The sentences are to be served concurrently. Blizzard was indicted in Franklin County Common Pleas Court on April 12, 2007, on one count of money laundering. Blizzard previously pleaded guilty in federal court on February 28, 2007, on a related charge of conspiring to bribe a public official, Terrence Gasper, former Chief Financial Officer of the Ohio Bureau of Workers' Compensation. In return, Gasper helped businesses that Blizzard was associated with, employed by, or a representative of, to obtain and retain hundreds of millions of dollars worth of OBWC investment business.

Terrence W. Gasper was sentenced in U.S. District Court in Akron on May 9, 2007, to 64 months in prison and ordered to pay \$60,405 in fines. Gasper was also sentenced to 64 months by Franklin County Common Pleas Judge Guy Reece, to be served concurrently with the federal sentence. Gasper had pleaded guilty on June 7, 2006, to one count of violating the federal racketeering statute (federal court) and one count each of money laundering and violating Ohio ethics laws in connection with his failure to report gifts or gratuities as required by public employees (Franklin County Common Pleas Court). Gasper had been accused of accepting things of value from investment brokers, dealers, and marketers seeking to obtain and retain lucrative Ohio Bureau of Workers Compensation investment contracts while employed as Chief Financial Officer for the OBWC.

Mark D. Lay was arraigned on July 2, 2007, after he was indicted on June 14, 2007, in U.S. District Court in Cleveland on one count each of engaging in investment advisory fraud, mail fraud, and conspiracy to commit mail fraud and wire fraud. Lay is accused of causing the Ohio Bureau of Workers' Compensation to lose \$216 million in an offshore hedge fund he managed for the agency. His trial began on October 15, 2007. The Division is part of an ongoing State and Federal Task Force investigating alleged misconduct at the OBWC.

William Mayes was sentenced on March 21, 2007, to 9½ years in prison. He had pleaded no contest to 58 counts, including 29 counts each of selling unregistered securities and securities fraud. On July 1, 2005, Mayes was indicted in Licking County on 26 counts in connection with the sale of limited partnership interests and a bond in Americable V, Cable-Tex and Cable Ventures Ltd. The indictment included securities fraud, false representations, sales of unregistered securities, and engaging in a pattern of corrupt activity. Mayes was re-indicted on June 30, 2006, on 90 counts, including 30 counts each of selling unregistered securities, securities fraud and engaging in a pattern of corrupt activity.

Gary L. McNaughton was sentenced on May 22, 2007, to 63 months in prison and ordered to pay \$6.8 million in restitution. McNaughton pleaded guilty on March 5, 2007, to 10 counts of fraud and tax evasion. McNaughton was indicted in U.S. District Court in Cleveland on November 14, 2006, on 13 felony counts, including one count of securities fraud, five counts of mail fraud, two counts of money laundering, three counts of tax evasion, one count of selling unregistered securities, and one count of making false statements. The indictment alleged that from 1999 through June 2003, McNaughton sold securities to approximately 200 investors in numerous states, including Ohio, for a total of approximately \$17 million. The Division of Securities assisted with the federal prosecution, and previously issued a Cease and Desist Order against Gary L. McNaughton and his company, The Haven Equity Co.

Jerry R. Rose pleaded guilty on July 18, 2007, in Butler County Common Pleas Court to a three-count Bill of Information. The counts included one count each of selling unregistered securities, forgery and perjury. Rose was an insurance agent in Hamilton, Ohio, who pooled over \$10 million from about 150 to 200 investors in the Butler County area and admitted that he is short approximately \$4 million to \$5 million from fully reimbursing investors. A Butler County judge issued a preliminary injunction and placed Rose and 10 companies under his control in receivership on July 6, 2007, after the Division determined that Rose was running a Ponzi scheme. Sentencing is scheduled for January 8, 2008. (*Editor's Note: See the article regarding the civil action involving Rose in this issue of the Bulletin.*)

Allen O. Snyder was sentenced on September 25, 2007, to two years in prison and ordered to pay \$108,860.90 in restitution to two Ohio investors. He pleaded guilty on June 19, 2007, to three counts of felony theft. On December 9, 2005, Snyder, of Indianapolis, Indiana, was indicted in Sandusky County Common Pleas Court on nine 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 was accused of luring Ohio investors to place their funds in an alleged qualified IRA custodian fund with his company, HiTech Accounting Services, in order to purchase government bonds.

Enforcement Section Reports

Listed below are the final orders issued by the Division for the first and second quarters of 2007. The orders can be found on the website at <http://www.securities.state.oh.us/FinalOrders/FinalOrders07/>

ORDER NO.	NAME OF RESPONDENT	DATE	TYPE OF ORDER
07-009	Steve Vilardo Frederick Klaus; OPE Inc. dba Complete Property Resources; and CPR Group Limited; Turnkey 1 Ltd.	1/24/07	Cease and Desist Order/Consent Agreement
07-023	Pine Mountain 2002 Ltd.; and Pike 2002 Ltd.	2/12/07	Cease and Desist Order/Consent Agreement
07-025	Joseph Jones; and Alpha Prosperity Project Inc.	2/20/07	Cease and Desist Order
07-032	Eavenson Family LP	2/28/07	Cease and Desist Order
07-033	James W. Spencer; Spensoft Intelligent Software Inc.; Intelligent Software; and Wright Brothers Entertainment Inc.	2/28/07	Cease and Desist Order/Consent Agreement
07-048	Roy Phillip Akers CRD No. 2173	3/17/07	Final Order to Deny Application for Securities Salesperson License
07-057	Perkins Smart & Boyd Inc. CRD No. 7221	4/4/07	Cease and Desist Order/Consent Agreement
07-058	Karma Funds LLC	4/9/07	Cease and Desist Order
07-062	Integrity Home Buyers Inc.; and E. Alan Cowgill	4/12/07	Cease and Desist Order/Consent Agreement
07-066	Robert E. Anderson	4/17/07	Cease and Desist Order
07-067	Vincent Hogue	4/20/07	Cease and Desist Order
07-084	Caprock Securities Inc. CRD No. 8014	4/27/07	Cease and Desist Order
07-085	Manarin Securities Corp. CRD No. 37611	4/27/07	Cease and Desist Order
07-112	Gary M. Poling	5/3/07	Cease and Desist Order

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Enforcement Section Reports

ORDER NO.	NAME OF RESPONDENT	DATE	TYPE OF ORDER
07-115	Robert Fredrick Glessner Jr. CRD No. 2354148	5/14/07	Revocation of Ohio Securities Salesperson License and Ohio Investment Adviser Representative License
07-134	Blue Pacific Grill – Perrysburg 1 LLC	5/17/07	Cease and Desist Order/Consent Agreement
07-139	Cynthia Mary Couyoumjian CRD No. 1456630	5/16/07	Final Order Denying Application for Securities Salesperson License
07-145	Lonnie L. Coulter	5/18/07	Cease and Desist Order/Consent Agreement
07-156	Jeffrey L. Sadlack; and Robby J. Sadlack	5/24/07	Cease and Desist Order
07-175	Superdrive Inc.	6/5/07	Cease and Desist Order
07-184	Steven Anthony Bencivenga Jr. CRD No. 3000161	6/6/07	Revocation of Ohio Securities Salesperson License
07-193	Strand Atkinson Williams & York Inc. CRD No. 1254	6/14/07	Cease and Desist Order
07-205	Donald G. Saling	6/20/07	Cease and Desist Order
07-208	Barry Francis Cassese CRD No. 2080657	6/8/07	Revocation of Ohio Securities Salesperson License
07-212	Drew A. Gillham	6/22/07	Cease and Desist Order
07-213	Jody R. Luikart dba The Financial Choice Group	6/22/07	Cease and Desist Order
07-228	Thomas Joseph Heaphy Jr. CRD No. 2540325	6/28/07	Final Order to Deny Application for Securities Salesperson License

Blue Flame Part II: Case Gives Guidance Regarding Internet Solicitations

Editor's Note: This article constitutes the last of a two-part series which reviews the case of Blue Flame Energy Corp. et al. v. Ohio Department of Commerce, Division of Securities. The case, which arises out of the Tenth Appellate District, sets forth several important holdings, mainly regarding the Division's jurisdiction over companies that have a presence on the internet, and the extent of federal pre-emption of certain provisions of the Ohio Securities Act. The jurisdictional issue was discussed in Part I of the article. Part II deals principally with the pre-emption issue. For a recitation of the facts and litigation history of the case, please refer to Part I of the article, which was published in issue 06:4 of the Ohio Securities Bulletin.

In considering the case of *Blue Flame Energy Corp. et al. v. Ohio Department of Commerce, Division of Securities*, the Franklin County Court of Appeals primarily dealt with two overriding issues that greatly impact the Division's ability to regulate issuers that do business over the internet. The first issue, discussed in Part I of this article, concerned the limits of the Division's jurisdiction over out-of-state issuers operating websites that potentially might be used to sell securities. The second issue concerns whether the Division can impose its own independent review of securities transactions that arguably would be addressed by federal law. The Court ultimately held that the Division can indeed base actions upon its own review as to whether issuers meet exemptions set down by federal law.

As outlined in the *Blue Flame* opinion, the appellees argued that their offerings were "covered securities" pursuant to Section 77r(b)(4)(D), which defines "covered securities" to include "securities offered and sold in transactions exempt under 'Commission rules or regulations issued under section 77d(2) of this title.' Section 77d(2) provides an exemption from federal registration requirements to 'transactions by a issuer not involving any public offering.'" Rule 506, which was promulgated by the SEC, states that sales of securities are deemed not to be public offerings if they satisfy conditions found in companion SEC rules 501 and 502. The issuers in this case insisted that, to qualify their sales as covered securities, they need only have relied on Rule 506 to seek this status, rather than actually complying with it. They buttressed their argument by citing the case of *Temple v. Gorman* (S.D. Fla. 2002), 201 F. Supp.2d 1238 and its progeny, which supported this view. However, this Court expressly rejected the issuers' argument, citing opposing legal authority, which pointed out that such a reading of federal law would allow issuers to avoid state regulation altogether, "allowing con artists to avoid state registration by telling the investor that the offering was a private placement under Rule 506." Following this reasoning, the Court concluded that "Section 77r expressly pre-empts state laws from regulating the issuance and sale of those securities that actually are exempt under Rule 506." But it is clear the Court is upholding the Division's authority to review offerings to verify that they do indeed qualify for a federal exemption. Additionally, the Court did not support the appellees' argument that Congress intended the SEC to retain sole authority to adjudicate whether a security qualifies as a covered security. The Court noted that "the SEC is not vested with exclusive power to regulate securities policy for the entire nation, thus eliminating any room for state regulation." In a footnote, the Court also noted that the National Securities Markets Improvement Act of 1996 "delegated to the states regulation of any fraud in connection with all securities." The Court also strengthened the Division's position by reiterating that the burden of proving an exemption is placed on the issuer.

Having held that the *Blue Flame* issuers had to prove to the Division's satisfaction that sales of their securities deserved a federal exemption, the Court set out to consider whether the securities at issue in this case indeed met the requirements of a Rule 506 exemption. To obtain a Rule 506 exemption, the issuer must adhere to the provisions of Rule 502. A lynchpin provision of this rule (and one that has stymied many issuers from claiming an exemption) is the ban on general advertising and solicitation. The court noted that Rule 502 involves two inquiries regarding this issue: "(1) is the communication in question a general solicitation or general advertisement? and (2) is the issuer or someone on the issuer's behalf using the communication to offer or sell the securities?" (This two-pronged test is found in the *Interpretive Release on Regulation D, Securities Act of 1933*, Release No. 33-6455 (March 3, 1983)). That the Blue Flame Energy Corp.'s website was publicly available was not in dispute. Its website was not the kind of limited-access, password-protected website catering to accredited or sophisticated investors that could have spared it from being regarded as a general advertisement. Therefore, the first prong of the test was easily proved.

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Blue Flame Part II continued...

The second prong requires that the issuer is using the communication to offer or sell securities. The Court noted that “(i)f the content indicates that the communication is designed to procure orders for a security, arouse interest in a security, or condition the public mind, then the communication is an offer to sell securities.” Importantly, the Court would even deem a communication as a sale of securities if it merely solicits investors to a program as a whole, as distinguished from securities that are presently being offered under an ongoing program. This type of scenario is common with oil and gas projects, in which the issuer will sell interests in multiple phases of an ongoing drilling project. Using this analysis, the Court found there was reliable, probative and substantial evidence that Blue Flame Energy Corp., through its website, engaged in acts designed to prompt people to contact the company regarding securities offered under its program, with a view towards sales. The Court noted that the company touted its programs as offering significant tax advantages and that “investors would have ‘(d)irect ownership of real assets,’ and that ‘(t)ime tested, private placement partnership format limits liability and maximizes tax sheltered income.” Blue Flame Energy Corp. was found to have engaged in general solicitation and advertisement in offering securities, and fulfilled the two-pronged test outlined above. It and its related issuers thereby violated Rule 502, disqualifying their sales from a Rule 506 exemption.

In summary, the Tenth District Court of Appeals reinforced the Division’s authority to independently review securities sold in Ohio, even in cases where the issuer is relying on federal law for an exemption from registration. The Court’s holdings as outlined above will definitely aid the Division in its quest to protect the integrity of Ohio’s securities market.

Administrative Code Rules changes continued...

As licensed securities dealers are subject to federal books and records regulations and net worth requirements, the books and records provisions and the net-worth requirement in Ohio Administrative Code section 1301:6-3-15 were deleted.

R.C. 1707.14.2(C) authorizes the Division to develop alternative books and records requirements and net worth standards for dealers that are not required to register as brokers or dealers with the SEC. Ohio Administrative Code section 1301:6-3-14.2(A) allows a dealer that is not required to register with the SEC to elect to comply with the Division’s rule in lieu of federal laws and regulations. Paragraphs (B) to (M) of Ohio Administrative Code section 1301:6-3-14.2 are essentially a restatement of the books and records requirements and the net-worth standards in the prior version Ohio Administrative Code section 1301:6-3-15.