

OHIO SECURITIES BULLETIN

A QUARTERLY PUBLICATION OF THE OHIO DIVISION OF SECURITIES

George V. Voinovich
Governor of Ohio

Donna Owens
Director of Commerce

Mark V. Holderman
Commissioner of Securities

A Second Look at Limited Liability Companies

by Jason C. Blackford, Esq.

Introduction

When Ohio enacted its limited liability company law (RC Chapter 1705), it was thought that this new form would be a wonderful way for small businesses to avoid corporate tax while sheltering members from the business's liabilities. Since July of 1994, many practitioners have used the limited liability company ("LLC") as the business form for many new small businesses. The use of the limited liability company form as an estate planning tool was not fully comprehended at the time of enactment.

"A Second Look"

1. Estate Planning Tool. The use of the LLC as an estate planning tool has been popularized through both public and professional seminars. The Revenue Reconciliation Act of 1993 increased the top marginal rate on the income of trusts and estates from 31% to 39.6% and reduced the income level at which this rate begins to \$7,500. IRC §1(e). The difference on the trust and individual marginal tax rate levels and the flexibility of the LLC form have made these LLCs a useful alternative to trusts.

Continued on page 2

The Fiduciary Duty of a Securities Salesman

by Thomas E. Geyer, Esq.

Regardless of the nature of a purchaser of securities, a securities salesman owes to the purchaser a fiduciary duty.

State v. Walsh,¹ a criminal prosecution for violations of the Ohio Securities Act, is usually cited for the proposition that "knowingly," as used in R.C. 1707.44(G), is defined in terms of "negligently." In connection with that holding, the Walsh court also stated:

Thus, for the purpose of fraudulent acts in selling securities in violation of R.C. 1707.44(G), a person is criminally liable if he represents facts to be different than he should have known them to be if he had exer-

cised reasonable diligence to ascertain the facts. On the other hand, of necessity a good-faith belief in the existence of the fact as represented creates no criminal liability since one cannot have a good-faith belief in facts which he should know to be otherwise had he exercised reasonable diligence. Good faith necessarily implies the exercise of reasonable diligence to ascertain the true state of facts.²

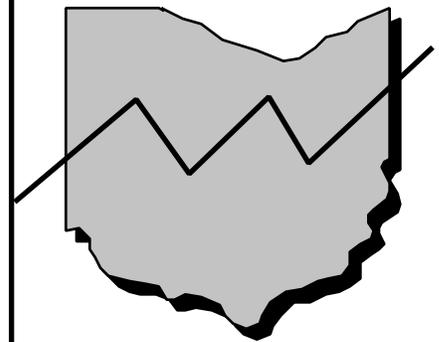
The foregoing passage illustrates judicial affirmation that a securities salesman is held to a high standard in the transaction of his business. The Walsh court recog-

Continued on page 4

OHIO

DEPARTMENT OF
COMMERCE

DIVISION OF
SECURITIES



Ohio Securities Bulletin

Issue 95:2

Table of Contents

A Second Look at Limited Liability Companies	1
The Fiduciary Duty of a Securities Salesman.....	1
Division Enforcement Section Reports	5
1995 Ohio Securities Conference	10
Registration Statistics	11
Licensing Statistics	11

Limited Liability

Continued from page 1

For example, limited liability companies have been used to hold life insurance contracts while avoiding the "transfer for value". If a life insurance contract is transferred for valuable consideration, the exclusion from gross income is limited to the amount equal to the sum of the actual value of the consideration (including the premiums and other amounts subsequently paid by the transferee). IRC §101(a)(2). This results in most of the proceeds of the policy being included in income. On the other hand these "transfer for value" rules do not apply to the transfer of a life insurance policy on the life of a member to the limited liability company. IRC §101(a)(2)(B). The insurance policy can be transferred, either with or without consideration to the insureds, without causing the life insurance proceeds to lose their tax free character. Also, holding life insurance contracts in limited liability company form avoids the alternative minimum tax that could be imposed if a corporation receives the proceeds of the life insurance policy.

Because a limited liability company is considered for tax purposes as a partnership, the tax basis of a LLC member's interest is "stepped up" on the death of that member. IRC §1014. Furthermore, if the limited liability company makes the appropriate election, upon the death or on the redemption of a member's interest, any gain recognized by a member is added to the tax basis of remaining LLC assets. IRC §754. There are certain provisions that may limit the estate planning advantages of the LLC, such as the family partnership rules of IRC §704(e) and the valuation provisions of IRC §§2701, 2703 and 2704.

There are non-tax pitfalls in using a LLC as an estate planning device. First, many estate planners have little experience with the federal and state securities laws. There

should be concern about compliance by the LLC with the requirements of the federal and state private placement exemptions or the perfection of the intra-state exemption under SEC Rule 147.

Another concern is the implication of the Ohio Supreme Court's opinions in *Arpadi v. First MSP, Inc.*¹ and *Galbreath v. Firestone*² The *Arpadi* decision created a duty for counsel for the limited partnership and its general partner to each of the limited partners.³ The Supreme Court opinion in the *Galbreath* case recognizes the tort of intentional interference with an expectancy or inheritance. What is the duty of a lawyer for an LLC used as an estate planning tool to ensure that all family members are treated fairly? Does the lawyer subject himself/herself to liability from a disgruntled relative who feels that the testator/LLC member has been coerced into altering the inheritance? The argument would be that the member-testator has a fiduciary duty to all other members and the attorney for the LLC shares this duty.

As these questions illustrate mixing a business form with estate planning can create unwanted risks for the lawyer. To avoid this possible liability, a lawyer could attempt to disclaim this duty to all members and to obtain an acknowledgement from each member that the attorney represents the LLC and does not owe a duty to that member.

2. Uncertainty as to Tax Consequences The Internal Revenue Service has not yet issued a ruling indicating that limited liability companies formed under RC Chapter 1705 will be considered to be "partnerships" for federal income tax purposes. Reliance must be placed on the absence of corporate characteristics in the operating agreement.⁴

Despite numerous Internal Revenue Service private letter rulings, some of the tax consequences to the members are still uncertain. For example, a limited partner's share of partnership income is not self-employment income. It is uncertain how a LLC member's income allocation will be treated for self-employment tax purposes.⁵

OHIO SECURITIES BULLETIN

Thomas E. Geyer, 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.

Portions of the Ohio Securities Bulletin may be reproduced without permission if proper acknowledgement is given.

Ohio Division of Securities

77 South High Street, 22nd Floor • Columbus, Ohio 43215

All listings are area code (614)

Receptionist	644-7381	Enforcement	466-6140
Broker-Dealer	466-3466	Examination	644-7467
Records	466-3001	Registration	466-3444

Another uncertainty is whether “the passive activity” rule would automatically be applicable to a LLC member for the purpose of determining if the activity is either active or passive to that member. Also it is uncertain whether any LLC debt for which a member is not secondarily liable is to be allocated to the members as nonrecourse debt.

Does the failure to disclose these uncertainties constitute legal malpractice? Is there a possible SEC Rule 10b-5 problem for a failure to disclose this uncertainty if tax considerations are material to investors? Should offering materials have a discussion of the tax implications of the LLC form? This author believes that a lawyer must include some form of tax analysis in any offering material of a LLC. How should the lawyer for the limited partnership convey the information on the uncertainties of the LLC to the investors when there is no offering material? An attachment to the subscription agreement is one way to accomplish that result.

3. Tax Shelter Registration. Congress became concerned that promoters of and investors in entities taxed as partnerships were profiting from the inability of the Internal Revenue Service to examine effectively every return. In the early 1980s, some promoters knew that even if a tax scheme was faulty, some of the investors’ incorrect returns would escape detection and many would enjoy a substantial deferral of taxes while the Internal Revenue Service searched for their returns. The Deficit Reduction Act of 1984 added provisions designed to require that promoters keep lists of customers and investments to enable the Internal Revenue Service to identify quickly all the participants in a related tax shelter investment. IRC §6111 requires tax shelter promoters to register their promotions with the Internal Revenue Service.

An LLC meeting the tax shelter tests must register as a “tax

shelter” with the Internal Revenue Service. First, the LLC must be subject to either federal or state securities registration requirements. This includes an exemption from registration requiring the filing of a notice with a federal or state agency regulating the offering or sale of securities. From a practical standpoint, only the intra-state exemption under SEC Rule 147 and the small offering exemption under RC §1707.03(O) escape this requirement. Transactions that are not required to be registered under a federal or state law regulating securities satisfy this requirement if the aggregate amount exceeds \$250,000 and there are expected to be 5 or more investors.

Second, the definition of a “tax shelter” includes any investment:

with respect to which any person could reasonably infer from the representations made, or to be made, in connection with the offering for the sale of interests in the investment that the tax shelter ratio for any investor as of the close of any of the first five years ending after the date on which the investment is offered for sale may be greater than 2 to 1...

The tax shelter ratio is defined as the ratio that the aggregate amount of deductions and 350% of the credits, which are represented to be potentially available to any investor for all periods up to the close of such year, bears to the “investment base” as of the close of such tax year. The term “investment base” means with respect to any tax year, the amount of money and the adjusted basis of contributed property (reduced by any liability to which the property is subject) contributed by the investors as of the close of such year. There are complicated rules that may increase or decrease this investment base.

Once these requirements are satisfied, the promoter must register the material on IRS Form 8271. Furthermore, the tax shelter identification number must be included with the entity’s information return. Any member who sells all or any portion of his/her interest in a limited liability company registered as a tax shelter must furnish the purchaser with the identification number as well as instructions on how it should be used. A person claiming any deduction, credit or his/her tax benefit received from a limited liability company registered as a tax shelter must include that number on the tax return. It is suggested that all lawyers forming an LLC require the LLC’s accountant to prepare projections to determine the “tax shelter ratio” for the first five years of operation. These projections should then be distributed to all members.

4. The Mechanics of Operation of a Limited Liability Company. Much has been written about the intricacies of forming the LLC, but little on the day to day operations. For example, by-laws should be created for all manager operated limited liability companies. These by-laws should outline how the managers are to function, including provisions relative to quorums, action without a meeting, officers, and responsibilities of officers. Minutes should be kept of all manager meetings. Regularly scheduled member meetings should be held with minutes recording the actions taken.

Many practitioners also issue membership certificates, which evidence the holder’s interest in the limited liability company. There should be a ledger and journal to record the transfers of membership interests. These membership certificates should also contain the appropriate legends to comply with the private placement exemption or the SEC Rule 147 intra-state exemption.

Continued on page 9

Fiduciary Duty

Continued from page 1

nized that an investor places special trust in his securities salesman, who occupies a superior position in their relationship. Consequently, a securities salesman must discharge his duties with honesty and reasonable diligence or, in other words, act in a fiduciary capacity.

Under Ohio law, a fiduciary relationship:

is one in which special confidence and trust is reposed in the integrity and fidelity of another and there is a resulting position of superiority or influence, acquired by virtue of this special trust.³

Ohio courts have expressly held that a fiduciary relationship exists between a securities salesman and his customer. For example, in *Silverberg v. Thomson, McKinnon Securities, Inc., et al.*,⁴ in reversing the dismissal of a complaint based on, among other things, misrepresentations made in selling securities, the Cuyahoga County Court of Appeals stated: "A broker-dealer [SIC] is a fiduciary who owes his customer a high degree of care in transacting his business."⁵ More recently, The Erie County Court of Appeals expressly held: "[a] broker and a client are in a fiduciary relationship."⁶

Similarly, in applying Ohio law, the Sixth Circuit Court of Appeals has consistently held that a fiduciary relationship exists between a securities salesman and his customer. For instance, in *Thropp v. Bache Halsey Stuart Shields, Inc.*,⁷ in reviewing a case based on alleged account mismanagement, in the Sixth Circuit noted that both parties agreed that the stockbroker had a fiduciary duty towards his customer.⁸ In *Street v. J.C. Bradford & Co.*,⁹ the appellate court stated: "a stock or commodities broker is the agent of the customer and a fiduciary relationship exists between them."¹⁰ And, in *Mansbach v.*

Prescott, Ball & Turben,¹¹ the Sixth Circuit held: "a broker-dealer [SIC] is a fiduciary who owes his customer a high degree of care in transacting his business."¹²

In addition, commentators agree that a securities salesman stands in a fiduciary capacity. Professor Louis Loss writes "there is in effect and in law a fiduciary relationship."¹³ Arnold Jacobs notes "brokers owe a fiduciary duty to their customers."¹⁴ The relationship is also expressly recognized by the Restatement (Second) of Agency, which states: "a broker-dealer [SIC] acting as an agent for his customer is a fiduciary with respect to matters within the scope of his agency".¹⁵

Further, the Securities and Exchange Commission ("SEC") has consistently held that a fiduciary relationship exists between a securities salesman and his customer. In the leading case of *Arleen Hughes v. SEC*,¹⁶ the appellate court upheld the SEC's revocation of broker's registration for breach of fiduciary duty where the broker failed to disclose that it was not selling securities to its clients at the best prices available. The fiduciary theory continues to play an important role in SEC administrative proceedings and private actions.¹⁷

The SEC has also used the "shingle theory" to protect the special relationship of trust and confidence that exists between a securities salesman and his customer. The shingle theory provides that a securities salesman, by virtue of being in the securities business ("hanging out his shingle"), makes an implied representation to the customer that the customer will be dealt with fairly. "Inherent in the relationship between a dealer and his customer is the vital representation that the customer will be dealt with fairly, and in accordance with the standards of the profession."¹⁸ The shingle theory first gained judicial acceptance in *Charles Hughes & Co. v. SEC*,¹⁹ where the Second Circuit Court of Appeals affirmed the SEC's revocation of a broker-dealer's li-

cense for selling stock at prices substantially in excess of the market price, stating:

When nothing was said about market price, the natural implication in the untutored minds of the purchasers was that the price asked was close to the market. The law of fraud knows no difference between express representation on the one hand and implied misrepresentation or concealment on the other.²⁰

Commentary and more recent judicial decisions indicate that the SEC now favors the broader shingle theory to establish the special relationship of trust and confidence between a salesman and his customer.²¹ For example, in *Brennan v. Midwestern United Life Insurance Co.*,²² the district court held that a broker-dealer's failure to disclose its insolvency to customers violated the shingle theory's implied representation of fair dealing. "Recent [SEC] decisions have tended to rely upon ... the obligation which broker-dealers owe to all customers [under the shingle theory]."²³

The authorities are clear in holding that a special relationship of trust and confidence exists between a securities salesman and his customer. Both Ohio courts and the Sixth Circuit Court of Appeals in applying Ohio law have expressly characterized that relationship as fiduciary in nature. The commentators uniformly agree with such characterization. And, the SEC has recognized the special relationship under both the fiduciary and shingle theories.

Mr. Geyer is a Staff Attorney in the Enforcement Section and Editor of the Ohio Securities Bulletin.

Continued on page 5

Division Enforcement Section Reports

Administrative Orders

E-Mail Partners I, Ltd. and Scott Noreuil

On February 1, 1995, the Division issued a final Cease and Desist Order, Division Order 95-005, against E-Mail Partners I, Ltd. and Scott Noreuil. E-Mail Partners is a Nevada limited partnership with a principal office located in Poway, California, and Noreuil is the general partner of E-Mail Partners.

The Division determined that Philip Downing, a securities salesman licensed through Brokers Investment Corporation, solicited Ohio investors to purchase E-Mail Partners limited partnership units. On November 5, 1992, an Ohio resident purchased one E-Mail Partners unit for \$12,500. However, the unit was not registered with the

Division, the subject matter of an exempt transaction, or otherwise exempt from the registration provisions of the Ohio Securities Act. Therefore, the sale was in violation of R.C. section 1707.44(C)(1).

On October 31, 1994, the Division had issued Division Order No. 94-198, a Notice of Opportunity for Hearing to E-Mail Partners and Noreuil, setting forth the allegation of the unregistered sale. When neither E-Mail Partners nor Noreuil requested an administrative hearing, the Division issued the final order.

Brunswick Suzuki, Inc. and Wayne R. Peskura

On February 28, 1995, the Division issued a final Cease and Desist Order, Division Order No. 95-009, against Brunswick Suzuki, Inc.

of Brunswick, Ohio, and Wayne R. Peskura of Strongsville, Ohio. In connection with the final order, Brunswick Suzuki and Peskura entered into a Consent Agreement with the Division in which they consented, stipulated and agreed to the findings and conclusions set forth in the final order. The order was based on the sale of unregistered securities in the form of cognovit notes.

The Division's investigation revealed that in November 1991, at least three Ohio residents purchased cognovit notes from Brunswick Suzuki. The purchasers were natural persons other than the officers and directors of Brunswick Suzuki and therefore the notes were deemed to be "offered to the public," pursuant to O.A.C. Rule 1301:6-3-02(C)(1) and (2), which was in effect at the time of the sales. Since the notes
continued on page 6

Fiduciary Duty

continued from page 4

Endnotes

¹ 66 Ohio App. 2d 85 (Franklin Cty. 1979). As in the Walsh opinion, for the sake of convenience and clarity the masculine gender is used in this Article to refer to all sellers of securities.

² Id. at 95.

³ Stone v. Davis, 66 Ohio St. 2d 74, 78 (1981); In re Termination of Employment, 40 Ohio St. 2d 107, 115 (1974).

⁴ No. 48545 (Cuyahoga Cty. Ct. App. Feb. 14, 1985).

⁵ Id., slip op. at 8.

⁶ Byrley v. Nationwide Life Ins. Co., 94 Ohio App. 3d 1 (Erie Cty. 1994).

⁷ 650 F.2d 817 (6th Cir. 1981).

⁸ Id. at 819.

⁹ 886 F.2d 1472 (6th Cir. 1989).

¹⁰ Id. at 1481.

¹¹ 598 F.2d 1017 (6th Cir. 1979).

¹² Id. at 1026.

¹³ 3 Loss, Securities Regulation 1508 (2d ed. 1961)

¹⁴ 5C Jacobs, Litigation and Practice Under Rule 10b-5 § 210.03 (1994).

¹⁵ 1 Restatement (Second) of Agency § 13 (1957).

¹⁶ 174 F.2d 969 (D.C. Cir. 1949).

¹⁷ See, e.g., Gochnauer v. A.G. Edwards & Sons, 810 F.2d 1042 (11th Cir. 1987).

¹⁸ Duker & Duker, 6 S.E.C. 386, 388 (1939).

¹⁹ 139 F.2d 434 (2d Cir. 1943), cert. denied, 321 U.S. 786 (1944).

²⁰ Id. at 436.

²¹ See, e.g., Broker Dealers, Market Makers and Fiduciary Duties, 9 Loyola University Law Journal 746, 753 (1978).

²² 286 F. Supp. 702 (N.D. Ind. 1968).

²³ Cohen & Rabin, Broker-Dealer Selling Practice Standards: The Importance of Administrative Adjudication in Their Development, 29 Law & Contemporary Problems 691, 704 (1964).

were not registered with the Division, the subject matter of an exempt transaction, or otherwise exempt from the registration provisions of the Ohio Securities Act, they were sold in violation of R.C. section 1707.44(C)(1).

On October 31, 1994, the Division had issued to Brunswick Suzuki and Peskura Division Order No. 94-197, a Notice of Opportunity for Hearing, setting forth the Division's allegations and notifying them of their right to request an administrative hearing on the matter. Instead of proceeding to an administrative hearing, the respondents entered into the Consent Agreement. The final order ordered Brunswick Suzuki and Peskura to cease and desist from future violations of the Ohio Securities Act.

Justin Sallows

On February 15, 1995, the Division issued a final Cease and Desist Order, Division Order No. 95-011, against Justin Sallows, an agent of H.J. Meyers & Co. H. J. Meyers is a California company with its principal place of business in Beverly Hills, California, and Sallows has a business address in Los Angeles, California. Sallows held an Ohio securities salesman's license from January 3, 1994 to January 5, 1994, and was re-licensed on August 19, 1994.

On January 10, 1994, Sallows contacted an Ohio resident about purchasing shares of Telefonica De Argentina stock. The Ohio resident agreed to invest and by personal check dated January 13, 1994, purchased 500 shares of Telefonica stock for a total of \$3,480. At the time of the sale, Sallows was not licensed to sell securities in Ohio. Therefore, the transaction was in violation of R.C. section 1707.44(A).

On November 4, 1994, the Division had issued Division Order No. 94-201, a Notice of Opportunity for Hearing to H. J. Meyers and

Sallows and another H. J. Meyers agent, Jason Stern, setting forth the Division's allegations and giving notice of their right to request an administrative hearing on the matter. After a copy of the order mailed to Sallows via certified mail was returned to the Division undelivered, the Division published notice of the order as required by R.C. Chapter 119. After the statutory publication requirements were satisfied and Sallows failed to request an administrative hearing, the Division issued the final order.

Ronald M. Parker

On March 7, 1995, the Division issued Division Order No. 95-015, a final order denying the application for an Ohio securities salesman's license by Ronald M. Parker of Belvedere, California. The final order adopted the recommendation of the hearing officer that Parker's application for license be denied.

On September 6, 1994, the Division had issued to Parker Division Order No. 94-166, a Notice of Intent to Deny Application for Securities Salesman's License and a Notice of Opportunity for Hearing. In the notice order, the Division alleged that Parker was not of "good business repute" as that term is used in R.C. section 1707.19(A) and O.A.C. Rule 1301:6-3-19(D)(7) and (9). Parker requested an administrative hearing, which was held on November 30, 1994, at the offices of the Division.

At the hearing, the Division presented evidence of Parker's failure to meet the considerations set forth in Rule 1301:6-3-19(D)(7) and (9). Specifically: in May 1994, Parker and his then dealer Bear Sterns & Co. settled a customer complaint for nearly \$2,000,000, based on allegations that the customer suffered a loss of nearly \$4,000,000, as a result of being provided with inaccurate and misleading information; in December 1991,

Parker settled a customer complaint for \$90,000 based on allegations that Parker made misrepresentations in inducing the investment; in June 1993, Parker was permitted to resign from W. E. Pollock & Co., based on allegations that he affected trade for his personal benefit in U.S. government securities in the account of a customer; and in February 1985, Parker consented to a penalty imposed by the New York Stock Exchange, consisting of a censure, an \$18,000 fine and a two month suspension, based on findings that Parker affected trades for his own benefit in the account of customer or corporate affiliate of his exchange member organization employer.

On January 31, 1995, the hearing officer issued his report concluding, as a matter of law, that Parker was not of "good business repute" as that term is used in the Ohio Securities Act and Rules. The Division then issued its final order adopting the hearing officer's recommendation.

Walter E. Schott, Jr.

On March 23, 1995, the Division issued Division Order No. 95-016, a final order denying the application for an Ohio securities salesman's license of Walter E. Schott, Jr. of Cincinnati, Ohio. The final order adopted the hearing officer's recommendation that Schott's application be denied.

On August 30, 1994, the Division had issued to Schott Division Order No. 94-153, a Notice of Intent to Deny Application for Securities Salesman's License and Notice of Opportunity for Hearing. The order alleged that Schott was not of "good business repute" as that term is used in R.C. section 1707.19(A) and O.A.C. Rule 1301:6-3-19(D)(1), (2), (3) and (9). Schott requested an administrative hearing, which was held on December 16, 1994.

At the hearing, the Division presented evidence of Schott's lack of "good business repute," including evidence that: in November 1987,

Schott entered a consent agreement with the Division that resulted in a final Cease and Desist Order being issued against Schott, ordering him to cease and desist from violating R.C. sections 1707.44(A) and (C)(1), in connection with the sales of securities of Fortuna Gold Corp.; in August 1978, in the United States District Court for the Southern District of Ohio, Schott pleaded guilty to eight felony counts pertaining to the transfer and concealment of property in contemplation of bankruptcy proceedings; and in November 1987, in Pima County Superior Court, Tucson, Arizona, Schott pleaded guilty and was convicted of solicitation of unregistered securities, a class one misdemeanor.

The hearing officer issued his report on January 26, 1995, and concluded as a matter of law that Schott was not of "good business repute" as that term is used in the Ohio Securities Act and Rules. The final order adopted the hearing officer's recommendation that Schott not be licensed.

Brokers Investment Corporation

On April 10, 1995, the Division issued a final Cease and Desist Order, Division Order No. 95-018, against Brokers Investment Corporation, ("BIC"), a California corporation with its principal office located in Woodland Hills, California.

The final order is related to Division Order No. 95-005, a final Cease and Desist Order issued on February 1, 1995, against E-Mail Partners, I, Ltd. and Scott Noreuil. The Division determined that Phillip Downing, a securities salesman licensed through BIC, solicited Ohio investors to purchase E-Mail Partners, Ltd. partnership units. On November 5, 1992, an Ohio resident purchased one E-Mail Partners unit for \$12,500. However, the unit was not registered with the Division, the subject matter of an exempt transaction, or otherwise exempt

from the registration provisions of the Ohio Securities Act. Therefore, the sale was in violation of R.C. section 1707.44(C)(1).

On October 31, 1994, the Division had issued to BIC Division Order No. 94-198, a Notice of Opportunity for Hearing, describing the allegations and giving notice of the right to request an administrative hearing on the matter. After a copy of the Order mailed to BIC via certified mail was returned to the Division undelivered, the Division published notice of the Order as required by R.C. Chapter 119. After the statutory publication requirements were satisfied and BIC failed to request an administrative hearing, the Division issued the final order.

Frank A. Warner, III

On May 2, 1995, the Division issued Division Order No. 95-021, a final Cease and Desist Order against Frank A. Warner, III, ("Warner"), of Powell, Ohio, after an administrative hearing had been held on the matter. The final order adopted the recommendation of the Hearing Officer that the Cease and Desist Order be issued.

On January 27, 1994, the Division had issued to Warner Division Order No. 94-010, a Notice of Opportunity for Hearing. In the notice order, the Division alleged that Warner made, or caused to be made, false representations concerning material or relevant facts in an application for an Ohio Securities Salesman License, a violation of R.C. section 1707.44(B)(3). Warner requested and administration hearing, which was held on April 26, 1994, at the offices of the Division.

At the hearing, the Division presented evidence that Warner made false representations concerning material and relevant facts on five separate license applications filed with the Division between 1989 and 1994. On each application, the false representations pertained to

the disclosure of Warner's record of any arrest, indictment for conviction upon charge of commission of a felony or misdemeanor (the "criminal record question").

In an application filed with Dublin Securities, Inc., in 1989, Warner responded to the criminal record question by stating "misdemeanor, disorderly conduct, May, 1989, fined."

In a 1991 application filed with Dublin Securities, Inc., Warner responded to the criminal record question by stating "none". Similarly, Warner responded "none" to the criminal record question in connection with applications filed in 1992 with Fizer Securities Company, Inc.; 1993 with Columbus Skyline Securities Company; and 1994 with Cranston Group.

The Division then presented the following evidence of Warner's criminal record: In 1987, Warner pleaded no contest and was convicted in Trumbull County of criminal trespass, a misdemeanor in the fourth degree; theft, a misdemeanor in the first degree; and cruelty to animals, a misdemeanor in the second degree. In a separate Trumbull County case in 1987, Warner was convicted of attempted breaking and entering, a misdemeanor in the first degree. In 1990, Warner pleaded guilty and was convicted in Franklin County of operating a motor vehicle while under the influence of drugs or alcohol, a misdemeanor of the first degree. And, in 1992, Warner pleaded guilty and convicted in Franklin County of passing bad checks, a misdemeanor of the first degree.

On April 12, 1995, the Hearing Officer issue his report concluding, as a matter of law, that Warner's failure to properly answer the criminal record question on the applications constituted a violation of R.C. section 1707.44(B)(3). The Division then issued its final order adopting the Hearing Officer's recommendation.

Continued on page 8

Marlow Lloyd Gish

On May 25, 1995, the Division issued a final Cease and Desist Order, Division Order No. 95-025, against Marlow Lloyd Gish of New York, New York.

On June 24, 1994, Gish had solicited an Ohio couple to purchase 50 shares of stock in Staples, Inc. At the time of the solicitation, Gish was not licensed by the Division and neither the securities nor the transaction were of a type exempting the solicitation from licensure.

On April 19, 1995, the Division had issued to Gish Division Order No. 95-020, a Notice of Opportunity for Hearing, setting forth the Division's allegations concerning the unlicensed sale and describing the right to request an administrative hearing on the matter. When Gish did not timely request an administrative hearing, the Division issued the final order.

Criminal Actions

Worthington Investments, Inc.

In February and April 1995, eight former employees of the now defunct intra-state securities dealer Worthington Investments, Inc., pleaded guilty to various counts of securities fraud, attempted securities fraud, theft, grand theft and corrupt activities. As reported in Bulletin 94:3, the eight, along with one other (against whom charges were dropped in exchange for an agreement to testify for the State) were named in a 107 count indictment returned by a Cuyahoga County Grand Jury in August 1994.

On May 31, 1995, the eight convicted defendants were sentenced in the Cuyahoga County Court of Common Pleas. Two defendants were incarcerated at the Lorain Correctional Institution: Robert W. Masters, of Worthington, former president, was jailed for one year, and Frank Ayyash, of Columbus, former branch manager of

Worthington Investments' suburban Cleveland office, was jailed for six months. The remaining six defendants received suspended sentences conditioned on compliance with the terms of probation.

Masters had pleaded guilty to violating the Ohio Corrupt Activities Act (Ohio's RICO statute) and to two counts of securities fraud for his role as the principal of Worthington Investments, which sold penny stocks to Ohio residents before filing for bankruptcy in January 1993. Masters was imprisoned on the securities fraud conviction and also received a suspended five to twenty-five year sentence on the Corrupt Activities count. The suspension was conditioned upon completing four years probation and making \$150,000 restitution.

Ayyash had pleaded guilty to four counts of securities fraud and one count of grand theft. In addition to the six months imprisonment on one count of securities fraud, Ayyash received a one and one-half year prison sentence on the remaining securities fraud and theft counts, suspended upon the completion of five years probation and the payment of \$25,000 restitution.

C. Patrick Harkins, of Columbus, who replaced Masters as president and pleaded guilty to two counts of grand theft, was sentenced to one year on each count, suspended upon the completion of five years probation and the payment of \$10,000 restitution. Harkins was also fined \$200 and ordered to perform eighty hours of community service.

Ken Guss, of Columbus, who served as the head trader of Worthington after Masters' departure and pleaded guilty to two counts of securities fraud, was sentenced to one and one-half years on each count. The sentences were suspended upon the completion of three years probation and making \$20,000 restitution. Guss was also fined \$500 and ordered to perform eighty hours community service.

Phil Archambault, of Columbus, a former salesman who pleaded

guilty to one count of securities fraud and one count of theft, was given concurrent one and one-half year sentences, suspended upon completing five years probation, performing eighty hours of community service and paying \$9,400 restitution.

Seth Brown, of Columbus, a former salesman who pleaded guilty to one count of securities fraud and one count of theft, was sentenced to concurrent one year terms, suspended upon completing two years probation and paying \$2,500 restitution. Brown was also ordered to pay a \$200 fine and perform eighty hours of community service.

LaRae Wiese, of Dublin, the former manager of Worthington Investments' Dublin office, who pleaded guilty to one count of securities fraud and one count of theft, was sentenced to concurrent one year terms. The terms were suspended upon completing two years probation and paying \$2,500 restitution. Wiese was also ordered to pay a \$200 fine and perform eighty hours of community service.

Vern Davis, of Delaware, a former salesman who pleaded guilty to one count of attempted securities fraud, was sentenced to the maximum of six months, suspended upon the completion of three years probation and the payment of \$3,000 restitution.

The sentencings brought to an end the Division's case against Worthington Investments, which began in May 1991. The Division first attempted to suspend Worthington Investments' Dealer's License in August 1991 for failure to meet the Division's net capital requirements and failure to maintain adequate books and records. After administrative proceedings, the Division revoked Worthington Investments' license in September 1992. However, the company obtained a stay order against the revocation from the Franklin County Court of Common Pleas and was able to operate until filing for bankruptcy in January 1993.

Bruce Sams

On February 21, 1995, Bruce Sams, formerly of Dublin, Ohio, pleaded guilty to six counts of sale of unregistered securities in violation of R.C. 1707.44(C)(1) and four counts of theft. That same day, Sams was sentenced in the Franklin County Court of Pleas to six months in jail.

As reported in Bulletin 93:2, Sams had been indicted by a Franklin County Grand Jury in December 1991. The indictment and the convictions resulted from the issuance of promissory notes by B&B Core Buyers. Sams falsely represented to investors that he was president of the company.

Robert L. Hill, Jr.

On January 24, 1995, Robert L. Hill, Jr., formerly of Worthington, Ohio, was sentenced in the Franklin County Court of Common Pleas to three and one half years incarceration for violations of the Ohio Securities Act and theft. As reported in Bulletin 94:3, Hill had been indicted on two separate occasions on a total of twelve counts of securities violations and theft. While the criminal case on those counts was pending, Mr. Hill was indicted on an additional sixteen counts, including unlicensed sale of securities, sale of unregistered securities, securities fraud and theft. All of the indictments arose out of the same scheme whereby Hill represented that he would make investments on behalf of Ohio residents in a mutual fund, but never forwarded the investment proceeds to the mutual fund.

On May 25, 1995, Hill pleaded guilty to charges contained in the sixteen count indictment, and was sentenced to an additional nine and one half to nineteen and one half years in jail. Nine to nineteen years of the sentence was suspended upon the completion of probation, including the payment of restitution.

Limited Liability

Continued from page 3

Conclusion

The actual operation of the limited liability company law has created even more uncertainties than existed at the time it was enacted. It will take several years before the lawyers become comfortable with the forms and documents used in the organizing and operating an LLC. This uncertainty raises the question as to the extent of the disclosure of such uncertainty to those becoming members in the LLC is required under the applicable securities laws. Since the LLC is a tax driven business form, there is a necessity for a tax opinion in securities registration and computation of the applicability of "tax shelter" provisions.

Mr. Blackford is a partner in the Cleveland law firm of Weston Hurd Fallon Paisley & Howley. He

is the author of the treatise Ohio Corporation Law (Banks-Baldwin Law Publishing) and the forthcoming Ohio Business Organizations (Banks-Baldwin Law Publishing).

Endnotes

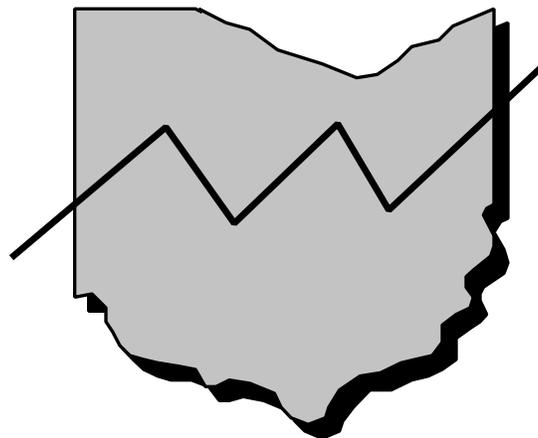
¹ 68 Ohio St. 3d 453 (1994).

² 67 Ohio St. 3d 87 (1993).

³ The Court reasoned that since the client (i.e. the general partner or the limited partnership) had a fiduciary duty to the limited partners, the lawyer had a duty to the limited partners.

⁴ IRC §7701.

⁵ There is a proposed Treasury Regulation on this issue. Treas. Reg. 1.1402(a)-18.



1995 OHIO SECURITIES CONFERENCE

November 6, 1995

Columbus Marriott North

6500 Doubletree Ave

Columbus, Ohio 43229

NEW ONE DAY FORMAT

8:00 to 8:30 a.m. Conference Registration
8:30 to 10:00 a.m. Private Placements Panel
10:00 to 11:45 a.m. Benefit Plans Panel
11:45 a.m. to 1:15 p.m. Lunch (with Speaker)
1:15 to 2:45 p.m. Division Panel
3:00 p.m. to 5:00 p.m. Advisory Committee Meetings
5:00 p.m. to 7:00 p.m. Reception
Luncheon Speaker: Nancy Smith, Director, Office of Consumer Affairs,
Securities and Exchange Commission

Panel Presentations

Private Placement

Planning Considerations

Thomas C. Daniels, Esq.

Jones, Day, Reavis & Pogue

Elizabeth A. Horwitz, Esq.

Cors & Bassett

Edward W. Moore, Esq.

Calfee, Halter & Griswold

Employee Benefit Plans

and Executive Compensation

Amy Haynes, Esq.

Cardinal Health, Inc.

Ben F. Wells, Esq.

Dinsmore & Shohl

Peter A. Rome, Esq.

Ulmer & Berne

David A. Zagore, Esq.

Squire, Sanders & Dempsey

Division Panel

Recent

Developments

Mark V. Holderman, Esq.

William E. Leber, Esq.

Caryn A. Francis, Esq.

Public Offering

Guidelines

Michael P. Miglets, Esq.

Mark R. Heuerman, Esq.

Enrollment Fee is \$175 per person in advance, \$200 at the door.

The Division has applied for five hours of CLE credit and for CPE credit for accountants.

1995 OHIO SECURITIES CONFERENCE ENROLLMENT FORM

Name: _____

Firm/Organization: _____

Address: _____

City: _____ State: _____ Zip: _____

Telephone: _____ Amount Enclosed: _____

Choice of Luncheon Entree: Beef Chicken

Do you plan to attend an Advisory Committee Meeting? Yes No

If "yes", which Advisory Committee? _____

For special accommodations, please contact Rich Pautsch at (614) 752-9448 before October 20, 1995.

Make checks payable to: "Ohio Securities Conference Committee, Inc." Send Enrollment Form and Payment to: Rich Pautsch, Ohio Division of Securities, 77 South High Street, 22nd Floor, Columbus, Ohio 43266-0548. Enrollment Deadline is October 30, 1995.

Registration Statistics

The table to the right sets out the number of registration filings received by the Division during the second quarter of 1995, compared to the number received during the second quarter of 1994, as well as the number of registration filings received by the Division in 1995 year to date, compared to the number received in 1994 year to date.

*Effective October 11, 1994, the Form 2(B) and Form 3-O filing requirements were eliminated.

	Q2 95	YTD 95	Q2 94	YTD 94
.02(B)*	0	0	262	542
.03(O)*	0	0	3,048	6,556
.03(Q)	253	629	303	748
.03(W)	23	61	40	67
.04	0	0	1	2
.041	0	1	0	0
.06(A)(1)	28	63	43	80
.06(A)(2)	6	18	14	25
.06(A)(3)	10	15	5	9
.06(A)(4)	6	12	16	30
.09	119	255	137	296
.091	872	1,711	847	1,691
.39	14	27	25	60
.391/.09	0	0	0	2
.391/.091	4	13	3	7
.391/.03(O)	47	166	228	484
.391/.03(Q)	31	79	34	98
.391/.03(W)	0	0	4	6
.391/.06(A)(1)	0	0	0	0
.391/.06(A)(2)	0	0	0	0
.391/.06(A)(3)	0	0	0	0
.391/.06(A)(4)	0	0	0	0
Totals	1,413	3,050	5,010	10,703

Licensing Statistics

The table below sets out the number of Salesmen and Dealers licensed by the Division at the end of the first and second quarters of 1995, compared to the same quarters of 1994, as well as the number of Salesmen and Dealers licensed by the Division at the end of the third and fourth quarters of 1994, compared to the same quarters of 1993.

	End of Q3 1994	End of Q3 1993	End of Q4 1994	End of Q4 1993	End of Q1 1995	End of Q1 1994	End of Q2 1995	End of Q2 1994
Number of Salesmen Licensed:	72,045	62,345	70,642	64,589	69,143	65,991	70,580	70,200
Number of Dealers Licensed:	1,894	1,812	1,759	1,800	1,837	1,778	1,873	1,842

OHIO SECURITIES BULLETIN

Ohio Division of Securities
77 South High Street
22nd Floor
Columbus, Ohio 43215

Bulk Rate
U.S. Postage
PAID
Columbus, Ohio
Permit No. 5455