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The Case for Considering Certain General Partnership Interests to be Securities Under Ohio Securities Law

By Thomas E. Geyer

Introduction

In general (no pun intended) an interest in a general partnership is not considered to be a "security" because in the normal circumstance, a general partner has control over the management or affairs of the partnership. In contrast, a "security" exists where, among other things, an investor lacks the ability to exercise control over the management or affairs of a venture.

However, over the past several years, the Division has investigated a number of instances where an investment opportunity was labeled a "general partnership interest" but in fact exhibited the characteristics of a security. Specifically, in at least four cases since 1994, the Division has asserted jurisdiction and taken enforcement action based on violations of the Ohio Securities Act in connection with the sale of a security that had been ostensibly labeled as a general partnership interest.

While the phrase "general partnership interest" is not included in the statutory definition of "security" set out in R.C. 1707.01(B), there are at least two places in that definition where an interest in a general partnership could fit under the right circumstances. First, an alleged general partnership interest may in fact constitute a "certificate or instrument that represents title to or interest in, or is secured by any lien or charge upon, the capital, assets, profits, property or credit of any person." Or, an alleged general partnership interest could constitute an "investment contract" as stated in the statute and refined by case law.

This article makes the case for considering certain general partnership interests to be securities under Ohio securities law. As with any inquiry into whether an investment opportunity constitutes a "security," the "economic realities" of the transaction must be reviewed. Thus, this article first discusses facts that tend to show that an investment labeled as a general partnership interest is in fact a security. Next, this article provides an overview of applicable Ohio case law. Finally, this article describes developing federal law and argues that it is completely appropriate, despite the fact that an investment is denominated an interest in a general partnership, to find that such an interest is in fact a security subject to the state and federal securities laws.

Considerations

Following are some factors to be considered when determining whether an alleged general partnership interest in fact constitutes a security.

First, a consideration of the number of "general partners" is appropriate. A general partnership interest is synonymous with the ability to exercise management control over the business of the general partnership. A highly fractionalized interest hardly grants any type of effective management right. Instead, the investor is more like a corporate shareholder whose singular voice cannot affect corporate management. For example, in one case the Division found that there were at least 127 "general" partners — this type of fractionalization does not grant effective management rights.

Second, consider whether the partnership agreement grants management authority over the affairs of the enterprise to a "managing partner" who is either the promoter or another person with unique entrepreneurial or management skills. Such an allocation of management authority may be tantamount to distribution as in a limited partnership or a corporation in which

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the single limited partner or shareholder has no managerial control.

Third, are the investors geographically dispersed? And regardless of geographical dispersion is there a mechanism for investors to contact each other? Geographical dispersion and the inability to communicate serve as impediments to concerted action by investors.

Fourth, consider whether the partnership in issue has direct management over the underlying asset or affairs, or is a step removed. For example assume that the partnership under consideration ("Partnership A") does not directly manage the revenue producing asset, but instead is a limited partner in a partnership ("Partnership B") that manages the revenue producing asset. Under these facts, even assuming for the sake of argument that a Partnership A investor has the ability to exercise some managerial power, such investor is still two steps removed from the management of the asset: the investor must first attempt to assert management authority over Partnership A and then cause Partnership A to assert management authority in the affairs of Partnership B in order to have any managerial say over the asset.

Fifth, consider whether partnership formalities were followed: for example, was the partnership filing required by R.C. 1777.02 made; were partnership agreements distributed to all investors; were investors informed of their management rights; were K-1 tax statements distributed; were meetings held if required by the partnership agreement; were restrictions on and procedures for transfer of interests followed?

Sixth, are indications of an equity investment apparent? For instance, did investors sign "subscription agreements" or were "certificates" issued to the investors?

Finally, does an investor have the right to exercise practical and actual control over the managerial decisions of the enterprise? And, if a right of management is granted, is that right illusory under the totality of the circumstances?

The foregoing list is not exhaustive, but rather is illustrative of some of the primary inquiries used to determine if an alleged general partnership interest is in fact a security.

Applicable Ohio Case Law

Brannon v. Rinzler, 77 Ohio App. 3d 749 (Montgomery Cty. 1991), J&S Enterprises v. Warshawsky, 714 F. Supp. 278 (N.D. Ohio 1989) and Conway v. Locks, No. 6456 (Montgomery Cty. Ct. App. Dec. 22, 1980) can generally be characterized as standing for the proposition that a general partnership interest will *not* be deemed to be a security under Ohio law if the investor has the *right* to participate in the management of the partnership, regardless of whether the investor exercises such right. However, these cases represent an unduly narrow view of the situation because each, especially the Brannon decision, focuses on the grant of a nominal management right, rather than the actual ability to assert any practical management control. Granting a management right that is incapable of exercise does not insulate an investment opportunity from consideration as a security. In fact, the courts in Brannon and J&S Enterprises reached their respective results only after expressly analyzing the partnership interests at issue under the four prong "investment contract" test established in State v. George, 50 Ohio App. 2d 297 (Franklin Cty. 1975). See Brannon, 77 Ohio App. 3d at 753; J&S Enterprises, 714 F. Supp. at 281.

The George test provides that:

> there is an investment contract and thence a security when (1) an offeree furnishes initial value to an offeror, and (2) a portion of this initial value is subjected to the risks of the enterprise, and (3) the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and (4) the offeree does not receive the right to exercise *practical and actual* control over the managerial decisions of the enterprise.

George, 50 Ohio App. 2d at 302-303 (emphasis added, internal quotation marks omitted).

Ohio Securities Bulletin

Desiree T. Shannon, Esq., Editor

The *Ohio Securities Bulletin* is a quarterly publication of the Ohio Department of Commerce, Division of Securities. The primary purpose of the *Bulletin* is to (i) provide commentary on timely or timeless issues pertaining to securities law and regulation in Ohio, (ii) provide legislative updates, (iii) report the activities of the enforcement section, (iv) set forth registration and licensing statistics and (v) provide public notice of various proceedings.

The Division encourages members of the securities community to submit for publication articles on timely or timeless issues pertaining to securities law and regulation in Ohio. If you are interested in submitting an article, contact the Editor for editorial guidelines and publication deadlines. The Division reserves the right to edit articles submitted for publication.

Ohio Division of Securities

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A review of Brannon, J&S Enterprises, and Conway demonstrates that they can be distinguished on their facts from a "partnership" that would raise the considerations discussed in the foregoing section. For example, in J&S Enterprises, the J&S partnership was formed to invest in real estate in South Carolina and consisted of *three* partners. The lawsuit was an action by the partnership against one of the partners for $66,667.23 in unpaid contributions. The delinquent partner defended on the grounds that the partnership interest he held had not been registered as a security, a defense the court rejected after concluding that the interest was not a "security." Similarly, the partnership at issue in Conway had *three* partners engaged in the business of selling boats, boat motors and boat supplies. Plaintiff Conway had bought into the partnership by signing a bill of sale and a sales agreement for a one-third interest in the business. The court rejected Conway's contention that the bill of sale and sales agreement constituted a "security," finding that as a one-third partner in the business Conway had an equal say as to the scope, direction and duration of the business. Finally, Brannon involved *eleven* partners in a tax shelter type investment known as MTA Associates. When a capital call was made upon the partners, Brannon and two other partners sued MTA and the managing partner, Rinzler & Associates, alleging the sale of unregistered securities. As previously stated, the court analyzed the investment under the George test and found that the fourth prong was not met where, under the facts of the case, each partner had the ability to exercise practical and actual control over certain management decisions, specifically, the right to remove the managing partner upon a 75% vote, the right to consent to the withdrawal of the managing partner and the right to dissolve the partnership upon a 75% vote.

Consequently, it is important to note Brannon, J&S Enterprises and Conway each involved a few number of partners, which made the exercise of practical and actual control over management a realistic contingency. This has not been the case in the actions that the Division has pursued. Further, it is important to note in Brannon and J&S Enterprises, the securities law argument was used in an attempt to avoid the payment of money due.

Although there is Ohio case law holding that general partnership interests do not constitute securities, those cases are distinguishable under different fact patterns and the label "general partnership" is not dispositive. Rather, it is:

> only *generally* true that an interest in a general partnership fails to qualify as a security. Further inquiry into the specific rights and obligations of the general partner whose interest is in question may still be necessary.

J&S Enterprises, 714 F. Supp. at 281 (emphasis in original).

Making the Case

A security is a transaction whose characteristics distinguish it from the generality of transactions so as to create a need for special fraud procedures, protections and remedies provided by the securities law. *** Accordingly, any formula that purports to guide the courts in determining whether a transaction constitutes a security must be broad enough to carry out the remedial purposes of securities laws.

Mazza v. Kozel, 591 F. Supp. 432, 436 (N.D. Ohio 1984) (applying Ohio securities law to an investment interest in a joint venture)(citation and internal quotation marks omitted).

Thus, it is well settled that the Ohio securities laws are remedial in nature and to be construed broadly. See In re Columbus Skyline Securities, 74 Ohio St. 3d 495, 498 ("in order to further the intended purposes of the [Ohio Securities] Act, its . . . provisions must be liberally construed"). Further, given this remedial purpose, courts construing Ohio securities law have not hesitated to look to the federal courts for guidance. See, e.g., George, 50 Ohio App. 2d at 301-302 (discussing S.E.C. v. W.J. Howey Co., 328 U.S. 293 (1946)); and Columbus Skyline, supra, (holding that federal case law may be applied to determine fraudulent conduct under the Ohio Securities Act).

In applying the four prong George test to an interest in a general partnership that may in fact be a security, the first three prongs of the test are typically met without much discussion: the investors furnish initial value; such initial value is subject to the risks of the enterprise; and the furnishing of the initial value is induced by representations of returns. The final prong of the test is where the analysis must take place.

The fourth prong of the George test provides: "the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise." George, 50 Ohio App. 2d at 303. The George court explained this fourth prong by commenting:

> The [fourth prong] relates to the right of the offeree to exercise *practical and actual* control over the managerial decisions of the enterprise *** Where the facts show that the offeree has *little or no* right to exercise a *substantial degree of control* over the enterprise into which he has contributed his initial value, then a "security" can well be found by the court.

Id. at 304 (emphasis added).

That the investors in a purported general partnership lack the practical and actual control to exercise a substantial degree of control over the enterprise is commonly demonstrated by, among other things, highly fractionalized interests, geographical dispersion, lack of a mechanism to allow for concerted action by the investors, and the allocation of management authority to the promoter or other individual with unique entrepreneurial or management abilities.

Federal courts have consistently held an interest in a general partnership is a security where the interest holder does not have an effective right of management. The wellspring case for this proposition is Williamson v. Tucker, 645 F.2d 404 (5th

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Cir.), cert. denied, 454 U.S. 897 (1981). Williamson was an appeal by a group of purchasers of certain joint venture interests in a parcel of undeveloped real estate. The District Court had dismissed their claims, holding that the interests did not constitute "securities" and therefore the court was without jurisdiction. In reversing the dismissal, the Fifth Circuit established a framework for analyzing general partnership and joint ventures interests, noting that: "the mere fact that an investment takes the form of a general partnership or joint venture does not inevitably insulate it from the reach of the ... securities laws." Id. at 422.

The Williamson court cited three examples of when a general partnership interest may be a security:

> A general partnership or joint venture interest can be designated a security if the investor can establish, for example, that (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.

Id. at 424 (footnote omitted). In connection with this analysis, the court stressed that "the power retained by the investors [must be] a real one which they are in fact capable of exercising." Id. at 419.

In Koch v. Hankins, 928 F.2d 1471 (9th Cir. 1991), the Ninth Circuit applied the Williamson analysis to interests in general partnerships for growing jojoba. In undertaking its review, the court stated: "thus the fact that the investments here are structured as 'general partnerships' is not determinative of their status as securities; rather we must examine the economic realities of the transactions to determine whether they are, in fact, investment contracts." Id. at 1475.

Another recent application of the Williamson reasoning is the decision in Securities and Exchange Commission v. Telecom Marketing, Inc., 888 F. Supp. 1160 (N.D. Ga. 1995). There the court considered alleged general partnership interests in separate ventures formed to invest in wireless cable television systems in Mobile, Alabama ("Mobile Partners") and Madison, Wisconsin ("Wisconsin Partners"). The evidence revealed that units in both Mobile Partners and Wisconsin Partners were sold to over 2,600 investors throughout the United States. Both partnerships put management in the hands of a managing partner that had unique familiarity with the FCC licensure process. In applying Williamson, the Telecom Marketing court stated:

> The partnership documents provide pro forma evidence that the partners possessed real power. In reality, however, investors were targeted for their ignorance of the law, accounting and the wireless cable television industry . . . Further, the number of partnership units sold so dilutes each partner's power that in actuality it appears none could exercise any meaningful partnership control.

Id. at 1166. The court went on to conclude that the units of both Mobile Partners and Wisconsin Partners constituted securities.

Reviewing the considerations previously discussed in the light of this case law demonstrates that an interest that triggers those considerations does in fact constitute a security. For instance, a highly fractionalized interest fails to provide any meaningful management authority. The Williamson court noted:

> One would not expect partnership interests sold to large numbers of the general public to provide any real partnership control; ... there would be so many partners that a partnership vote would be more like a corporate vote, each partner's role having been diluted to the level of a single shareholder in a corporation.

Williamson, 645 F.2d at 423.

Further, geographic dispersion of investors and geographic distance from the revenue producing asset impedes the assertion of any management rights by the investors. In Hocking v. DuBois, 885 F.2d 1449 (9th Cir. 1989), the Ninth Circuit reviewed the dismissal of securities laws claims by a Nevada resident purchaser of an interest in a condominium arrangement in Hawaii. In reversing, the Hocking court applied the Williamson analysis, noting that:

> The record presents a material question of fact: [whether] Hocking was unable to exercise control over his investment *** He resides thousands of miles away from the location of his investment *** [His] investment is a unit in a resort condominium ... with many investors pooling their units together. In order [to replace the managing partner], he would have to gain the votes of 75 percent of participating investors.

Hocking, 885 F.2d at 1461.

Finally, where an investor is two steps removed from the management of the asset, there is typically the absence of any practical or actual control over the managerial decisions of the enterprise. The Williamson court noted that there is little management control "where the investment asset is not owned directly, but is held instead through a joint ven-

ture or general partnership." Williamson, 645 F.2d at 421.

The second and third categories of the Williamson analysis amplify a common theme: even where the investors are granted some legal right to management control, if the attendant circumstances make the actual exercise of such management control illusory or impractical, the interests will be considered investment contracts. Further, the Hocking court noted that an investment contract may be found where "factors give rise to such a dependence on the promoter or manager that exercise of control would be effectively precluded." Hocking, 885 F.2d at 1460.

George teaches that any inquiry into an investment opportunity must recognize "the current necessities of the business world, and the basic purpose of the enactment of the securities laws." George, 50 Ohio App. 2d at 302. Similarly, the Williamson court stated:

> A scheme which sells investments to inexperienced and unknowledgeable members of the general public cannot escape the reach of securities laws merely by labeling itself a general partnership or joint venture. Such investors may be led to expect profits to be derived from the efforts of others in spite of partnership powers nominally retained by them.
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> Williamson, 645 F.2d at 423.

Conclusion

Building upon the fundamental securities law principle of considering the economic realities of a transaction, developing jurisprudence holds that a general partnership interest is a security under certain circumstances. This article has discussed the propriety of this outcome under Ohio law. Consequently, the reader is urged to consider the economic realities of a transaction denominated a general partnership before concluding that the securities laws do not apply.

Mr. Geyer is the Commissioner of Securities

Enforcement Advisory Committee Meeting Minutes

October 24, 1997

by Caryn Francis

The Enforcement Advisory Committee meeting was chaired by Caryn Francis and Alan Blue. Caryn Francis brought the meeting to order and opened the meeting with discussion of Investment Advisor (IA) legislation. Chairwoman Francis noted that approximately 9000 IAs and 900 IA firms will no longer be regulated by the SEC. There was discussion of how this will affect staffing because of an anticipated increase in examinations and registration.

The next item of business was a discussion of Internet monitoring. Mark Pusey, staff attorney for the Division of Securities, reviewed the Division's procedures for finding offerings on the Internet, determining if the Division has jurisdiction by determining whether or not a security is involved, contacting the offeror, and asking the offeror to either comply with state rules or cease to advertise. If the offeror does not comply in some manner, the Division will issue a Cease and Desist Order if necessary. Guidelines the Division now uses for monitoring are set forth in the administrative rule 1301:6-3-03(D)(9). The Division has been monitoring the Internet for over a year and has three attorneys who regularly monitor the Internet. The Division also receives leads from the public and practitioners in the securities field. On average, the Division sends out two letters per month to different companies that are offering securities on the Internet. To date the Division has issued one final Cease and Desist order.

The next item of business was a discussion of a pending investigation from the Division's Internet monitoring - The Infinity Group. Matt Fornshell, staff attorney for the Division of Securities, discussed The Infinity Group case which stems from outside inquiries as well as from the Internet. The Infinity Group was purporting to offer capital units in a trust in addition to some other kind of multi-level marketing products. Infinity promised returns of 138%. The Division attempted to conduct an examination or audit of their offices in northern Ohio. The Division was denied access and its subpoenas were ignored. The Division sought an injunction under R.C. 1707.25 to force compliance with Division subpoenas. The Division obtained a preliminary injunction, but Infinity refused to comply with the Division's records request. The Division obtained search warrants in both Geauga and Lake County and obtained the documentation that it had earlier requested. The SEC also has a case against Infinity. They filed an injunctive action at the beginning of September and obtained a TRO and preliminary injunction in which they asked the court to appoint a trustee. The SEC obtained a freeze of all the assets of Infinity until the permanent injunction hearing.

Ross Tulman raised the issue of sharing information between states if the Division finds offerings that are made in those states as well as Ohio. Caryn Francis indicated that the Division does let other states know if it finds activity in their state.

The next item of business was a discussion of the National Securities Markets Improvement Act ("NSMIA") and the impact on enforcement work. The Committee also discussed licensing issues involving salesmen and dealers.

The Committee elected a new co-chair for 1998, Mr. Ross Tulman. After the election of a co-chair the meeting was adjourned.

Takeover Advisory Committee Meeting Minutes
October 24, 1997

By Tom Geyer

The meeting of the Takeover Advisory Committee of the Ohio Division of Securities was called to order at 3:50 p.m. by Co-Chairman Thomas Geyer. Committee members in attendance were: Michael Miglets, Edward Schrag, Jr., Sam Simon, John Gall, Leigh Trevor, David Zagore and Professor Peter V. Letsou. Committee members Gary Kreider and David Porter were unable to attend but submitted comments in writing. Co-Chairman James Tobin was unable to attend.

Mr. Miglets covered the first item on the meeting agenda by describing the six control bid filings that had been made with the Division during 1997 to date.

Mr. Geyer covered the second item on the meeting agenda by reviewing the amendments to R.C. 1707.041(A). The amendments, which were contained in House Bill 215 and became effective on July 1, 1997, extended the Division's control bid review period set out in R.C. 1707.041(A)(3) from three calendar days to five calendar days and made a corresponding reduction in the post-suspension period set out in R.C. 1707.041(A)(4) from sixteen calendar days to fourteen calendar days. Mr. Geyer noted that the amendments were carefully crafted to maintain 19 calendar days as the maximum timeframe for state involvement, in order to stay faithful to the decision in Cardiff Acquisitions, Inc. v. Hatch, 751 F.2d 906 (8th Cir. 1984), appeal after remand 751 F.2d 917 (8th Cir. 1984), and to the committee comments that accompanied the 1990 amendments to the Control Bid Statute.

The next item on the meeting agenda was a discussion of the recent amendments to R.C. 1701.831 and R.C. 1701.832. Mr. Gall distributed the text of Amended Substitute House Bill 170, along with the Final Analysis of the Bill prepared by the Legislative Service Commission. Mr. Gall noted that the effective date of the amendments is November 21, 1997. Mr. Zagore then explained the highlights of the amendments which include: (i) establishing that the cut-off date for the determination of "interested shares" is the record date for the special meeting of shareholders; (ii) establishing that shares transferred subsequent to the record date will not be "interested shares" unless accompanied by the power to vote or direct the voting of the shares; (iii) eliminating the second quorum requirement of the special meeting of shareholders; and (iv) codifying legislative findings regarding the use of information gathering proxies and the use of presumptions in connection with special meeting. Mr. Schrag commented that the amendments would have to be studied further before their full impact could be determined.

The next item on the meeting agenda was a discussion of proposed administrative rules O.A.C. 1301:6-3-041(A) and (B). Mr. Porter submitted written comments regarding proposed O.A.C. 1301:6-3-041(A), and those comments were reiterated by Mr. Trevor: first, as drafted the proposed rule would include debt securities and the suggestion was made that the rule should extend only to equity tender offers; second, as drafted the proposed rule appeared to extend beyond the Division's jurisdictional nexus of "control bid;" third, the proposed rule should include a reference to S.E.C. rule 13e-4 if the proposed rule was intended to include issuer tenders. Committee members present at the meeting concurred with these concerns. In addition, Mr. Zagore suggested that the references to federal law be general in nature rather than specific citations. Mr. Geyer responded that he would prepare a revised draft of proposed rule 1301:6-3-041(A), including substituting the phrase "control bid" for "tender offer," and circulate the revised draft among the Committee for comment.

With respect to proposed rule 1301:6-3-041(B), Mr. Kreider submitted written comments that Mr. Geyer conveyed to the committee. Specifically, Mr. Kreider expressed concern about the use of the word "withdraw," as it implied action to be taken by the offerer. The Committee concurred with this concern, and it was decided that the word "terminate" would be substituted for "withdraw" to clearly indicate that the Division, by its sole action, could bring an end to the control bid. Mr. Kreider also expressed a preference for the alternative draft of proposed rule 1301:6-3-041(B) that contained enumerated subsections, and the Committee also concurred in this regard. At the conclusion of this discussion Mr. Geyer stated that he would draft a revised version of proposed rule 1301:6-3-041(B) and circulate it for comment.

Mr. Geyer then opened the floor for discussion of any other issues. Mr. Zagore raised the possibility of adding to the Ohio Securities Act a more general anti-fraud prohibition in the nature of S.E.C. rule 10b-5. Members of the Committee expressed support for this concept. Mr. Geyer asked Mr. Zagore to draft proposed statutory language, and Mr. Zagore agreed to do so. Mr. Geyer suggested that a proposed amendment could be included in the bill that contains the Division's investment adviser initiative.

Finally, the Committee discussed Committee Co-Chairmen for 1998. Michael Miglets and James Tobin were unanimously elected as Co-Chairmen for 1998. After the election, the meeting was adjourned.

Registration Advisory Committee Meeting Minutes

October 24, 1997

by Debbie Dye Joyce

The meeting was attended, alphabetically, by: Carol Barnum, Jason Blackford, Glenn Bower, Jack Donenfeld, Debbie Dye Joyce, Howard Friedman, Ann Gerwin, Greg Glick, Mark Heuerman, Mark Holderman, Scott Jancura, Thomas Julius, and Denise Stewart.

Debbie Dye Joyce, Registration Supervisor for the Division of Securities, called the meeting to order and opened the floor for general discussion.

A question was raised as to the "technical" definitions of the terms "dealer," and "investment adviser." A brief discussion took place regarding the definition of the term "investment adviser" in proposed legislation that will clarify that investment adviser activities will not include dealer activities. To the extent that a person engages in actions considered to be those of a dealer or salesman, the appropriate license must be obtained.

The members discussed a frequently raised issue—that the 3(O) exemption does not apply to limited partnerships. One of the members indicated that the 3(O) exemption was most likely created as it exists, because while corporate shareholders and limited liability company members have some say in the operations of the entity, limited partners in a limited partnership do not participate in running the partnership.

One of the members noted the helpfulness of the One Stop Business Permit Center of the Office of Small Business of the Ohio Department of Development (1-800-248-4040.) The members briefly discussed the information available from that agency as well as the information available from the Secretary of State's office.

It was noted that the Division is promoting its web site and hopes to be able to include copies of its forms on this valuable resource soon. (Some forms have recently been added to the web site).

The members discussed the issue of the Division's future plans with regard to electronic filings. Prior to accepting an electronic filing, statutory changes are necessary to enable the Division to accept an electronic signature.

Licensing Advisory Committee Minutes

October 24, 1997

by Joyce Cleary

The annual Licensing Advisory Committee meeting was held at the Ohio Securities Conference on October 24, 1997. The following members and guests of the Committee were present:

Dale Jewell, Chairman and supervisor of the Licensing section of the Ohio Division of Securities, Co-Chairman Greg Betchkal, Karl Cline, John Matsumoto, and Jack Frost. Also present were Richard Pautsch, Bill Leber, and Joyce Cleary.

The Division's potential regulation of Ohio investment advisers was discussed. It was suggested there should not be an additional license requirement if the dealer is already licensed. A committee member suggested the Division look at the Pennsylvania, Kentucky, and Michigan securities acts. (Copies of sections of those securities acts were presented.) These acts exempt registered dealers from registering as an investment adviser. Concern was expressed regarding the larger dealers having the additional regulations. It was suggested that the focus be directed upon the small companies who may need the regulation. A Division staff member brought up the fact that by licensing all investment advisers, the Division would have jurisdiction to take enforcement action against them, if necessary. It was noted the larger dealers may attempt to claim assets of 25 million dollars or more in order to escape state regulation. The statement was made that although many companies or individuals are engaging in investment adviser activities, they are not calling it that. Mention was made that ADV filings are going to require the Division to do a detailed review, unlike the form B/D. This will entail a lot of work for the Division.

The impact of the National Securities Market Improvement Act of 1996 (NSMIA) on the Division's Licensing Section was discussed.

The Division has implemented changes under NSMIA. The resulting developments in licensing were discussed during the conference. Comments and questions were requested. There were none.

There was discussion as to whether Ohio should adopt NASAA's interpretive order concerning broker dealers, investment advisers, broker dealer agents and investment adviser representatives using the Internet for general dissemination of information on products and services. The Division regularly reviews the Internet for possible violations of the Ohio Securities Act. The NASD reviews the Internet for specific reasons only, although it may look more into general areas. The committee agreed it was important to have uniformity and therefore Ohio should adopt NASAA's interpretive order.

The Division has recently started to examine branch offices of broker/dealers. Representatives claiming to be independent contractors appear to be commonly found in the industry. The NASD, as well as the Division, does not recognize independent contractors. Adequate supervision is a concern and is required. A discussion ensued regarding questioning how a representative promotes him or herself through business cards, letterhead, etc. If business cards, the name on the door, etc. state the subject offers securities, the name of the affiliated dealer should be included. Federal law preempts state law as to where branches must keep their books and records. However, the Division requires the records be produced upon request.

Division Enforcement Section Reports

Administrative Orders

FIX-CORP. INTERNATIONAL, INC.

On August 29, 1997, the Division issued Order No. 97-326, a Cease and Desist Order, against Fix-Corp. International, Inc. (Fix-Corp.), an Ohio company.

The Division had previously issued a Notice of Opportunity for Hearing, Order No. 97-137, against this company. The Order alleged that Fix-Corp. had violated R.C. 1707.44(C)(1) and 1707.44(B)(1), selling unregistered securities and making false representations concerning material and relevant facts in regard to registering securities by description. Fix-Corp. requested an adjudicative hearing regarding these allegations, but then withdrew its request, resulting in the Division's issuance of Order No. 97-326. The Order incorporated the allegations set forth in the Notice of Opportunity for Hearing as findings.

RICHARD GEIGER

On September 16, 1997, the Division issued a Final Order to Deny Application for License, Order No. 97-237(A), against Richard Geiger ("Respondent"), an Ohio resident.

The Division had previously issued a Notice of Opportunity for Hearing against the Respondent, Order No. 97-156. The Order apprised the Respondent of its intention to deny his application for licensure based on allegations that he was "not of good business repute" as that phrase is used in Revised Code sections 1707.16 and 1707.19 and Ohio Administrative Code Rule 1301:6-3-19(D)(7) and (9). The Respondent requested and received an adjudicative hearing to address these allegations in accordance with Chapter 119 of the Revised Code. The Hearing Officer ultimately recommended the Respondent be denied a license. The Division approved this recommendation, thereby issuing Order No. 97-237(A).

SHELBY HEMAN/EDP CAPITAL GROUP, INC.

On September 25, 1997, the Division issued Order Nos. 97-336 and 97-337, against EDP Capital Group, Inc. and Shelby Heman ("Respondents"), respectively. EDP Capital Group is a Texas company, and Shelby Heman is a Nebraska resident.

The Division had previously issued a Notice of Opportunity for Hearing to both Respondents, Order No. 96-114, alleging that they sold unregistered securities in violation of R.C. 1707.44(C)(1). Heman requested an adjudicative hearing regarding the Division's allegations in accordance with Chapter 119 of the Revised Code. EDP Capital Group, Inc., after being properly served, did not request a hearing. A hearing was held, and the Hearing Officer found in Heman's favor. The Commissioner reviewed the Hearing Officer's Report and Recommendation and rejected the Hearing Officer's Recommendation. This upholding of the Division's allegations enabled the Division to issue Cease and Desist Orders against both Heman and EDP Capital Group, Inc., Order Nos. 97-336 and 97-337

SHOPPING AMERICA, INC.

On September 29, 1997, the Division issued Order No. 97-338, a Final Order to Cease and Desist, against Shopping America, Inc. ("Respondent").

The Division had previously issued a Notice of Opportunity for Hearing, Order No. 97-131, to the Respondent. In this Order, the Division alleged the Respondent violated Revised Code sections 1707.44(B)(4) and 1707.44(C)(1), by knowingly making material misrepresentations for the purpose of selling securities and selling unregistered securities, respectively. The Respondent exercised its right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was held, with the Respondent submitting its case in writing. The Hearing Officer issued a Report and Recommendation, finding in the Division's favor. The Division approved the Hearing Officer's Report and Recommendation, thereby issuing Order No. 97-338, incorporating the allegations cited in the Notice of Opportunity for Hearing.

TIMOTHY C. BARTELT

On September 30, 1997, the Division issued Order No. 97-339, a Final Order to Cease and Desist, against Timothy C. Bartelt ("Respondent").

The Division had previously issued a Notice of Opportunity for Hearing, Order No. Amended 97-031, alleging that the Respondent violated Revised Code sections 1707.44(B)(4) and (G), by knowingly making material misrepresentations for the purpose of selling securities and engaging knowingly in an act which is declared illegal, defined as fraudulent, or prohibited by the Ohio Securities Act. The Respondent exercised his right to an adjudicative hearing pursuant to Revised Code Chapter 119. The Hearing Officer issued a Report and Recommendation finding in favor of the Division and recommending that a final order to Cease and Desist be issued. The Division approved the Hearing Officer's recommendation, thereby issuing Order No. 97-339, incorporating the allegations cited in the Notice of Opportunity for Hearing as findings.

FACT GOLD TECHNOLOGIES CANADA, LTD.; RICHARD FURRER; M. WARD HUGHES

On October 2, 1997, the Division issued a Final Order to Cease and Desist, Order No. 97-341, against Fact Gold Technologies Canada, Ltd., Richard Furrer and M. Ward Hughes ("Respondents"). Fact Gold Technologies Canada (FACT) is an unincorporated Canadian entity.

The Division had previously issued a Notice of Opportunity for Hearing, Order No. 97-103, to the Respondents. The Order alleged that the Respondents had violated R.C. 1707.44(C)(1), selling unregistered securities, and that FACT and Furrer had violated of R.C. 1707.44(B)(4),

knowingly making false representations concerning a material and relevant fact for the purpose of selling securities. The Respondents requested a hearing pursuant to Chapter 119 of the Revised Code. A hearing was held and the Hearing Officer recommended that a Cease and Desist Order be issued. The Division approved this recommendation, and issued a Cease and Desist Order, Order No. 97-341, incorporating the allegations cited in the Notice of Opportunity for Hearing as findings.

DAVID F. KLIMA; INVESTORS UNITED FOR HUMANITARIAN ADVANCEMENT AND GM DIVERSIFIED TRUST

On October 3, 1997, the Division issued Order No. 97-344, a Cease and Desist Order, against David F. Klima, Investors United for Humanitarian Advancement ("Respondents") and GM Diversified Trust, all located in Ohio.

The Division had previously issued a Notice of Opportunity for Hearing, Order No. 97-309, against the Respondents. The Order alleged that the Respondents violated provisions of Revised Code sections 1707.44(C)(1),(B)(4) and (G): respectively, these sections prohibit the selling of unregistered securities, the selling of securities while knowingly making misrepresentations of material fact, and selling securities while knowingly engaging in an act which is declared illegal, defined as fraudulent or prohibited by the Ohio Securities Act. The Respondents did not exercise their right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code after being served Order No. 97-309. Therefore, the Division issued Cease and Desist Order No. 97-344, incorporating the allegations cited in the Notice of Opportunity for Hearing as findings.

WILDER RICHMAN SECURITIES CORP.

On October 10, 1997, the Division issued Order No. 97-351, a Revocation of Ohio Securities Dealer License No. 204024, against Wilder Richman Securities, Corp. of Connecticut ("Respondent").

The Division had previously issued a Suspension and Notice of Intent to Revoke Ohio Securities Dealer License No. 204024, Order 97-233. This Order was issued because the Respondent failed to maintain a minimum net capital of $5,000, as required by state and federal securities laws. The Respondent failed to exercise its right to a hearing pursuant to Chapter 119 of the Revised Code. Therefore, the Division issued its Revocation of Ohio Securities Dealer License No. 204024, Order No. 97-351.

JOHN J. ZUR, JR.; WARD INVESTMENT CO.

On October 10, 1997, the Division issued Order No. 97-352, a Cease and Desist Order, against John J. Zur, Jr. and Ward Investment Co. of Ohio ("Respondents").

The Division had previously issued a Notice of Opportunity for Hearing against the Respondents, Order No. 97-325. The Order alleged the Respondents violated R.C. 1707.44(C)(1), selling unregistered securities. The Respondents requested an adjudicative hearing pursuant to Chapter 119 of the Revised Code. The Respondents later withdrew their request for the hearing, and the Division issued Cease and Desist Order No. 97-352, incorporating the allegations cited in the Notice of Opportunity for Hearing as findings.

HOME NET GENERAL PARTNERSHIP; VAN AUSTIN; JAMES C. Q. SLATON; WORLD NET DEVELOPMENT GROUP, INC.

On October 15, 1997, the Division issued Order No. 97-362, a Cease and Desist Order, against the following Respondents: Home Net General Partnership (HNP), Van Austin, James C.Q. Slaton, and World Net Development Group, Inc. (WNDG). All the Respondents have addresses in California.

The Division had previously issued a Notice of Opportunity for Hearing, Order No. 97-105. The Order alleged the following: that WNDG had violated R.C. 1707.44(A) and 1707.44(C)(1); that HNP had violated 1707.44(C)(1); that Austin and Slaton had violated R.C. 1707.44(C)(1), 1707.44(G) and 1707.16. R.C. 1707.44(C)(1) prohibits the sale of unregistered securities; R.C. 1707.44(A) prohibits persons from engaging in any act or practice that violates division (A), (B) or (C) of R.C. 1707.14 (this statute prohibits persons from acting as a dealer, unless the person is licensed as a dealer by the Division of Securities); R.C. 1707.44(G) prohibits persons from knowingly engaging in fraudulent or prohibited acts and practices; R.G. 1707.16 requires every salesman of securities to be licensed by the Division. The Division served this Order on the Respondents in the manner prescribed by Chapter 119 of the Revised Code. The Respondents failed to timely request an adjudicative hearing pursuant to Chapter 119 of the Revised Code. Therefore, the Division issued Cease and Desist Order No. 97-362.

CRIS DAVID SAGNELLI

On October 21, 1997, the Division issued a Final Order to Deny Application for Securities Salesman License against Cris David Sagnelli ("Respondent"), a Georgia resident.

The Division had issued a Notice of Opportunity for Hearing, Order No. 97-308, to the Respondent. The Order alleged that the Respondent was not of "good business repute" as that term is used in Administrative Code Rule 1301:6-3-19(D)(2) and (9) and Revised Code section 1707.19(A). The Order also informed the Respondent that the Division intended to deny him a securities salesman license on this basis. Upon being served the Order, the Respondent did not timely request an adjudicative hearing pursuant to Chapter 119 of the Revised Code. Therefore, the Division issued the Final Order to Deny Application for Securities Salesman License, Order No. 97-374.

IGOR ERIC STOLYAR

On October 23, 1997, the Division issued a Final Order to Deny Application for Securities Salesman License, Order

Continued on page 10

No.97-376 against Igor Eric Stolyar ("Respondent"), a resident of New York.

The Division had previously issued a Notice of Opportunity for Hearing, Order No. 97-242. The Order alleged that the Respondent was not of "good business repute" as that term is used in Ohio Administrative Code Rule 1301:6-3-19(D)(7) and (9) and Revised Code section 1707.19(A). The Order also informed the Respondent that the Division intended to deny him a securities salesman license on this basis. Upon being served the Order, the Respondent did not request an adjudicative hearing pursuant to Chapter 119 of the Revised Code. Therefore, the Division issued the Final Order to Deny Application for Securities Salesman License, Order No. 97-376.

RONALD L. SALYER

On October 31, 1997, the Division issued a Final Order, Order No. 97-378, to Ronald L. Salyer ("Respondent") of Virginia. The Order granted Salyer an Ohio securities salesman license.

The Division had previously issued a Notice of Opportunity for Hearing, Order No. 97-378, to the Respondent. The Order alleged the Respondent was not of "good business repute" as that term is used in Revised Code sections 1707.16, 1707.19 and Ohio Administrative Code Rule 1301:6-3-19(D)(7) and (9). The Order also informed the Respondent that the Division intended to deny him a securities salesman license on this basis. The Respondent requested an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was held, and the Hearing Officer recommended that the Respondent be granted a license. The Division approved the Hearing Officer's recommendation, thereby issuing Order 97-378, granting the Respondent a license.

STEPHEN H. CHIPMAN

On November 3, 1997, the Division issued Order No. 97-379, a Final Order, to Stephen H. Chipman ("Respondent"), an Arizona resident. The Order granted Chipman a securities salesman license.

The Division had previously issued a Notice of Opportunity for Hearing, Order No. 97-147, to the Respondent. The Order alleged that the Respondent was not of "good business repute" as that term is used in 1707.16, 1707.19 and Ohio Administrative Code rule 1301:6-3-19(D)(2), (D)(7) and (D)(9). The Order also informed the Respondent that the Division intended to deny him a securities salesman license on this basis. The Respondent requested an adjudicative hearing pursuant to Chapter 119 of the Revised Code and a Hearing was held. The Hearing Officer recommended that the Respondent be granted a securities salesman license, and the Division approved the Hearing Officer's recommendation. The Division issued Order No. 97-379, granting the Respondent a license.

JERRY G. SUTTON

On November 3, 1997, the Division issued Order No. 97-380, a Final Order, to Jerry G. Sutton, a Michigan resident. The Order granted Sutton a securities salesman license.

The Division had previously issued a Notice of Opportunity for Hearing, Order No. 97-117 to the Respondent. The Order alleged that the Respondent was not of "good business repute" as that phrase is used in Revised Code sections 1707.16, 1707.19 and Ohio Administrative Code Rule 1301:6-3-19(D)(7) and (9). The Order also informed the Respondent that the Division intended to deny him a securities salesman licenses on this basis. The Respondent requested an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was held, and the Hearing Officer recommended that the Respondent be granted a license. The Division approved the Hearing Officer's Recommendation, thereby issuing Order No. 97-380, granting the Respondent a securities salesman's license.

Editor's Note: Reports of additional Final Administrative Orders issued by the Division during the fourth quarter of 1997 will appear in the next issue of the Ohio Securities Bulletin. Those wishing further information regarding any of the above enforcement actions may contact the Division and review the Orders cited above.

Criminal Actions

JOSEPH T. NEMCHIK; KURT FUCHS

On October 3, 1997, Joseph T. Nemchik was sentenced in Lorain County Common Pleas Court to 12 years imprisonment and ordered to make restitution. Nemchik had plead no contest to 121 felony counts on July 15, 1997, and was found guilty on all counts. He was found guilty on 38 counts of selling unregistered securities, 30 counts of misrepresentations in selling securities, 38 counts of making omissions in the selling of securities, and 15 counts of theft by deception. Nemchik, who held an Ohio securities salesman's license and was registered with the SEC as an investment advisor, sold promissory notes issued by Government Financial, a Delaware corporation. He represented to customers that the notes were insured. Customers lost more than one million dollars.

In a related action, Kurt Fuchs was sentenced on October 17, 1997 to six years imprisonment by the Lorain County Common Pleas Court. He had pled guilty on August 1, 1997, to 21 felony theft counts, after he was indicted in October, 1996. Fuchs was involved in investment sales with Joseph T. Nemchik.

Editor's Note: This case synopsis supersedes the one that appeared in Ohio Securities Bulletin 97:3 captioned "Joseph T. Nemchik."

ROBERT T. KING

On October 7, 1997, Robert T. King of Dublin, Ohio was indicted by a Richland County Grand Jury on five felony counts. The counts include one felony count each of the unregistered sale of securities, unlicensed sale of securities, misrepresentations in the sale of securities, publication of false statements involving securities, and theft. He was arrested October 10, 1997 and subsequently transferred to Richland County.

Registration Statistics

The following table sets forth the number of registration and exemption filings received by the Division during the fourth quarter of 1997, compared to the number of filings received during the fourth quarter of 1996, and the number of filings received during all of 1997 compared to all of 1996.

Filing Type	4Q'97	1997	4Q'96	1996
1707.03(Q)	381*	1402	306	1130
1707.03(W)	20	66	25	132
1707.04	0	0	0	0
1707.041	1	6	5	11
1707.06	25	147	38	162
1707.09	20	657	134	401
1707.091	120	1958	862	3849
Form NF**	983	1690	NA	NA
1707.39	4	18	7	29
1707.391	28	129	18	147
Total	**1582**	**6073**	**1395**	**5861**

Editor's Note: Note that the format for the registration statistics table has changed. Several catagories were condensed to render the table more relevant and easier to read.

** Includes 210 filings submitted on federal Form D for offerings made pursuant to Rule 506 of Regulation D. Use of the federal Form D was not accepted before April 21, 1997.*

***The Form NF is a form adopted by the North American Securities Administrators Association, Inc. to be used by investment companies in making notice filings. The form was drafted as a result of the National Securities Markets Improvement Act of 1996, and is used at the election of the issuer. Statistics for its use do not exist for 1996.*

Licensing Statistics

The table below sets forth the number of Salesmen and Dealers licensed by the Division at the end of each quarter of 1997, compared to the corresponding quarter of 1996.

	End of Q4 1997	End of Q4 1996	End of Q3 1997	End of Q3 1996	End of Q2 1997	End of Q2 1996	End of Q1 1997	End of Q1 1996
Number of Salesmen Licensed:	83,238	82,498	83,545	83,438	82,135	81,795	80,289	78,890
Number of Dealers Licensed:	2,170	2,060	2,154	2,061	2,113	2,011	2,050	1,928

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