

OHIO SECURITIES BULLETIN

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Viatical Settlements as Securities: Murky Area of Securities Law Begins to Clear

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It is naive to assume that the evaluation of any new investment vehicle as a security takes place in a vacuum. For better or worse, such analysis will be heavily influenced by political, public policy, and social considerations as to the perceived "goodness" or "badness" of the investment. The classification of the new vehicle will often turn more on political factors and its "goodness" than on pure "investment contract" analysis.

Viatical settlements represent a situation where these political and social considerations have had an improper influ-

ence on the classification process. Viatical settlements involve the purchase by a third party of all or part of the life insurance policy of a terminally ill person prior to the person's death. A number of companies are in the business of buying the policy or an interest therein from the insured and re-selling these interests to investors.

Effect of Public Policy

As noted in the introduction to this section, unfortunately, political and social values often play a substantial role in the determination of whether a particular scheme involves an investment contract. This is certainly true in the case of viatical settlements. There are two strong, yet

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Division Receives Legal Advice Regarding "E-Proxies"

Commissioner's Note: The Division of Securities has received legal advice from the Office of the Attorney General indicating that shareholders of an Ohio corporation may vote by proxy via electronic computer transmission. The legal advice letter from the Office of the Attorney General as well as the Division's letter of inquiry are reprinted below.

As corporation law, securities law and technology continue to converge, the Division of Securities has received inquiries regarding use of computer transmissions, including "e-mail" and the Internet, to communicate with potential investors, investors and shareholders. E-mail and Internet communications in connection with the purchase and sale of securities are clearly governed by the provisions of the Ohio Securities Act that apply generally to communications, subject the Internet "safe harbors" established in O.A.C. 1301:6-3-03(D)(9) and 1301:6-3-

14(A)(5). However, less clear are the standards governing communications between Ohio corporations and their shareholders. In particular, questions arose regarding the legality of allowing shareholders to vote by proxy via electronic computer transmission. Since such "e-proxies" are not expressly authorized by the proxy statute, R.C. 1701.48, the Division sought the advice of the Attorney General. The Division also sought guidance as to whether "e-proxies" would be permitted in connection with a special meeting of shareholders held pursuant to R.C. 1701.831, and as to whether the availability of "e-proxies" in a control bid transaction would have to be disclosed pursuant to R.C. 1707.041.

Parties wishing to rely on this legal advice should note the last paragraph of the response letter, which states that the response letter "does not constitute a formal or infor-

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OHIO DEPARTMENT OF COMMERCE DIVISION OF SECURITIES



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conflicting, public feelings about viatical settlements.

Because these agreements involve the making of a profit from the death of people with serious health problems such as AIDS and cancer, these agreements definitely have their dark side. The failure of the viatical companies to fully disclose this dark side caused the North Dakota Administrator and NASAA to take the position early on that these agreements are securities, subject to the disclosure requirements of the securities acts.¹

On the other side, if handled correctly and with proper profit and risk disclosure, these agreements clearly can have great social utility for AIDS patients and other terminally-ill patients. Such settlements allow these people to realize and enjoy the benefits of their life insurance coverage during their life. This money can be used for support or additional medical care or for making financially possible other final wishes and desires.

It is clear that the federal courts in *SEC v. Life Partners, Inc.*² were strongly swayed by their belief in the social benefit and utility of these agreements. While the trial judge believed the agreement (sic) were securities, he initially refused to issue an injunction against Life Partners.³ In doing so, he expressly recognized the social desirability of such agreements, saying:

This case is unusual . . . in that there are no allegations that any investor, terminally ill patient, or insurance company has been defrauded, misled, or is in any way dissatisfied with the LPI viatical settlement.⁴ This is despite an apparently exhaustive two year investigation by the Commission. . . . The Court must consider the effects of the Commission's request for relief on a business that helps so many terminally ill patients. . . .

The Court must consider the valuable funds provided AIDS patients in their final illness. The availability of such funds provides through the private sector what the already depleted public sector would oth-

erwise have to supply. The Court cannot ignore these beneficial results, results which caused the National Association of People with AIDS to side with the defendants. That organization is motivated by a fear that a major disruption in LPI's business will adversely affect terminally ill patients who cannot wait while the viatical market is reconstituted.⁵

Rather than stopping the sale of viatical settlements entirely, the trial judge gave Life Partners an opportunity to comply with the securities acts.⁶ It wasn't until Life Partners essentially refused this opportunity and the SEC sought a contempt order that the trial judge reluctantly, without finding contempt, entered an injunction against further sale.⁷

On appeal, the court of appeals echoed the social benefits of the sale of viatical settlements. Over a strong dissent, the majority entered two result-oriented opinions that dropped all pretense at a dispassionate analysis of these agreements in light of standard investment contract theory. Both in its original opinion⁸ and upon rehearing⁹, the majority undertook a defense of the agreements, based largely on

their perceived social "goodness" or politically correctness.

While the approaches by both NASAA and the federal courts are understandable from an emotional social policy standpoint, neither represents a correct approach to resolving the issue of whether these agreements are investment contracts. This issue should be decided in a dispassionate way by comparing the elements of these programs and the way that they are marketed to the standard investment contract model. If the agreements and the program under which they are sold meet the standard investment contract model and there is no registration or exemption, then further sales should be enjoined until compliance is accomplished.¹⁰

Ignoring the political and social disputes, this section will attempt to review viatical settlements in light of the accepted investment contracts principles. When such review is undertaken, the author submits that it is clear that these agreements do involve the offer and sale of investment contracts.¹¹

Viatical Settlements and the Way They Are Sold

Before attempting a legal analysis of viatical settlements, it is necessary to un-

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

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

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derstand the nature of viatical settlements and the way they are sold. Traditionally, these settlements involve people who are terminally ill, most frequently with a life expectancy of twenty-four months or less,¹² who have purchased life insurance policies on their own life. These policies *do not have to be paid up* policies,¹³ but may be policies on which further payments are due. Nor do the policies have to be noncontestable.¹⁴

Usually, but not always, the insured has no close relatives who are dependent upon him for financial support. As a result, the beneficiary of the policy is frequently the estate of the insured. The insured, for any one of a number of reasons,¹⁵ is willing to forego the death benefit in exchange for a present cash payment. Thus, the viatical settlement is entered into. A third-party pays the insured an amount between 60 and 80 percent of the face value of the policy and, in exchange, is named the beneficiary on the policy.¹⁶

A review of available documents and case law reveals four general plans or models under which viatical settlements are marketed to the general public. Of these four, only two involve investment contracts.¹⁷

The Life Partners Approach

The first model is used by the largest of the viatical companies, Life Partners, Inc.¹⁸ It involves the sale of preselected viatical settlements that are offered to the public. The potential investor is given a list of the viatical settlements that Life Partners has in inventory.¹⁹ The investor, then, selects from this list a fractional interest in a particular settlement he wishes to purchase.²⁰

The promoter, Life Partners, claims to be an expert in the acquisition of these settlements.²¹ It believes that the first step in the successful selection of settlements is to establish underwriting guidelines for both the insured individuals with whom it will deal and the policies it will buy.²² Life Partners has developed six criteria for selecting settlements it will enter into. These criteria are: (1) that the policy holder be diagnosed with "Full Blown AIDS"; (2) that the policy holder have a life expectancy of twenty-four months or less;²³ (3) that the policy holder be certified as men-

tally competent; (4) that the policy be issued by a company with A- or higher rating by a national insurance rating service; (5) that the policy be in good standing and noncontestable; and (6) that the policy be transferable or eligible for irrevocable transfer of beneficiary.²⁴ Normally, Life Partners does not directly approach the policy holder about entering into a settlement agreement. Instead, the information concerning the individuals and their policies is gathered by others who then approach Life Partners.²⁵ Upon receiving such applications, Life Partners does an independent verification of the information.²⁶ If this verification process shows that its underwriting criteria are substantially met, it secures a certificate as to mental competency of the selling insured. Once this certificate has been obtained, Life Partners approaches the potential seller and begins the negotiation leading to the viatical settlement. In a typical case, it will seek to buy all or a portion of insured's insurance contract²⁷ at a price that reflects a substantial discount of 20 to 40 percent. The amount of the discount largely depends upon life expectancy of the insured, in addition to his negotiation skill.²⁸ The more imminent the death of the insured, the less time before the purchaser of the settlement realizes his profit through payment of the face value of the policy. Therefore, the less the policy is normally discounted.²⁹

When the settlement agreement is struck, Life Partners takes title to the insurance policy as an agent for an "independent" trustee.³⁰ (Presently, this "independent" trustee is the Sterling Trust Company.³¹ However, Sterling can hardly be considered "independent." Its former president, Mike Posey, has replaced Brian Pardo as President of Life Partners.³²) At this point, apparently no money is paid to the policy holder.³³ The agreement remains executory on the part of Life Partners.

To summarize, Life Partners performs the following acquisition functions before investors are sought: (1) it evaluates the insured's medical condition; (2) it reviews the insurance policy; (3) it negotiates the actual purchase of the settlement, including the sales price; and, finally, (4) it drafts all the legal documents necessary for the acquisition of the policy.³⁴ It does not, however, pay for the settlement.

Life Partners markets these viatical settlements to the general public through some 500 independently commissioned "licensees," most of whom are independent financial planners.³⁵ While some companies sell whole viatical settlements, Life Partners appears to market only fractional interests in such settlements. As a result, the investor purchases only a portion of a particular settlement,³⁶ and there are multiple investors in a single settlement.³⁷ The average investment ranges from \$50,000 to \$100,000 per investor. Normally, to spread the risk, this investment is usually spread over a number of settlements, fractionalized in increments of \$5,000 to \$20,000.³⁸ However, in some cases, these fractional interests amount to as little as 3 percent of the base policy and sell for as low as \$650.³⁹

Concerning the mechanics of the purchase, Life Partners furnishes these "licensees" with a list of its inventory. This list, however, is reserved for the exclusive use of the sales agents and Life Partners. *It is not to be given to potential investors.*⁴⁰ Instead, the licensee shows a potential purchaser the inventory list of available policies from which the investor must select one or more interests he wishes to buy.⁴¹ However, the list does not contain the name of the insured selling the viatical settlement.⁴² It merely identifies the insurance company, the policy number, and amount of the policy.⁴³

If the potential purchaser wishes to invest, he selects the interest or interests he wishes to purchase from the tendered list. The transaction is then completed by the investor transmitting funds to Sterling Trust to pay for his purchases. It is only after the check is received by Sterling Trust that the investor finally receives a letter which, for the first time, identifies the policy and individual on which his investment is based.⁴⁴ Also at this point, for the first time the investor is given the confidential case history of the selling insured.⁴⁵

Upon receipt of investor funds, Sterling Trust acting as escrow agent, does four other important things. First, it subtracts its own fees for acting as escrow agent and trustee.⁴⁶ Second, it subtracts Life Partners' net compensation. This amounts to approximately 10 percent of the purchase price of the settlement after payment of

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referral and other fees.⁴⁷ Next, it escrows an amount necessary to pay any premium due on the policy for the next two years. Finally, Sterling pays over the remaining proceeds to the insured who sold the policy.

The fact that Sterling escrows funds to pay any premiums due on the policy for the next two years is significant for two reasons. First, it is clear that Sterling, acting as the agent of Life Partners, actually pays these premiums.⁴⁸ This payment, while labeled by the court of appeals as merely an administrative act,⁴⁹ is in fact a major post-sale managerial effort. If Sterling, for Life Partners, does not pay the premium, the policy will lapse and the investor will not get paid upon the death of the insured.

Second, what happens if the insured lives longer than the projected two year period? Presumably, Sterling, acting as Life Partners' agent, will continue to make the payments. But, who must supply the money? It would seem that the obligation should fall on either Life Partners or the investor. The insured certainly has no interest in making these payments. If the obligation is Life Partners, (sic) then this again is a significant managerial obligation. If Life Partners does not pay, the policy will lapse and the return is lost. If the obligation is the investor's this is a material fact that should be disclosed to him. Further, if Sterling either pays the premium out of its own funds and bills the investor or collects from the investor first, the obligation to see that the payment gets made is still a major post-sale managerial duty.

Again, in summary, as a result of this marketing process, the purchaser does not know the name of the individual whose policy he is buying.⁵⁰ Nor is the investor given any confidential case history of the selling insured until after the policy selection has been made.⁵¹ As a result, neither the independent sales agent nor the purchaser can make any independent investigation of the policy or person insured.⁵² They must blindly rely on the representations of Life Partners that the individual and the policy meet the underwriting guidelines it established.⁵³

Additionally, the investor must rely on Life Partners to determine the life expectancy of the insured.⁵⁴ These facts make clear that the investor is relying on the special skills of the promoter to make his investment profitable.

Life Partners, through their agent Sterling Trust, also provided a number of post-sale services.⁵⁵ This is the point at which the three different versions of the Life Partners plans differ.⁵⁶ In the original version, while technically optional, the investors were not told that they did not have to use the post-sale services offered by Life Partners. In the second version, the investors were informed that they did not have to use these services. However, Life Partners continued to provide the services unless the investors made an effort to perform them themselves.⁵⁷ In the third version, Life Partners did not offer any post-sale services, but left the investors to do the work themselves or to seek a third party to perform the services for them.

The trial judge found all three versions to involve the sale of an investment contract.⁵⁸ The court of appeals, of course, reversed all three on the basis that these post-purchases were "administrative" efforts and not managerial efforts to support a finding on an investment contract. Assuming, as the author does, that the court of appeals was wrong in classifying these efforts as merely administrative, it should not make a significant difference for the investment contract analysis of versions one or two whether the services were mandatory or optional. It must be remembered that the focus is upon economic reality. Therefore, as the court said in *Daggett v. Jackie Fine Art, Inc.*:

The theoretical possibility that an investor would refuse the efforts of others is not fatal to a determination that profits are to be earned from third party efforts. The focus is on whether the typical investor would accept third party efforts.⁵⁹

Further, as the *Howey* case points out, it is equally a violation of the securities laws to offer a security as it is to sell one. In versions one and two, each investor was offered the entire package.⁶⁰ In the third version, Life Partners did not offer any post-sale services.⁶¹

One of the post-purchase services consisted of tracking the status of the insured and notifying the investor of insured's death. The tracking process normally was accomplished by having the patient mail postcards to the agent as long as he was still able.⁶² Once the Sterling Trust had notice of the death of the insured, it secured a death certificate and filed the claim for the death benefits with the insurance company.⁶³ Other post-purchase services involved assuring that the policy did not lapse; converting a group policy into an individual policy where required; and arranging for resale of the investor's fractional interest, if the investor wished to sell his interest.⁶⁴

Viaticum Approach

The second model is used by Viaticum, Ltd. It differs from the Life Partners' approach outlined above in only one major respect. The investor's money is taken *before* the viatical settlements are secured from the insured. Thus, the capital pools (sic) is secured first. Then one or more settlements are purchased to employ this pool. In both these cases, the investor has a direct interest in the one or more viatical settlements in which he invests.

This difference is extremely important for our analysis because the court of appeals in *SEC v. Life Partners* held that the prepurchase services done by Life Partners were managerial efforts, but would not support a finding of an investment contract.⁶⁵ This being so, it is clear that under the Viaticum approach even the court of appeals would find the Viaticum agreement an investment contract because Viaticum performed these same functions *after* the investor made his investment.

Editors's Note: The second installment of this article will appear in the next Ohio Securities Bulletin, No. 98:3. Joseph C. Long is a professor at the University of Oklahoma Law School and has written extensively on a variety of securities issues.

Endnotes

¹ This led to the North Dakota Administrator and NASAA being sued by Brian Pardo, the President of Life Partners,

Inc., for liability. See *Pardo v. Pomeroy*, Civ. A. No. W-92-CA-222 (W.D. Tex. Oct. 6, 1992). This action was later dismissed with prejudice.

² *SEC v. Life Partners, Inc.*, 318 U.S. App. D.C. 302, 87 F.3d 536 (D.C. Cir.), reh'g. denied with opinion, 322 U.S. App. D.C. 189, 102 F.3d 587 (D.C. Cir. 1996), *rev'ing* 912 F. Supp. 4 (D.D.C. 1996) and 898 F. Supp. 14 (D.D.C. 1995).

³ *SEC v. Life Partners, Inc.*, 898 F. Supp. 14 (D.D.C. 1995).

⁴ [Author's note]. The court had earlier indicated that the alleged misrepresentations and omissions alleged by the SEC were "less than overwhelming." 898 F. Supp. at 22.

⁵ *SEC v. Life Partners, Inc.* 898 F. Supp. 14, 23 (D.D.C. 1995). These sentiments were echoed by the court of appeals. *SEC v. Life Partners, Inc.*, 318 U.S. App. D.C. 304-05, 87 F.3d 538-39 (D.C. Cir. 1996).

⁶ Even so, *Life Partners, Inc.*, within less than a month, sought a stay of the trial court order pending appeal. *SEC v. Life Partners, Inc.* 318 U.S. App. D.C. 304, 87 F.3d 538 (D.C. Cir. 1996). This stay was denied, and *Life Partners* was given 20 days to report on its steps to bring itself within compliance with the securities acts. *Id.* Thus, it would appear to be a "Catch 22." *Life Partners* could continue to sell the agreements and the SEC could not object. However, because the court determined that the agreements were the sale of securities, a sale of the agreement constituted a felony and subjected the issuer to strict civil liability. In effect, the trial judge was saying the sale of these agreements is illegal, but we will allow the illegal sales to continue for a period because of their social utility until defects can be corrected and the *future* sales made legal. The judge does not have the power to allow such continued violation. Regardless of the social utility of the agreements, their sale should be stopped until necessary compliance has been accomplished and the sales may legally resume. The failure to issue the injunction merely gave *Life Partners, Inc.* a false sense of security.

⁷ *SEC v. Life Partners, Inc.* 912 F. Supp. 4 (D.D.C. 1996). Subsequently, *Life Partners* modified its offering plan and gave notice that it was going to resume sales under the modified plan which it felt did not violate the securities acts. The trial court concluded that the new plan was a security and enjoined it as well. *SEC v. Life Partners, Inc.* 1996 WL 195136 (D. D.C. Mar. 1996)

⁸ 318 U.S. App. D.C. 302, 87 F.3d 536 (D.C. Cir. 1996).

⁹ 322 U.S. App. D.C. 189, 102 F.3d 587 (D.C. Cir. 1996).

¹⁰ Such compliance may result in Congress or the state legislature deciding, for social utility reasons, that such agreements should be excluded from the registration provisions of the securities acts. In such case, a new exemption from registration should be created. Or, Congress or the state legislature may decide that it is improper to regulate these agreements under the securities acts at all. In which case, they should create a statutory exclusion from the statutory definition of a security.

¹¹ This does not mean to say that the sale of these agreements should be banned entirely, absent the showing of fraudulent conduct. It merely means that registration will be required and full disclosure made. Registration of these agreements may be difficult. However, the problems here should be no greater than those encountered in the registration of option contracts or securitized investment vehicles such as home mortgages or other types of commercial paper.

¹² *SEC v. Life Partners, Inc.*, 898 F. Supp. 14, 17 (D.D.C. 1996). *Life Partners* has a special program under which policies on patients with longer life expectancies are accepted. *Id.* Another company, *Mutual Benefits Corp.* also has a similar plan. See *In Re Advanced Fin. Resources Group*, 1996 WL 173469 (Colo. Div. Sec. NAL, Feb. 15, 1996). This opinion has the text of the *Mutual Benefits* investor agreement attached.

¹³ *Id.*

¹⁴ While other companies will take policies which are still contestable, apparently, *Life Partners* requires them to be noncontestable. 898 F. Supp. at 17. *But see Mutual Life Ins. Co. v. Needham*, 1996 U.S. LEXIS 10662 (N.D. Cal. July 22, 1996), where both *Life Partners* and *Sterling Trust* were named defendants in a contestability action along with the insured.

¹⁵ Such as present medical expenses, future extended or expanded care, quality of life concerns, or simply to enable them to enjoy life experiences such as travel. See *SEC v. Life Partners, Inc.*, 898 F. Supp. 14, 17 (D.D.C. 1996).

¹⁶ *SEC v. Life Partners, Inc.* 318 U.S. App. D.C. 302, 303, 87 F.3d 536, 537 (D.C. Cir. 1996).

¹⁷ The first of the alternative plans involves the sale of stock in a corporation which will, in turn, use the proceeds of such sale to invest in viatical agreements. See *Shanah D. Glick*, "Are Viatical Settlements Securities Within the Regulatory Control of the Securities Act of 1933." 60 *U Chi. L. Rev.* 957 (1993). The second merely substitutes the investment trust for the corporation. See *In re Federal Funding Foundation*, Docket S-3175-I (Ariz. Corp. Comm'n Temporary Cease & Desist Order Oct. 29, 1996), and *Private Placement Summary*, *Sierra Short Term Investment Trust No. 1* (May 20, 1996). Again the trust interests are sold, and the proceeds used to buy viatical settlements which become the *res* of the trust. In both cases, essentially what is created is a mutual fund dedicated to investing in viatical settlements. There is no direct investment in the viatical settlements, and there is no question that the stock or the trust interests are securities. In *re University Gems, Inc.*, 1987 *Wa. Sec. LEXIS* 536 (Wa. Sec. Div. Cease and Desist Order Dec. 2, 1987) (mutual fund investing in diamonds).

¹⁸ *Brian Pardo* claims that there are some sixty companies selling viatical settlements. He also claims that, in 1994, *Life Partners* accounted for more than half of industry's estimated annual revenues of

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\$300 million. 318 U.S. App. D.C. at 305, 87 F.3d at 539.

¹⁹ As in the case of many securities schemes, the Life Partners marketing program underwent a series of changes in an attempt to avoid securities classification. Life Partners used three different versions. These versions are discussed in 318 U.S. App. D.C. 302, 87 F.3d 536. The trial court found all versions to be securities. The appellate court, on the other hand, found none to be securities. Version one is described here, unless noted otherwise.

²⁰ *Id.* Pardo Deposition at 123.

²¹ Pardo Deposition at 122-23; 898 F. Supp. at 16.

²² *Id.* at 122. See 898 F. Supp. at 17 for these criteria.

²³ This is determined by Life Partners' "independent reviewing physician," Dr. Jack Kelly. Dr. Kelly is not in fact "independent." He is a member of the Life Partners Board of Directors, 898 F. Supp. At 23, and a five percent shareholder. 318 U.S. App. D.C. at 305, 87 F.3d at 539. Neither the identity of the person performing this review or his relationship with Life Partners was revealed to the investors.

²⁴ 898 F. Supp. at 17.

²⁵ Such persons are paid referral fees. 318 U.S. App. D.C. at 305, 87 F.3d at 539.

²⁶ Pardo Deposition at 158, 170-71.

²⁷ Pardo Deposition at 176, 191-92. Sometimes, however, Life Partners will have commitments from investors to buy a particular viatical settlement even before Life Partners and the insured have agreed to sell. Pardo Deposition at 352-54. In these instances, the Life Partners' sales are not Model One sales, but Model Two sales.

²⁸ 318 U.S. App. D.C. at 303, 87 F.3d at 537.

²⁹ Most policies have a period after they are issued in which the insurer can contest the policy on the basis that the insured did not make full disclosure of the condition of his health at the time of purchasing the policy. As noted above, Life Partners apparently does not buy policies which are still in the contestability period. Other companies do.

Evaluation of the risk of successful contest by the insurance company should be a factor to be considered in setting the discount from the face of the policy. Further, handling contest actions for the public purchaser of the settlement is certainly a post-sale service to be considered in determining when the efforts of others test has been met.

³⁰ Pardo Deposition at 176, 191-92; 318 U.S. App. D.C. at 305, 97 F.3d at 539. While the investors may actually be named as beneficiaries of the insurance policy, most prefer to leave the trustee as the named beneficiary. Pardo Deposition at 181.

³¹ 318 U.S. App. D.C. at 306, 87 F.3d at 540. Originally, it was a lawyer who used his escrow account. Pardo Deposition at 138.

³² 1996 WL 195136 at #1.

³³ 318 U.S. App. D.C. at 306, 87 F.3d at 540.

³⁴ 318 U.S. App. D.C. at 305, 87 F.3d at 536.

³⁵ *Id.*

³⁶ Pardo Deposition at 124, 137. The inventory lists reflect those fractional interests available.

³⁷ Pardo Deposition at 174-175.

³⁸ Pardo Deposition at 125.

³⁹ 318 U.S. App. D.C. 305, 87 F.3d at 539.

⁴⁰ Pardo Deposition at 121-122.

⁴¹ *Id.* at 121-122.

⁴² Pardo Deposition at 122.

⁴³ *Id.*

⁴⁴ Pardo Deposition at 140-41.

⁴⁵ Pardo Deposition at 130-31, 135. Even after the purchase the investor is given only limited information from the case history.

⁴⁶ 318 U.S. App. D.C. at 306, 87 F.3d at 540.

⁴⁷ *Id.* The court did not elaborate as to what these other "fees" are. This estimate of the Life Partners profit conflicts with Brian Pardo's earlier testimony. He indicated Life Partners receives 15 percent of the investors' initial investment for its services and to cover its expenses and fees. Pardo Deposition at 145-149. The difference may be that Pardo was talking in terms of gross profit, while the court's figure may be the net profit after payment of fees and expenses.

Further, it is not clear whether Life Partners sold the settlement interests at the price at which they were purchased. If not, then, Life Partners would also get the difference between the amount paid the insured for the settlements and the price collected from the investors. See *In re Viatical Settlements*, 1995 WL 852, 542 (Kan. Sec. Comm'n Nov. 14, 1995).

⁴⁸ 318 U.S. App. D.C. at 306, 87 F.3d at 540.

⁴⁹ *Id.*

⁵⁰ Pardo Deposition at 122.

⁵¹ Pardo Deposition at 130-131, 135. Even after the purchase the investor is given only limited information from the case history.

⁵² *Id.*

⁵³ Pardo freely admits that no purchaser has ever contacted a policy holder to independently verify his condition. Pardo Deposition at 155.

⁵⁴ Pardo Deposition at 357.

⁵⁵ 318 U.S. App. D.C. at 306, 87 F.3d at 540.

⁵⁶ The differences in the versions are outlined in the Court of Appeals original opinion. *Id.*

⁵⁷ 912 F. Supp. at 9.

⁵⁸ *Id.*

⁵⁹ *Daggert v. Jackie Fine Art, Inc.*, 152 Ariz. 559, 567; 733 P.2d 1142, 1150 (App. 1986). [Citations omitted].

⁶⁰ In the third version, Life Partners did not offer any post-sale services, but left

the investors to do the work themselves or to seek a third party to perform the services for them. The trial judge concluded this also involved an investment contract, saying:

As the SEC notes, it is neither realistic nor feasible for multiple investors, who are strangers to each other, to perform post-purchase tasks without relying upon the knowledge and expertise of a third party. Moreover, the third party in this case will almost certainly be Sterling Trust, the former president of which, Mike Posey, has just been installed as the president of defendant Life Partners, Inc. Defendants claim that there are numerous companies

that perform post-purchase services, however, defendants have failed to identify any such company except Sterling Trust 1996 WL 195136 at #1.

⁶¹ 912 F. Supp. at 9-10.

⁶² Pardo Deposition at 151-52.

⁶³ Pardo Deposition at 147.

⁶⁴ 318 U.S. App. D.C. at 305; 87 F.3d at 539.

⁶⁵ *Id.* at 314; 87 F.3d at 548.

Division Receives Legal Advice Regarding "E-Proxies"

Continued from page 1

mal opinion of the Attorney General but is the legal advice of the Assistant Attorney General assigned to represent the Department of Commerce, Division of Securities."

[Letter of Inquiry]

May 27, 1998

The Honorable Betty D. Montgomery
Ohio Attorney General
30 East Broad Street
Columbus, Ohio 43215-3428

Dear Attorney General Montgomery:

On behalf of the Ohio Division of Securities (the "Division"), I am writing to request the informal opinion of the Attorney General on three questions that exist at the intersection of technology and Ohio law. The questions are:

- (i) Pursuant to Ohio Revised Code ("R.C.") 1701.48, may the shareholders of an Ohio corporation vote by proxy in an annual or special meeting of the shareholders via an electronic computer transmission?
- (ii) May the shareholders of an Ohio corporation vote by proxy via an electronic computer transmission in a special meeting of the shareholders held pursuant to R.C. 1701.831?
- (iii) Pursuant to R.C. 1707.041, must the availability of voting by proxy via an electronic computer transmission be disclosed to the offerees of a control bid?

Ohio law establishes the right of shareholders of an Ohio corporation to vote "on each matter properly submitted to the shareholders." R.C. 1701.44. Voting by proxy is authorized by R.C. 1701.48, which states in pertinent part:

- (A) A person who is entitled to attend a shareholders' meeting, to vote thereat, or to execute consents, waivers, or releases, may be represented at such meeting or vote thereat, and execute consents, waivers, and releases, and exercise any of his other rights, by proxy or proxies appointed by a writing signed by such person.

A plain reading of R.C. 1701.48(A) reveals three requirements: (i) the entitlement to vote; (ii) appointment by a writing; and (iii) the writing signed by the person entitled to vote. The entitlement to vote is determined by other provisions of the Ohio corporate code and the corporation's constituent documents, and thus is not relevant to this discussion.

However, the requirements of "writing" and "signed" are relevant. R.C. 1701.48(B) states:

- (B) A telegram or cablegram appearing to have been transmitted by such person, or a photographic, photostatic, or equivalent reproduction of a writing, appointing a proxy is a sufficient writing.

While this provision indicates that these alternative forms of proxies satisfy the "writing" requirement, the provision is silent as to whether the signature requirement is also satisfied. One could argue that the signature requirement is impliedly satisfied since, for example, a telegram would not be signed. Nonetheless, the statute is not precise on this point.

It seems that the notion of an electronic computer transmission is not inconsistent with the alternative forms of proxies authorized by R.C. 1701.48(B).

While the substance of proxy law is established on the state level, the process of proxy law, including proxy solicitation, is governed by the federal securities laws. §14 of the Securities Exchange Act of 1934, 15 U.S.C. § 78n. Provided that there is no conflict with state law, the Securities and Exchange Commission (the "SEC") has authorized the electronic delivery of proxy statements and annual reports to shareholders. *See, e.g., Use of Electronic Media for Delivery Purposes*, SEC Release No. 33-7233 (Oct. 6, 1995), 1 Fed. Sec. Law Rep. (CCH) ¶ 3200; *Use of Electronic Media by Broker-Dealers, Transfer Agents and Investment Advisers For Delivery of Information*, SEC Release No. 33-7288 (May 9, 1996), 1 Fed. Sec. Law Rep. (CCH) ¶ 3201. Specifically, the SEC has set forth three requirements for sufficient electronic delivery: (i) the electronic communication must provide timely and adequate notice; (ii) use of the electronic medium cannot be so burdensome that the recipient cannot effectively access the information; and (iii) there must be evidence to show delivery. *Id.*

Beyond electronic delivery, the SEC has suggested that the electronic voting of proxies is consistent with the federal proxy rules. *Use of Electronic Media by Broker-Dealers, Transfer Agents and Investment Advisers For Delivery of Information*, SEC Release No. 33-7288 (May 9, 1996), 1 Fed. Sec. Law Rep. (CCH) ¶ 3201, Part IV, Example (3). However, state law governs whether a proxy is valid and actually confers authority. R.C. 1701.48. *See also* Friedman, *Securities Regulation in Cyberspace* § 11.05 (1997). Thus, we return to the first question presented: May the shareholders of an Ohio corporation vote by proxy in an annual or special meeting of the shareholders via an electronic computer transmission? In particular, would the use of "e-mail," with proper security measures in place, be a proper means of casting shareholder ballots at a meeting of the shareholders?

The second question presented asks whether such electronic voting would be permitted in a special meeting of the shareholders held pursuant to R.C. 1701.831. R.C. 1701.831 provides that a special meeting of the shareholders shall be called and held for the shareholders to vote upon certain transactions known as "control share acquisitions." The most typical type of control share acquisition is a takeover transaction. Because of the nature of takeover transactions, R.C. 1701.831 establishes specific shareholder voting requirements and procedures. *See* R.C. 1701.832.

Although certain voting requirements and procedures are established by R.C. 1701.831, that statute refers to the shareholders' meeting held under R.C. 1701.831 as simply "a special meeting of the shareholders." See R.C. 1701.831(C), (D) and (E)(1). That being the case, R.C. 1701.48, which by its terms applies to all "shareholders' meetings" (see R.C. 1701.48(A) *supra*), governs voting by proxy at such a meeting. Therefore, it would seem that if voting by proxy via an electronic computer transmission is permitted by R.C. 1701.48 generally, it would also be permitted at a special meeting of the shareholders held pursuant to R.C. 1701.831.

The third question presented inquires whether pursuant to the Ohio Control Bid Statute, R.C. 1707.041, which is administered and enforced by the Division, the availability of voting by proxy via electronic computer transmission must be disclosed to the offeree shareholders. In the case of a "control bid" for, or attempted takeover of, a company with significant ties to Ohio, R.C. 1707.041 requires that certain materials be filed with the Division and that certain information be disclosed to the shareholders of the "target" corporation. R.C. 1707.041(A)(2) enumerates specific information that must be disclosed. Among these disclosure requirements is R.C. 1707.041(A)(2)(h), which requires disclosure of:

- (h) Such other and further documents, exhibits, data, and information as may be required by regulations of the division of securities, or as may be necessary to make fair, full, and effective disclosure to offerees of all information material to a decision to accept or reject the offer.

It seems that the availability of voting by proxy via electronic computer transmission is material information that would fall within this disclosure requirement.

Thank you for your consideration of these questions. Please do not hesitate to contact me if you have any questions or require additional information.

Sincerely,

/s/ Thomas Geyer

Thomas E. Geyer
Commissioner of Securities

cc: Donna Owens, Director of Commerce
Sara Vollmer, Office of the Secretary of State

[Response of the Attorney General's Office]

July 10, 1998

Thomas E. Geyer
Commissioner of Securities
77 South High Street, 22nd Floor
Columbus, Ohio 43266-0548

Dear Mr. Geyer:

You have asked the Attorney General for an informal legal opinion on three related questions relating to the use of computer generated electronic mail ("e-mail") as the means of transmitting shareholder votes by proxy in corporate elections. As the Assistant Attorney General assigned to represent the Division of Securities, your inquiry has been forwarded to me for a response.

Specifically, you have asked:

- (i) Pursuant to Ohio Revised Code (“R.C.”) 1701.48, may the shareholders of an Ohio corporation vote by proxy in an annual or special meeting of the shareholders via an electronic computer transmission?
- (ii) May the shareholders of an Ohio corporation vote by proxy via an electronic computer transmission in a special meeting of the shareholders held pursuant to R.C. 1701.831?
- (iii) Pursuant to R.C. 1707.041, must the availability of voting by proxy via electronic computer transmission be disclosed to the offerees of a control bid?

Ohio corporation law provides that shareholders may exercise voting rights by proxy, in accordance with R.C. 1701.48, which provides in part:

- (A) A person who is entitled to attend a shareholders’ meeting and vote thereat ... may be represented at such meeting or vote thereat ... by proxy or proxies appointed by a writing signed by such person.
- (B) A telegram or cablegram appearing to be transmitted by such person, or a photographic, photostatic or equivalent reproduction of a writing, appointing a proxy is a sufficient writing.

Clearly, e-mail is not a “telegram or cablegram”. The General Assembly obviously did not intend these terms to include e-mail, which did not exist at the time of the statute’s enactment. As e-mail is not specifically permitted, the question becomes whether e-mail will qualify as an “equivalent reproduction of a writing” to qualify as a sufficient writing for purposes of R.C. 1701.48(B). I conclude that it does.

The term “writing” is not defined in Chapter 1701. However, under the general provisions for statutory interpretation as set forth at R.C. 1.59(J), “writing” includes “any representation of words, letters, symbols or figures”. This definition is broad enough to include computer transmitted documents such as e-mail.

It is noted that an e-mail proxy would not bear the signature of the shareholder as seemingly required by R.C. 1701.48(A). However, R.C. 1701.48(B) specifically authorizes telegram and cablegram proxies that do not bear a signature. Thus, an e-mail proxy “appearing to be transmitted by such person” would likewise satisfy the statute.

This interpretation is consistent with the position adopted in other jurisdictions. Several states, such as Delaware and California, have proxy laws broad enough to permit an electronically transmitted proxy vote so long as it is accompanied by an identifying code or other means of authentication. *See* Delaware General Corporation Law §212(c)(2); California Corporations Code §178. Increasingly, public companies and their transfer agents are permitting registered shareholders to vote on-line. For example, Bell & Howell held its 1997 annual meeting via Internet technology. The registered shareholders were able to vote their proxies by e-mail until the start of the meeting. Also in 1997, First Chicago Trust, a transfer agent, established an on-line pilot program in which three public companies participated: McDonald’s Corp., First Chicago NBD Corp. and Ameritech Corp. *U.S. Securities and Exchange Commission Report to Congress: The Impact of Recent Technological Advances on the Securities Markets*, at n. 71. Under this program, each shareholder is provided with a PIN number, which was mailed by the transfer agent directly to the shareholder, or which is transmitted along with the proxy or voting instructions. The shareholders must enter their PIN into their computers and transmit the PIN number in order for the agent to verify the authenticity of the voting instructions.

With appropriate security measures, e-mail voting could provide shareholders and the corporation with better safeguards and protections than are afforded by telegram and cablegram transmissions. Like a telegram or cablegram, an e-mail is transmitted electronically from one point to another via an electronic

signal which is converted at the receiving end into readable form. Although an e-mail does not permit the transmission of a shareholder's signature, neither does a telegram or cablegram. The identity of the originator of a telegram or cablegram may or may not be authenticated on the transmitting-end by the cable company obtaining the signature of the shareholder. Even if they do, this signature is not physically transmitted to the recipient. Similarly, the transmission of voting instructions by e-mail is not accompanied by a signature. The shareholder's identity is verified by the use of a PIN number, which is authenticated by the independent agent. Therefore, the statute's concerns about authenticity and verification are satisfied, and, in fact, using the PIN number may provide a greater measure of security than a manual signature. It would be advisable for the Division to draft an administrative rule outlining the security measures necessary to ensure the integrity of the vote tabulations and to guaranty the authenticity of the proxy, whether by an assigned PIN for each shareholder or such other means as the Division deems appropriate.

Your second question concerns the use of e-mail proxies at special shareholder meetings contemplated by R.C. 1701.831. As you correctly point out, the special voting procedures for set out under .831 do not extend to the form of a proxy to take part in such a meeting. The general rule on proxies set forth in R.C. 1701.48 applies to all shareholder meeting, including .831 meetings. This is made clear by the fact that R.C. 1701.48(C) makes special provision for the revocability of proxies at .831 meetings. Thus, if e-mail proxies are generally permissible, as I have concluded they are, then such proxies are allowed at .831 meetings provided they otherwise comply with state and federal law.

The third and final issue concerns whether the availability of voting by e-mail proxies must be disclosed pursuant to R.C. 1707.041. I agree that the e-mail proxy procedure, like any other proxy information, must be disclosed to shareholders under subsection (h).

The foregoing does not constitute a formal or informal opinion of the Attorney General but is the legal advice of the Assistant Attorney General assigned to represent the Ohio Department of Commerce, Division of Securities. If you have any questions or require additional information, please do not hesitate to contact me.

Sincerely,

BETTY D. MONTGOMERY
Attorney General

/s/ Stephen H. Johnson

STEPHEN H. JOHNSON
Assistant Attorney General



Year 2000 and Applicants for Securities Registration

The year 2000 may bring some unexpected consequences for many applicants seeking to register securities. Many computer systems may not be able to process or interpret the year 2000. These computer systems use hyphens or slashes to separate the dates and years, i.e., 6/25/98 or 07-19-99. Many computer systems have been designed to always recognize that the first two digits in the date of a year as "19." Thus, when a system operator enters information into the computer system on or for the year 2000, that information may erroneously be interpreted as the year 1900. This information that is erroneously reported as the year 1900 may be inaccurately maintained or deleted from the system. Many computer applications need accurate dates to perform future calculations. Any information entered into a computer and any recurring calculations may be affected by the year 2000 including payment obligations or receipts on or before the year 2000. Please note that the year 2000 problem could include all operational activities performed by an entity on a computer. The complexity of the issue may extend beyond the entity and include customers or suppliers and distribution channels for all goods and services of the entity.

The Securities and Exchange Commission and the accounting profession has advised issuers and investors of potential problems in computer systems that may arise on or before the year 2000.¹ Many applicants for registration pursuant to sections 1707.06 or 1707.09 of the Ohio Revised Code may not be required to file disclosure documents with the Securities and Exchange Commission.² These SEC-exempt entities may not have auditors or system operators to explain the nature of the problems to management. These entities, regardless of size, may have some similar problems. Some applicants may be aware of the problem but have not fully assessed its impact nor taken corrective action. Even start-up entities may wish to test applications for year 2000 compliance before purchasing computer systems. The Division is concerned that these non-public or SEC-exempt entities may expose themselves and security holders to significant risks and potential liability if the issuer does not disclose at a minimum the nature of these material issues to offerees. Many filings are received at the Division that do not address year 2000

issues. The Securities and Exchange Commission has encountered similar concerns.³

The Division may require entities that file solely with the Division to disclose any material impact year 2000 issues will have on the applicant for registration. The guidance established by the Securities and Exchange Commission in Staff Legal Bulletin No. 5 (CF/IM), revised January 12, 1998 will assist applicants. This is a disclosure issue that the Division believes is necessary for sellers of securities to comply with the obligation to fully disclose to offerees all material terms known, or, in the exercise of reasonable diligence should be known to the seller of the securities. See sections 1707.44(B)(4) and 1707.44(G) of the Ohio Revised Code.

Briefly, the Division will require issuers to disclose the plans and costs of addressing the year 2000 issue in any or all of the following sections of their offering circular for registrations by description and qualification: the risk factors section, description of the business, financial statements and accompanying notes to financial statements, or management discussion and analysis of certain relevant factors.⁴ See rule 1301:6-3-06(D)(7),(8), and (11) of the Ohio Administrative Code, rule 1301:6-3-09(E) O.A.C. and questions 2 - 4, 45-50 of the form U-7. This disclosure should include past and anticipated expenditures to the extent known.

An issuer that has not considered any year 2000 problems may be asked to exercise reasonable due diligence and review its computer systems, making inquiries of their customers, suppliers or constituents. The Division encourages applicants that are not aware of the year 2000 issue to review various sources including the Staff Legal Bulletin No. 5 (CF/IM)⁵.

Applicants for registration that have undertaken year 2000 compliance efforts and have ascertained that the issue is not material or that they are year 2000 compliant should inform the Division in a cover letter.⁶ Specifics should be discussed which include applicants' compliance efforts with their own computer systems and those of any customers, suppliers or constituents.

On a related matter, the Division has undertaken an extensive analysis of its own year 2000 compliance. Many of the systems purchased by the Division were year 2000 compliant at the time of purchase. Records

for registration, exemption, broker/dealer and salesman licensing are considered compliant by the Division.

Endnotes

¹ SEC Staff Legal Bulletin No. 5 (October, 1997; revised January 12, 1998); "SEC Enhances Year 2000 Disclosure Guidance" Deloitte & Touche Review, February 2, 1998. Also: The American Institute of Certified Public Accountants and Internet web sites at www.aicpa.org/index.htm and www.aicpa.org/members/y2000/index.htm.

² Applications for registration by coordination are filed pursuant to section 1707.091 of the Ohio Revised Code. These applications include documents filed with the Securities and Exchange Commission and the Ohio Division of Securities.

³ Practicing Law Institute's 27th annual "SEC Speaks" reported at CCH Federal Securities Law Reports Number 1808. "If you are silent with respect to year 2000, people will draw one of two conclusions, Mr. Lane surmised. Either you are year 2000 compliant or you are clueless." Mr. Brian Lane is Director of the SEC's Division of Corporate Finance.

⁴ SEC Staff Legal Bulletin No. 5 discusses the disclosure for two sections: (1) management discussion and analysis of financial condition and results of operation, and (2) description of business.

⁵ <http://www.frbsf.org/fiservices/cdc/smallbuss/index.html> (Federal Reserve Board San Francisco, Financial Institution Services, Century Date Change); <http://www.sba.gov/y2k> (Small Business Administration Web Site); <http://www.aicpa.org/members/y2000/index.htm> (American Institute of Certified Public Accountants); <http://www.state.oh.us/y2k/> (State of Ohio year 2000 projects).

⁶ Practicing Law Institute's 27th annual "SEC Speaks" Brian Lane, "If the information is not material, that is fine." "There probably is no need to disclose unknowns about third parties."

Division Enforcement Section Reports

Administrative Orders

**Michael R. Kusserow;
Larry L. Chapman**

On December 23, 1997, the Division issued Order No. 97-429, a consented Cease and Desist Order, against Michael R. Kusserow and Larry L. Chapman. The Respondents are Ohio residents.

The Division had previously issued Order No. 97-149, Amended, a Notice of Opportunity for Hearing. The Order alleged the Respondents had violated R.C. 1707.44(G), which prohibits knowingly engaging in any act or practice which is declared illegal, defined as fraudulent or prohibited: specifically, failing to disclose material information in the sale of a security. The Respondents and the Division negotiated and executed a consent agreement. The agreement principally required the Respondent to acknowledge and consent to the findings, conclusions and orders set forth in the accompanying Cease and Desist Order (Order No. 97-429) and to the issuance of this Order. The Cease and Desist Order incorporated the allegations set forth in the Notice of Opportunity for Hearing as findings.

Michael John Bishop

On March 20, 1998, the Division issued a Final Order to Deny Application for Securities Salesman License, Order No. 98-096, to Michael John Bishop, a Tennessee resident.

The Division had previously issued Division Order No. 97-251, a Notice of Opportunity for Hearing, to the Respondent. The Order alleged the Respondent was not of "good business repute" as that term is used in Administrative Code Rule 1301:6-3-19(D)(7) and (9) and Revised Code section 1707.19(A) and gave him notice of intent to deny his application for licensure as a salesman of securities. The Respondent failed to request an adjudicative hearing pursuant to Chapter 119 of the Revised Code upon receiving service of the Order. Therefore, the Division issued its Final Order to Deny Application for

Securities Salesman License, Order No. 98-096, incorporating the allegations set forth in the Notice of Opportunity for Hearing.

Billy Don Lively

On March 18, 1998, the Division issued Order No. 98-095, a Final Order to Deny Application for Securities Salesman License, to Billy Don Lively, an Arkansas resident.

The Division had previously issued Division Order No. 97-258, a Notice of Opportunity for Hearing, to the Respondent. The Order alleged the Respondent was not of "good business repute" as that term is used in Administrative Code Rule 1301:6-3-19(D)(3) and (9) and Revised Code R.C. 1707.19(A) and gave him notice of intent to deny his application for licensure as a salesman of securities. The Respondent did not request an adjudicative hearing regarding the impending denial pursuant to Chapter 119 of the Revised Code upon receiving service of the Order. Therefore, the Division issued its Final Order to Deny Application for Securities Salesman License to the Respondent, incorporating the allegations set forth in the Notice of Opportunity for Hearing as findings.

Edward Adolph Lewis

On March 23, 1998, the Division issued Order No. 98-100, a Final Order to Deny Application for Securities Salesman License, to Edward Adolph Lewis, a California resident.

The Division had previously issued Order No. 97-345, a Notice of Opportunity for Hearing, to the Respondent. The Order alleged the Respondent was not of "good business repute" as that term is used in Administrative Code Rule 1301:6-3-19(D)(3) and (9) and Revised Code section 1707.19(A) and gave him notice of intent to deny his application for licensure as a salesman of securities. The Respondent did not request an administrative hearing pursuant to Chapter 119 of the

Revised Code upon receiving service of the Order. Therefore, the Division issued its Final Order to Deny Application for Securities Salesman License to the Respondent, incorporating the allegations set forth in the Notice of Opportunity for Hearing as findings.

Kristine Mary Cook

On March 23, 1998, the Division issued Order No. 98-101, a Final Order to Deny Application for Securities Salesman License, to Kristine Mary Cook, a Colorado resident.

The Division had previously issued Order No. 97-247, a Notice of Opportunity for Hearing, to the Respondent. The Order alleged the Respondent was not of "good business repute" as that phrase is used in Administrative Code Rule 1301:6-3-19(D)(3) and (9) and Revised Code section 1707.19(A) and gave the Respondent notice of intent to deny her application for licensure as a salesman of securities. The Respondent did not request an administrative hearing pursuant to Chapter 119 of the Revised Code upon receiving service of the Order. Therefore, the Division issued its Final Order to Deny Application for Securities Salesman License to the Respondent, incorporating the allegations set forth in the Notice of Opportunity for Hearing as findings.

Victor Alan Lessinger

On March 23, 1998, the Division issued Order No. 98-102, a Final Order to Deny Application for Securities Salesman License, to Victor Alan Lessinger, a Florida resident.

The Division had previously issued Order No. 97-257, a Notice of Opportunity for Hearing, to the Respondent. The Order alleged the Respondent was not of "good business repute" as that phrase is used in Administrative Code Rule 1301:6-3-19(D)(2) and (9) and Revised Code 1707.19(A) and gave the Respondent notice of intent to deny his application for licensure as a salesman of securities. The Respondent did not request an administra-

tive hearing pursuant to Chapter 119 of the Revised Code upon receiving service of the Order. Therefore, the Division issued its Final Order to Deny Application for Securities Salesman License to the Respondent, incorporating the allegations set forth in the Notice of Opportunity for Hearing as findings.

Jason Eric Feldman

On March 23, 1998, the Division issued a Final Order to Deny Application for License, Order No. 98-104, to Jason Eric Feldman, a New York resident.

The Division had previously issued Order No. 97-304, a Notice of Opportunity for Hearing, to the Respondent. The Order alleged the Respondent was not of "good business repute" as that term is used in Administrative Code Rule 1301:6-3-19(D)(2),(7) and (9) and Revised Code section 1707.19(A). The Order also gave the Respondent notice of intent to deny his application for licensure as a salesman of securities. The Respondent did not request an administrative hearing regarding the matter pursuant to Chapter 119 of the Revised Code upon receiving service of the Order. Therefore, the Division issued its Final Order to Deny Application for Securities Salesman License to the Respondent, incorporating the allegations set forth in the Notice of Opportunity for Hearing as findings.

Glen Bruce Shane

On March 23, 1998, the Division issued Order No. 98-106, a Final Order to Deny Application for License, to Glen Bruce Shane, a Florida resident.

The Division had previously issued Order No. 98-036, a Notice of Opportunity for Hearing, to the Respondent. The Order alleged the Respondent was not of "good business repute" as that term is used in Administrative Code Rule 1301:6-3-19(D)(7) and (9) and Revised Code section 1707.19(A) and gave the Respondent notice of intent to deny his application for licensure as a salesman of securities. The Respondent did not request an adjudicative hearing regarding the matter pursuant

to Chapter 119 of the Revised Code upon receiving service of the Order. Therefore, the Division issued its Final Order to Deny Application for Securities Salesman License, incorporating the allegations set forth in the Notice of Opportunity for Hearing as findings.

Donald L. Simons

On March 31, 1998, the Division issued Order No. 98-115, a Cease and Desist Order, to Donald L. Simons, an Ohio resident.

The Division had previously issued Order No. 98-054, a Notice of Opportunity for Hearing, to the Respondent. The Order alleged the Respondent had violated R.C. 1707.44(C)(1), selling unregistered securities and advised him of the Division's intent to issue a final Cease and Desist Order. The Respondent failed to timely request an adjudicative hearing pursuant to Chapter 119 of the Revised Code upon being served the Order. Therefore, the Division issued its final Cease and Desist Order No. 98-115 to the Respondent. The Order incorporated the allegations set forth in the Notice of Opportunity for Hearing as findings.

Frank Nicholas Rossani

On April 14, 1998, the Division issued Order No. 98-133, a Final Order to Deny Application for Securities Salesman License, to Frank Nicholas Rossani, a New York resident.

The Division had previously issued Order No. 98-058, a Notice of Opportunity for Hearing, to the Respondent. The Order alleged the Respondent was not of "good business repute" as that term is used in Administrative Code Rule 1301:6-3-19(D)(7) and (9) and Revised Code section 1707.19(A) and gave him notice of intent to deny his application for licensure as a securities salesman. The Respondent failed to request a hearing regarding the matter pursuant to Chapter 119 of the Revised Code upon being served the Order. Therefore, the Division issued its Final Order to Deny Application for Securities Salesman License, incorporating the

allegations set forth in the Notice of Opportunity for Hearing as findings.

Richard Christopher Stoyeck

On April 14, 1998, the Division issued Order No. 98-134, a Final Order to Deny Application for Securities Salesman License, to Richard Christopher Stoyeck, a Connecticut resident.

The Division had previously issued Order No. 98-067, a Notice of Opportunity for Hearing. The Order alleged the Respondent was not of "good business repute" as that term is used in Administrative Code Rule 1301:6-3-19(D)(7) and (9) and R.C. 1707.19(A) and gave him notice of intent to deny his application for licensure as a salesman of securities. The Respondent did not request a hearing regarding the matter pursuant to Chapter 119 of the Revised Code upon receiving service of the Order. Therefore, the Division issued its Final Order to Deny Application for Securities Salesman License, incorporating the allegations set forth in the Notice of Opportunity for Hearing.

Maurice Arthur Gross, Jr.

On April 15, 1998, the Division issued Order No. 98-141, a Final Order to Deny Application for Securities Salesman License, to Maurice Arthur Gross, Jr., a New York resident.

The Division had previously issued Order No. 98-090, a Notice of Opportunity for Hearing, to the Respondent. The Order alleged the Respondent was not of "good business repute" as that term is used in Administrative Code Rule 1301:6-3-19(D)(9) and Revised Code section 1707.19(A) and gave him notice of intent to deny his application for licensure as a salesman of securities. The Respondent did not request a hearing regarding the matter pursuant to Chapter 119 of the Revised Code upon receiving service of the Order. Therefore, the Division issued its Final Order to Deny Application for Securities Salesman License, incorporating the allegations set forth in the Notice of Opportunity for Hearing.

Andrew Paul Bodnar

On April 27, 1998, the Division issued Order No. 98-157, a Final Order Confirming the Suspension of the Right to Sell Securities in the State of Ohio, to Andrew Paul Bodnar, Jr., an Ohio resident.

The Division had previously issued Order No. 98-147, a Suspension of the Right to Sell Securities in the State of Ohio, to the Respondent. The Order alleged Bodner sold promissory notes which were not registered or exempted by Chapter 1707 or its accompanying administrative rules in violation of R.C. 1707.44(C)(1). The Order also ordered that a hearing on the continuation or revocation of the Suspension Order be held. A hearing was held, after which the Division ordered that the suspension on the Respondent's right to buy, sell or deal in promissory notes be confirmed. Therefore, the Division issued its Final Order Confirming the Suspension of the Right to Sell Securities in the State of Ohio.

Sherwin Presley Brown

On May 19, 1998, the Division issued Final Order No. 98-183 to Sherwin Presley Brown, a Minnesota resident, granting him a securities salesman license.

The Division had previously issued Order No. 98-118, a Notice of Opportu-

nity for Hearing, to the Respondent. The Order alleged the Respondent was not of "good business repute" as that phrase is used in Administrative Code Rule 1301:6-3-19(D)(7) and (9) and R.C. 1707.16 and 1707.19. The Respondent was also given notice of intent to deny his application for licensure as a securities salesman. The Respondent timely requested an adjudicative hearing pursuant to Chapter 119 of the Revised Code after receiving service of the Order. The Hearing Officer ruled against the Respondent; the Division disapproved the Hearing Officer's recommendation. Therefore, the Division issued its Final Order granting the Respondent a securities salesman license.

John E. Dhonau; MHM Company, Inc.

On May 22, 1998, the Division issued Order No. 98-195, a Cease and Desist Order to John E. Dhonau and MHM Company, Inc., both of Ohio.

The Division had previously issued Order No. 98-061, Amended, a Notice and Opportunity for Hearing, to the Respondents. The Order alleged the Respondents had violated R.C. 1707.44(C)(1), selling unregistered securities and advised Respondents that the Division intended to issue a final Cease and Desist Order. The Division perfected service of this Order by publication; the Respondents failed to

timely request an adjudicative hearing pursuant to Chapter 119 of the Revised Code. Therefore, the Division issued its final Cease and Desist Order, incorporating the allegations set forth in the Notice of Opportunity of Hearing.

Editor's Note: Enforcement Section Reports of Division Orders issued or finalized for the remainder of the second quarter will be reported in the next Ohio Securities Bulletin. Those wishing further information regarding any of the above enforcement actions may contact the Division and review the Orders summarized above.

Criminal Actions

Robert T. King

On April 29, 1998, Robert T. King was sentenced in the Richland County Common Pleas Court to 18 months each on one count selling unregistered securities and one count unlicensed sales of securities. Additionally, he was sentenced to two years on one count of theft. The sentences were suspended and King was placed on probation for five years. He was also ordered to pay investors \$500 per month plus eight percent interest for the next five years. King, a resident of Dublin, Ohio, was originally indicted on October 7, 1997, as reported in *Ohio Securities Bulletin* 97:4.



Text of Amended and Newly Created Administrative Rules

Certain amendments to the administrative rules of the Ohio Division of Securities became effective on August 10, 1998.

- Ohio Administrative Code 1301:6-1-03 was amended to delete the requirement that public notice for rule promulgation be published in the Ohio State Bar Association Report and in the CCH Blue Sky Reporter.
- Ohio Administrative Code 1301:6-3-041 was created to provide withdrawal rights to shareholders who tender shares in a tender offer that is not subject to the federal Williams Act. The rule will also allow the Division, under certain conditions, to terminate a control bid that has been suspended.
- Ohio Administrative Code 1301:6-3-14 was amended to allow dealers and individuals to provide certain information over the Internet without being licensed in Ohio.

KEY

- New language appears in the UPPERCASE.
- Language to be deleted is ~~lined through~~.
- *** indicates where unamended language has not been reprinted.

1301:6-1-03 Public notice of promulgation of rule.

(C) At least thirty days prior to the date of the hearing, public notice shall be published in the "Ohio Securities Bulletin" or a copy of the public notice shall be mailed to all subscribers of the "Ohio Securities Bulletin." Any person who requests public notice of proposed rules changes of the division shall be made a subscriber of the "Ohio Securities Bulletin." Additionally, public notice ~~shall be submitted to the "Blue Sky Reporter" and the "Ohio State Bar Association Report" for publication~~ MAY BE PUBLISHED ON THE DIVISION'S WEB SITE.

(D) This rule applies to any proposed rule changes affecting Chapters ~~1707., 1708., 1310., and 3949.~~ of the Revised Code.

1301:6-3-041 CONTROL BIDS.

(A) IF AN OFFEROR MAKES A CONTROL BID FOR ANY SECURITIES OF A SUBJECT COMPANY PURSUANT TO A TENDER OFFER OR REQUEST OR INVITATION FOR TENDERS THAT IS NOT SUBJECT TO SECTION 14(d) OF THE SECURITIES EXCHANGE ACT OF 1934, ANY PERSON WHO DEPOSITS SECURITIES PURSUANT TO THE TENDER OFFER, REQUEST OR INVITATION HAS THE RIGHT TO WITHDRAW SUCH SECURITIES DURING THE PERIOD SUCH OFFER, REQUEST OR INVITATION REMAINS OPEN.

(B) THE DIVISION SHALL:

(1) TERMINATE A CONTROL BID FILING MADE PURSUANT TO SECTION 1707.041 OF THE REVISED CODE IF ALL OF THE FOLLOWING CONDITIONS ARE MET:

(a) PURSUANT TO DIVISION (A)(3) OF SECTION 1707.041 OF THE REVISED CODE, THE DIVISION SUSPENDS THE CONTINUATION OF THE CONTROL BID;

(b) PURSUANT TO DIVISION OF (A)(4) OF SECTION 1707.041 OF THE REVISED CODE, THE DIVISION MAINTAINS THE SUSPENSION OF THE CONTROL BID; AND

(c) THE CONTROL BID REMAINS SUSPENDED FOR SIXTY DAYS AFTER THE DATE THE DIVISION MAINTAINS THE SUSPENSION.

(2) GIVE NOTICE OF A TERMINATION TO THE OFFEROR AND TO THE SUBJECT COMPANY.

- (3) PERMIT THE OFFEROR TO REINSTITUTE THE CONTROL BID BY FILING NEW OR AMENDED INFORMATION WITH THE DIVISION PURSUANT TO SECTION 1707.041 OF THE REVISED CODE.

1301:6-3-14 EXCEPTIONS TO ~~Dealer~~ DEALER license and securities and exchange commission registration requirements.

- (A) A dealer's license shall be required of a person who acts as a dealer, as defined in division (E) of section 1707.01 of the Revised Code subject, to the provisions of division (A)(1) of section 1707.14 of the Revised Code, and to the following exceptions:

- (5) WITHOUT A LICENSE, A PERSON MAY DISTRIBUTE INFORMATION ON AVAILABLE PRODUCTS AND SERVICES ON OR THROUGH THE INTERNET OR SIMILAR ELECTRONIC MEDIUM PROVIDED THAT:
- (a) THE DISTRIBUTION OF INFORMATION IS NOT SPECIFICALLY DIRECTED TO ANY PERSON IN THIS STATE;
 - (b) THE DISTRIBUTION OF INFORMATION CONSISTS SOLELY OF THE DISSEMINATION OF GENERAL INFORMATION REGARDING PRODUCTS AND SERVICES;
 - (c) THE DISTRIBUTION OF INFORMATION CONTAINS A LEGEND WHICH CLEARLY STATES THAT:
 - (i) THE PERSON MAY ONLY ACT AS A DEALER OR SALESPERSON IN THIS STATE IF THE PERSON IS FIRST LICENSED BY THE DIVISION OR PROPERLY EXCEPTED FROM LICENSURE; AND
 - (ii) FOLLOW-UP INDIVIDUALIZED RESPONSES BY THE PERSON IN THIS STATE THAT INVOLVE ACTING AS A DEALER OR SALESPERSON WILL NOT BE MADE UNLESS THE PERSON IS FIRST LICENSED BY THE DIVISION OR PROPERLY EXCEPTED FROM LICENSURE;
 - (d) THE DISTRIBUTION OF INFORMATION CONTAINS A MECHANISM, INCLUDING BUT NOT LIMITED TO, A TECHNICAL "FIREWALL" OR OTHER IMPLEMENTED POLICIES AND PROCEDURES, DESIGNED TO REASONABLY ENSURE THAT PRIOR TO ANY DIRECT COMMUNICATION RESULTING FROM THE DISTRIBUTION OF INFORMATION, THE PERSON IS FIRST LICENSED BY THE DIVISION OR PROPERLY EXCEPTED FROM LICENSURE;
 - (e) IN THE CASE OF DISTRIBUTION OF INFORMATION BY A PERSON WHO WOULD QUALIFY AS A "SALESMAN" AS DEFINED IN DIVISION (F) OF SECTION 1707.01 OF THE REVISED CODE, IN ADDITION TO THE FOREGOING:
 - (i) THE DEALER WITH WHOM THE PERSON IS ASSOCIATED IS PROMINENTLY DISCLOSED IN THE DISTRIBUTION OF INFORMATION;
 - (ii) THE DEALER WITH WHOM THE PERSON IS ASSOCIATED RETAINS RESPONSIBILITY FOR REVIEWING AND APPROVING THE CONTENT OF THE DISTRIBUTION OF INFORMATION;
 - (iii) THE DEALER WITH WHOM THE PERSON IS ASSOCIATED FIRST AUTHORIZES THE DISTRIBUTION OF INFORMATION; AND
 - (iv) THE DISTRIBUTION OF INFORMATION IS WITHIN THE SCOPE OF AUTHORITY GRANTED TO THE PERSON BY THE DEALER WITH WHOM THE PERSON IS ASSOCIATED.

THE EXEMPTION GRANTED BY PARAGRAPHS (A)(5)(a) TO (A)(5)(e)(iv) OF THIS RULE PERTAINS SOLELY TO THE DEALER AND SALESPERSON LICENSING REQUIREMENTS OF CHAPTER 1707. OF THE REVISED CODE, AND DOES NOT AFFECT THE APPLICABILITY OF OTHER REQUIREMENTS OR PROHIBITIONS OF CHAPTER 1707. OF THE REVISED CODE.

Capital Formation Statistics
Amounts in Thousands (rounded up)

Filing Type	Second Quarter 1998	YTD 1998
Exemptions		
Form 3(Q) & Form D*	\$592,110	\$1,925,154
Form 3(W)	17,688	39,771
Registrations		
Form .06	207,876	342,004
Form .09	38,845	371,106
Form .091	2,680,059	3,480,367
Investment Companies		
Definite	240,214	341,463
Indefinite**	650 filings	1323 filings
TOTAL	\$4,426,792	\$7,822,865

**Reflects sales actually reported. Remaining categories reflect amount of securities registered or eligible to be sold in Ohio by issuers.*

***Investment companies may seek to sell an indefinite amount of securities by submitting maximum fees. Based on the maximum filing fee of \$1,100, an indefinite filing represents the sale of a minimum of \$1,000,000 worth of securities with no maximum. For purposes of calculating an aggregate capital formation amount, each indefinite filing has been assigned a value of \$1,000,000.*

Because the Division's mission includes enhancing capital formation, the Division tabulates the aggregate dollar amount of securities to be sold in Ohio pursuant to filings made with the Division. As indicated in the notes to the table, the aggregate dollar amount includes a value of \$1,000,000 for each "indefinite" filing. However, the table does not reflect the value of securities sold pursuant to "self-executing exemptions" like the "exchange listed" exemption in R.C. 1707.02(E) and the "limited offering" exemption in R.C. 1707.03(O). None the less, the Division believes that the statistics set out in the table are representative of the amount of capital formation taking place in Ohio.

Registration Statistics

The following table sets forth the number of registration and exemption filings received by the Division during the second quarter of 1998, compared to the number of filings received during the second quarter of 1997. Likewise, the table compares the year-to-date filings for 1997 and 1998.

Filing Type	2Q'98	YTD'98	2Q'97	YTD'97
1707.03(Q)	413*	785	346	660
1707.03(W)	12	30	19	33
1707.04	0	0	0	0
1707.041	0	1	3	5
1707.06	30	69	51	89
1707.09	25	36	263	506
1707.091	93	193	670	1516
Form NF**	1069	2125	91	91
1707.39	3	4	4	12
1707.391	40	67	39	75
Total	1685	3310	1486	2987

*Includes 247 filings submitted on federal Form D for offerings made pursuant to Rule 506 of Regulation D. Use of the federal Form D was not available 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. Usage of the Form NF began in 1997, with its usage increasing throughout the year.

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 1998, compared to the corresponding quarters of 1997 as well as the third and fourth quarters of 1997 compared to the corresponding quarters of 1996.

	End of Q2 1998	End of Q2 1997	End of Q1 1998	End of Q1 1997	End of Q4 1997	End of Q4 1996	End of Q3 1997	End of Q3 1996
Number of Salesmen Licensed:	85,526	82,135	81,210	80,289	83,238	82,498	83,545	83,438
Number of Dealers Licensed:	2,106	2,113	2,082	2,050	2,170	2,060	2,154	2,061

OHIO SECURITIES BULLETIN

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