# Ohio Securities Bulletin

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# Oil and Gas Securities: a Primer


Department of Commerce
Division of Securities



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**Ohio Securities Bulletin**

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## Introduction

The oil and gas industry continues to make headline news. Rapidly fluctuating oil prices, combined with the ever-increasing demand for domestic energy sources, have made national drilling projects more desirable than ever. The Marcellus and Utica Shale natural gas reserves have been the subject of recent drilling activity in Pennsylvania and West Virginia, and oil and gas companies are now focusing their attention on Ohio. All these factors may mark this decade as the beginning of a new oil-rush in our region.

In the early phases of the Utica Shale exploration, energy companies are negotiating with land holders and obtaining leasehold interests in the acres of land covering the deposits. In the months and years to come, companies will begin the process of financing the drilling and operation of these wells. Invariably, this will be accomplished through the issuance and sale of securities.

## Investments in Oil and Gas Wells

The first and most commonly known method of investing in the oil and gas market is by purchasing the stock of an oil and gas company, typically in the secondary market. This is an indirect means of investing in oil or gas, as these securities are an investment in the corporation itself, rather than a direct investment in the wells the company is drilling. Such investments pose the same issues and raise the same concerns as any investment in the stock market.

The second means of investing in the oil and gas market is the direct participation in the oil and gas wells themselves, and it raises unique regulatory concerns. In such an investment, the investor actually purchases a "non-operating working interest" in the wells and receives a share of the income those particular wells generate. A "non-operating working interest" in an oil or gas well - which means that the investor owns an interest in the well but does not have any responsibility for its operations - is deemed a security under the Ohio Securities Act, as well as the Securities Act of 1933. See R.C. 1707.01(B) ("Security" ... includes… interests in or under oil, gas, or mining leases"); 15 U.S.C. 77b(a); Section 2(1) of the Securities Act ("The term 'security' means any …fractional undivided interest in oil, gas, or other mineral rights.") As such, these oil and gas investments are subject to all of the rules and requirements of the Ohio Division of Securities and the Securities and Exchange Commission.

A direct investment in an oil or gas venture is often structured as the sale of a working interest in a particular well. Investors own an actual fractional working interest in the well itself, thereby earning a percentage of the profits derived from that well. Other times, the investment is structured as the participation in a general or limited partnership, a joint venture, or limited

*continued page 2*

liability company. In that arrangement, the business entity owns the working interests in the wells, but the investor contracts for a percentage of those profits. However structured, these investments are generally deemed securities. Like any investment contract, the investor's profit expectations and the passive nature of the investor's role in the business operation indicate the investment should be considered a security rather than a commercial venture. See e.g. *SEC v. Howey Co.*, 328 U.S. 203 (1946) (investment contracts considered securities where there is an investment of money in a common enterprise, with an expectation of profits derived through the efforts of others).

Oil and gas offerings are most commonly sold as part of a drilling program: investor funds are used to finance the drilling of the oil or gas well(s), and investors subsequently earn a portion of the proceeds of the well output once it starts producing. Oil and gas offerings may also be sold as part of a working interest program, where the wells are already drilled and producing and investor funds are used for maintenance and operational expenses. Less frequently, an oil and gas offering might involve a well "rework" program, where drilled but non-producing or under-producing wells are cleaned or repaired in some way as to render them profitable again. It is not uncommon to see multiple types of programs within the same oil and gas offering, i.e. a drilling program that also involves a partial working interest program in existing wells.

Some oil and gas programs may offer certain tax benefits to investors, as the tangible and intangible drilling costs may be deductible. Some offerings are more speculative in nature, such as exploratory drilling programs, which (as the name suggests) drill in areas without known or proven oil and gas reserves. Regardless of form, however, oil and gas offerings are a speculative, higher-risk investment, suitable only for those investors who are well-informed and understand the risks involved.

## Common Problems

The most common regulatory problem seen with oil and gas offerings is the unregistered sale of those securities. Offerings that should be registered with state regulators and the Securities and Exchange Commission simply are not.

More commonly, issuers claim a registration exemption (commonly a Rule 506 Regulation D "safe harbor" exemption) but fail to meet the requirements for such exemption. Past administrative actions in Ohio and other states involve oil and gas offerings that, despite claiming a "private offering" exemption, nevertheless advertise or offer those securities to the public at large. The issuers might advertise the offerings online, thereby destroying any claimed exemption under Reg. D and R.C. 1707.03(X). Or more frequently, issuers might engage in cold-calling campaigns from remote locations or "boiler-rooms" staffed with telemarketers who essentially offer the securities to the public at large.

Occasionally, the oil and gas issuer ruins its safe harbor exemption by using the services of unlicensed own dealers to market and sell the product. This might be committed by the issuer's relationship with its own employees by the payment of sales-based commissions for the sale of the securities. An issuer and its employees are typically exempt from the definition of a "dealer" under R.C. 1707.01(E)(1)(A) (and are thereby exempt from the licensing requirements of R.C. 1707.14), except when they receive commissions or other sales-based remuneration for the sale of securities.

The "boiler-room" tactics utilized by some oil and gas issuers are also ripe for other types of securities violations besides unregistered sales. The term "boiler-room" derives from the "heat" and high-pressure sales tactics used by callers in such operations. Telephone sales personnel are often telemarketers with no securities license and no real knowledge about the security being offered or the needs of the particular investors. They typically read from a prepared script, and pressure individuals into making quick investment decisions. As a result, investors may receive misleading, inadequate, or inaccurate information about the offering.

The high-risk nature of the investment may be minimized, and the investors are never told about the possibility of drilling a dry well or the virtual illiquidity of their investment. Written disclosures such as Private Placement Memoranda are often incomplete, or are not even provided to the investor prior to the purchase of the security. These material misrepresentations and omissions may even arise to the level of securities fraud.

**Conclusion**

While oil and gas private offerings are a higher-risk investment, these risks can be reduced by thorough disclosures and strict adherence to Ohio and federal securities regulations. Potential investors are urged to discuss their investment questions with a trusted, licensed securities professional before making an investment decision. As always, investors are urged to contact the Ohio Division of Securities with any questions about the registration or licensing status of an oil and gas offering and its providers.

## Comments from Commissioner Andrea Seidt

What an exciting and challenging time it is to be a state securities regulator. Assistant Commerce Director Donnell ("Don") Grubbs and I just returned home from the annual Spring Public Policy Conference hosted by the North American Securities Administrators Association (NASAA) in Washington, D.C. As Ohio's Securities Administrator and a member of NASAA's Board of Directors, I also attended the Spring Board Meeting and all-member Business Meeting that led up to the Conference. Don and I enjoyed talking shop with our peers in other states, the Canadian provinces, and the Securities and Exchange Commission (SEC). If you have never attended the NASAA Spring Conference, I really recommend it. It is a great opportunity to meet one-on-one with your federal and state regulators and learn firsthand about their priorities in the coming year.

At the Spring Conference this year, the regulatory buzz shifted from Dodd-Frank to the Jumpstart Our Business Startups (JOBS) Act. From IPO on-ramps to crowdfunding and public advertising in private offerings under Rule 506, the JOBS Act provided no shortage of material to discuss. Be on the lookout for future Bulletin articles on these topics in the coming year. We also expect to feature some of those issues at our own Conference in the Fall.

NASAA Conference speakers and attendees also discussed proposed federal legislation that was recently introduced in Congress, the "Investment Advisor Oversight Act of 2012," which would require all investment advisers, state and federal, to become members of a self-regulatory organization (SRO). The impetus behind the bill is an SEC study acknowledging that it lacks the resources to timely examine federally-registered investment advisers.

Industry participants appear to be split on the issue. Dual broker-dealer investment adviser firms tend to weigh in favor of the bill while financial planners and larger investment adviser-only shops tend to be opposed. The one group that would likely experience the greatest financial impact– small state-registered investment advisers – has been relatively quiet. The Division adheres to a 1-3 year examination cycle for our Ohio investment advisers so it is not clear what value, if any, an SRO would provide our firms for the added expense they would incur to become a member. If you are an Ohio investment adviser or other party impacted by this proposal, please contact us here at the Division to share your perspective on this proposed legislation.

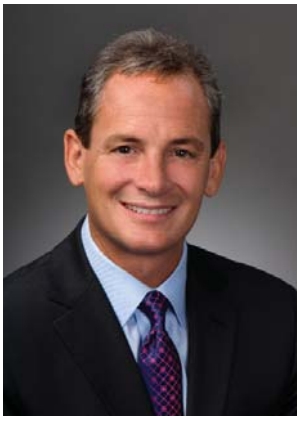
Moving onto the litigation front, the Division has been monitoring two securities cases appealed to the Ohio Supreme Court. The first Ohio Supreme Court case, Goodman v. Mayhew, Case No. 10-2159, was a direct appeal by the Division seeking to overturn a Court of Appeals' ruling that narrowly construed the Division's authority under R.C. 1707.26. The Court of Appeals held that the Division's equitable jurisdiction did not extend to benefactors of securities fraud that were not themselves involved in the fraudulent act or other violation of the Ohio Securities Act. The benefactors in the Mayhew case were beneficiaries of several million dollar life insurance policies that were fraudulently purchased with investor funds. The Supreme Court ruled in the Division's favor on April 12, 2012 on procedural grounds and vacated the Court of Appeals' decision.

The second Ohio Supreme Court case, State v. Willan, Case No. 12-0216, involves cross-appeals by the criminal defendant and prosecuting attorney and covers numerous issues, including various licensing, registration, and enforcement provisions of the Ohio Securities Act. That case has significant implications for Division enforcement here in Ohio and for states securities enforcement across the country. Consequently, the Division was able to solicit amicus curiae support by both the Ohio Attorney General's Office and NASAA in recommending review by the Ohio Supreme Court. Unfortunately on May 23rd, the Supreme Court declined to accept jurisdiction and the appeal has been dismissed. More detailed information on the Willan case will be provided in the next Bulletin.

Finally, the 2012 Ohio Securities Conference and Advisory Committee meetings will be held on October 12. Due to the overwhelming interest in last year's conference, this year's event is being held at a larger location to accommodate even more attendees. Additional details and brochures will be mailed out this summer. As in years past, we are looking forward to joining our partners at The University of Toledo College of Law in sponsoring the conference. I welcome your suggestions on ways to improve our conference, including any ideas you may have for a panel discussion.

Andrea Seidt, Commissioner
Division of Securities

## Message from Commerce Director David Goodman:



Dear Securities Professional:

The Division of Securities works diligently to ensure that businesses can raise capital to invest in their communities while balancing investor protections through consistent application of the Ohio Securities Act.

In this issue, we provide a review of the administrative hearing process to assist legal counsel when representing a client in a Division of Securities administrative case. We also provide brief summaries of several statutory changes. Our featured article looks down the road at the future of shale oil and gas exploration in Ohio. While oil and gas exploration has been going on in Ohio since the early 1800s, new technology is making the industry viable in Ohio and surrounding states. Our article looks at issues surrounding the sale of securities to finance the drilling and operation of these wells. Governor John R. Kasich is committed to ensure the shale oil and gas industry is bringing jobs to Ohio and contributing to the energy needs of the region and the nation under the safest possible conditions. One important component of this balanced success is to get out-of-state oil and gas producers to pay their fair share of taxes.

Ohio's oil & gas taxes are among the lowest in the nation. The state's 40-year-old oil and gas tax system is outdated. For example, there is no tax on natural gas liquids. Even with an increase, tax on production will still be among the lowest of oil and gas states. Just as Ohio is updating its environmental, health and safety regulations to keep pace with new technologies for the high-volume horizontal oil and gas wells, the tax policies associated with this industry must also be updated.

The benefit should be passed on to all Ohioans, who pay higher income taxes than two-thirds of the rest of the country. This tax cut would be particularly beneficial to the 75% of small businesses that file business taxes through their personal tax return. The Governor's plan to pass on new revenue from oil and gas taxes directly to small businesses and taxpayers puts money in Ohioans' pockets which will further fuel Ohio's economy.

I hope you enjoy this issue of the Ohio Securities Bulletin. If you need assistance on any issue involving the Division of Securities, don't hesitate to call on us to guide you so that you can operate lawfully, businesses can succeed as job creators, and Ohioans can meet their financial goals.

David Goodman
Director,
Ohio Department of Commerce

### Settle Delinquent Ohio Taxes at the Lowest Possible Cost

The Ohio Department of Taxation is offering Ohio taxpayers a chance to catch up on unpaid or underreported taxes at the lowest possible cost. The Ohio General Tax Amnesty Program is available May 1 to June 15, 2012 and covers a broad range of taxes, including personal income, estate, sales, various excise, and school district income taxes. The Ohio Department of Taxation is authorized to waive all penalties and half of the accrued interest on taxes that were due and payable prior to May 1, 2011 and that have not been subject to an assessment or audit. To apply or find out more about the program, please visit **OhioTaxAmnesty.gov** or call **1-800-304-3211**.

The Ohio Securities Bulletin is a quarterly publication of the Ohio Department of Commerce, Division of Securities.

The Division encourages members of the securities community to submit for publication articles on timely or timeless issues pertaining to securities law and regulation in Ohio. If you are interested in submitting an article, contact Karen Bowman at karen.bowman@com.state.oh.us for editorial guidelines and publication deadlines. The Division reserves the right to edit articles submitted for publication.



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## Advisory Committee Updates

Several issues that dominated discussions during last year's Advisory Committee meetings are now moving forward.

As members of the Registration Section's Advisory Committee may recall, the Division discussed a potential registration filing fee waiver for certain small business offerings. The General Assembly is currently considering that proposal as part of Governor Kasich's Mid-Biennial Review. The legislation would eliminate the registration filing fees for certain small business offerings up to $50,000.

The Registration Advisory Committee also discussed the prospect of a streamlined state crowdfunding registration as another way of easing regulatory requirements for small issuers in our state. Since then, Congress enacted a new federal crowdfunding exemption in the JOBS Act. The JOBS Act preempts state registration of crowdfunding filings and calls upon the SEC to implement rules over the next nine months that will spell out the do's and don'ts for this new form of online investing.

The Licensing Section's Advisory Committee continued discussions of the Dodd-Frank investment adviser switch that was originally slated for last July. The switch is now underway. SEC-registered firms that are currently notice-filed with us but manage less than $100 million in client assets are switching to full state registration now through June 28, 2012.

A focal point emanating from all Advisory Committee meetings was the Division's desire to more effectively balance its capital formation and investor protection mandates in ways that promote yet protect small business in the state. To that end, the Division continues to solicit feedback in support of the larger state-wide Common Sense Initiative instituted by Lieutenant Governor Mary Taylor. Please do not hesitate to contact any of the Division Chiefs or Commissioner Seidt if you have a suggestion on ways to improve Ohio securities regulation.

## Division of Securities Welcomes New Staff Members

The Division of Securities has welcomed new staff members, including four new attorneys. These new staff members enhance the Division's experienced, knowledge-able and professional team and improve the speed in which the Division responds to licensing, registration and compliance issues.

In Registration, the Division recruited practitioner Frank Esposito to serve as Control Bid Attorney to review any takeover filings that might occur here in Ohio. He will partner with Registration Section Chief Counsel Mark Heuerman in leading registration review and policy for all filings submitted to the Division. Frank joins the Division from the Squire Sanders law firm where he enjoyed an extensive securities practice.

In Licensing, new Compliance Counsel, Anne Marie Christ, boasts significant transactional experience from her time with the Roderick, Linton, Belfance LLP firm in Akron, Ohio. Anne Marie devoted a significant portion of her practice to oil and gas deals, which has expanded the Division's wealth of knowledge in the emerging Ohio shale industry.

In Enforcement, the Division welcomed two new Enforcement Attorneys. Brian Peters joined the Division from the Ohio Attorney General's Office and Roger Patrick had recently worked at the Ohio Department of Corrections. Both attorneys have hit the ground running tackling their share of the Enforcement Section's growing caseload.

The Division also hired key administrative support staff. Ryan Rodgers is the new office assistant in Administration and Jacqueline Raglin is the new Registration clerk. They are working at the speed of business to serve you.

The Division is very thankful for the support of David Goodman, Director of the Ohio Department of Commerce, and his senior staff for their support in hiring these talented and dedicated employees.

Please feel free to arrange a visit to the Division to meet these new staff members in person.

**Mark Your Calendar!**

**Date has been set**

**2012 Ohio Securities Conference**

**October 12, 2012**

# Administrative Hearings Pursuant to Ohio Revised Code Chapter 119

The Division of Securities (the "Division") investigates alleged violations of the Ohio Securities Act through its Enforcement Section and if a violation is suspected, proceeds against the persons involved. That proceeding may be either through the criminal or civil courts or through an administrative action. The latter, an administrative hearing pursuant to Revised Code ("R.C.") Chapter 119 (a "119 Hearing"), is offered to afford the Respondent (the subject of the Division's action) in a Division action to be heard and to challenge the Division's allegations.

The majority of administrative actions by the Division take the form of Cease and Desist orders against violators of the Ohio Securities Act and disciplinary actions against licensees. 119 Hearings are afforded to determine whether a proposed Cease and Desist order should be issued, or whether a proposed denial, suspension, or revocation of a dealer or salesperson license should be imposed.

Even experienced trial counsel sometimes are unclear regarding what to expect in administrative hearings before the Division. Part of that uncertainty results from the Ohio Administrative Procedure Act, R.C. Chapter 119 itself, which only generally describes the hearing an agency must provide. The specific mechanics are left to the individual agencies, who may employ somewhat different procedures. In addition, different Hearing Officers (the administrative law judges) may vary procedures even within the same agency.

**Notice of Opportunity for Hearing**

The Division's hearing process begins with an administrative order, pursuant to R.C. 119.07. This is analogous to a complaint by the Division and is captioned "Notice of Opportunity for Hearing" (the "Notice"). The Notice will contain the Division's allegations, and it will end with a statement indicating the Respondent (the subject of the Division's action) is entitled to a hearing if requested within 30 days from the date the Notice was mailed. That request must be received by the Division by the 30th calendar day.

If a hearing request is not submitted within 30 days, Section 119.07 permits the Division to issue a final Order. Failure to exhaust administrative remedies may cause dismissal of any appeal of that order.

Where the Division seeks the license revocation against a dealer, salesperson, investment adviser or investment adviser representative, however, a final Order will not be issued without a hearing. This is due to the language of R.C. 1707.19 and the holding in *Goldman v. State Med. Bd.* (1996), 110 Ohio App.3d 124. If a licensee fails to timely request a hearing for a noticed license revocation, the Division will proceed with a *Goldman*–style evidentiary hearing. This hearing is not conducted pursuant to Rule 119, and although the Respondent may attend the hearing he or she will not be permitted to introduce any evidence or participate in his or her defense.

If the Respondent submits a request for a 119 Hearing within the 30-day period, the Division will immediately respond in writing and set a hearing date, time and place. The hearing will almost always be held at the Division's office in Columbus. R.C. 119.07 requires the hearing to be set for a date between seven and 15 days after the party requests it. Since the Division recognizes that the statutory time frame is usually inadequate for the Respondent to prepare for the hearing, the Division may use the authority contained in R.C. 119.09 to initially continue the hearing to a date beyond the 15-day period. R.C. 119.09 gives the Division the authority to continue the hearing on the motion.

**Appointment of Hearing Officer**

The hearing date is established, the Division will appoint a Hearing Officer who will immediately assume control of the administrative hearing process. The Hearing Officer should be contacted if the Respondent desires to have subpoenas (or subpoenas duces tecum) issued pursuant to R.C. 119.09. Names and addresses of those to be subpoenaed must be provided at least two weeks before the hearing. Motions, including motions for continuance, will also be ruled on by the Hearing Officer.

The Attorney General's Office represents the Division in 119 Hearings and will become involved shortly after the request for the hearing is received.

Any substantive litigation issues should be addressed to the Hearing Officer or the Assistant Attorney General representing the Division. Procedural questions of a general nature may be directed to the Hearing Officer or the Enforcement staff person handling the case.

The Respondent may appear with or without counsel, or present his/her position in writing. R.C. 119.07 and 119.13 provide that a party may be represented by an attorney or by such other representative as is lawfully permitted to practice before the agency. However, only an attorney may represent a party or an affected person at a hearing at which a record is taken which may be the basis of an appeal to court. R.C. 119.13. Furthermore, corporations must always be represented by counsel. *Bd. of Educ. of Worthington v. Bd. of Revision* (1999), 85 Ohio St. 3d 156.

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**Out-of-State Attorneys**
Out-of-state attorneys seeking to practice in Ohio, including appearing at Division hearings, are required to follow the pro hac vice requirements of the Supreme Court. Beginning Jan. 1, 2011, out-of-state attorneys seeking permission to appear *pro hac vice* in an Ohio proceeding must first register with the Supreme Court Office of Attorney Services.

After an out-of-state attorney completes the registration requirements and receives a Certificate of *Pro Hac Vice* Registration, the attorney must file a Motion for Permission to Appear *Pro Hac Vice* with the Division by serving a copy of to the Hearing Officer and Assistant Attorney General of record.

If the out-of-state attorney receives permission to appear *pro hac vice* in an Ohio proceeding, the attorney must notify the Office of Attorney Services. Counsel should keep in mind the time necessary to complete these steps.

**The Administrative Hearing**
The 119 Hearing is adjudicative and adversarial in nature and will be conducted in a manner similar to any trial-level adjudication. In opening and closing statements, and presenting the case-in-chief, the Division will precede the Respondent. Witnesses will testify under oath and the opportunity for cross-examination will be provided. Regardless of whether the Respondent testifies on his or her own behalf, the Division may, nevertheless, require that party to testify as if upon cross examination (R.C. 119.09; 1960 OAG 1573). At his or her discretion, the Hearing Officer may keep the record open long enough to allow closing arguments to be made in writing, rather than, or in conjunction with, oral closing arguments. If counsel wishes to coordinate such a written closing argument with the availability of the hearing transcript, counsel must make a request to the Hearing Officer at the time of the ruling on written closing arguments.

The most conspicuous difference between the Division's 119 Hearings and judicial proceedings is that all the parties are typically seated around one table. Counsel will notice that an important substantive difference between the administrative hearing and a judicial proceeding is the application of evidentiary rules. The Rules of Evidence are not as strictly construed in the administrative hearings as in a judicial proceeding. For example, the admission of hearsay testimony maybe allowed in the hearing. However, the rules of evidence are generally followed as a guideline to admissibility. Evidence, when admitted, will be accorded the weight the Hearing Officer deems appropriate. The Hearing Officer will rule on the admissibility of evidence and any evidence not admitted may be proffered into the record. R.C. 119.09.

Pursuant to R.C. 119.07, a record of the hearing will be made. The Division uses court reporters who prepare a written transcript of the proceedings. If the Respondent desires a copy of the transcript he or she may request it of the court reporter directly at the reporter's usual fee.

**Hearing Officer's Report**
After the close of the hearing, the Hearing Officer will prepare a written report setting forth findings of fact, conclusions of law, and a recommendation. R.C. 119.09. Within five days of the submission of the report and recommendation to the Division, the report and recommendation shall be served upon the Respondent or counsel. Within 10 days of the Respondent's receipt of the Hearing Officer's report, the Respondent may file with the Division any written objections to the report and recommendation.

The Commissioner of Securities, after that 10-day period, will then rule to accept, reject, or modify the report and recommendation, taking into account any objections by the Respondent. Reasonable requests for extensions of time to file objections will be allowed at the discretion of the Commissioner. The Commissioner's decision, as set forth in the final Division Order, will be served on the Respondent with a copy sent to the Respondent's attorney. Pursuant to R.C. 119.12, the final Division Order may be appealed to common pleas court. The Respondent must appeal within 15 days after the certified mailing of the Division's final Order.

There are specific procedures which must be followed to perfect the appeal and it is recommended that those procedures be reviewed carefully.

This article serves as a basic description of the 119 Hearing process as it is applied by the Division. It is not intended to replace a thorough examination of R.C. Chapter 119 and relevant case law, nor does the Division represent that the procedures described are immutable. However, when read in conjunction with the applicable statutes, it should provide a sufficient description of the hearing process to allow counsel to focus on the substantive issues when preparing for an administrative hearing before the Division of Securities.

## Criminal Updates

**Perrin Burse // The Burse Investment Management Group**

On March 12, 2010, a Hamilton County Grand Jury returned an indictment against Perrin Burse, from Cincinnati, Ohio charging him with 10 counts of theft, including one count of theft from the elderly or disabled. Burse sold at least one investment contract from 2006, which was signed by Perrin F. Burse, President of The Burse Investment Management Group. Burse was last licensed with the Division in November 2001.

On April 11, 2011 after a two-day trial, the jury returned a conviction against Burse on all 10 counts of theft, which included two counts of theft from an elderly or disabled adult. On April 28, 2011, Perrin Burse was sentenced to eight years in prison and ordered to pay restitution of $161,000.

**Mark G. Kirchoff // Kirchoff & Associates Financial Services, LLC**

On September 21, 2010 upon referral from the Division, Mark G. Kirchoff was indicted in the Clermont County Common Pleas Court, on 21 counts involving securities fraud, theft from the elderly, and engaging in a pattern of corrupt activity. Kirchoff was the owner and operator of several businesses located in and around Cincinnati, Ohio, including Kirchoff & Associates Financial Services, LLC, G.K. Insurance & Financial Services Ltd., Legacy Insurance & Financial, Ltd. and Kirchoff & Associates Financial Services, LLC.

The Division investigation revealed that Kirchoff solicited funds in excess of $250,000 from 10 elderly victims residing in Ohio, Indiana and Kentucky for investment in fraudulent securities. On November 4, 2010, 4, 2010, Kirchoff pleaded guilty to 10 counts of theft from the elderly and one count of securities fraud. On November 22, 2010, Judge W. Kenneth Zuk sentenced Kirchoff to 15 years in prison and ordered him to pay restitution in the amount of $219,875.00 to his victims. On September 19, 2011, the Twelfth Appellate District Court upheld Kirchoff's conviction. See *State v. Kirchoff*, 2011-Ohio-4718.

**Melvin Wilder // Wilder and Associates**

On July 14, 2010, after a referral from the Division to the Franklin County Prosecutor, a Franklin County grand jury indicted Melvin Wilder of Columbus with 12 felony counts, including three counts of selling unregistered securities, three counts of securities fraud, and six counts of making false reports of transactions in securities. Wilder was the owner of Wilder & Associates, a tax preparation business in Worthington. Mr. Wilder was not licensed by the Division of Securities.

Wilder sold $30,000 in securities to a former Ohio resident who had subsequently moved to Michigan. Wilder did not disclose his prior felony conviction for collecting and failing to remit withholding taxes and that the company was no longer in business to the investor.

On March 29, 2011, Wilder pleaded guilty to five counts in exchange for a dismissal of the remaining seven counts contained in the indictment. On May 18, 2011, Melvin Wilder was sentenced to five years of community control and ordered to pay restitution in the amount of $73,000.

**Joanne C. Schneider, et. al.**

On March 12, 2009 after referral from the Division and a subsequent criminal indictment, Joanne Schneider entered a guilty plea to 13 counts (including one count of engaging in a pattern of corrupt activity) and was given a sentence of three years.

Based on Ohio Revised Code sentencing guidelines which impose a 10-year mandatory minimum sentence for violations of the Ohio corrupt activity statute where the predicate offense is a felony of the first degree, the Cuyahoga County Prosecutor's Office filed a Motion to Vacate Sentence on April 8, 2009. The State also filed an appeal on April 10, 2009 seeking the reversal of the erroneous sentence. On May 13, 2010, the Court of Appeals for the Eighth Appellate District issued a decision upholding Schneider's conviction, but reversing and remanding the case back to the lower court for re-sentencing in lieu of the statutory minimum.

Subsequently, on August 26, 2010, Schneider filed a motion for leave to withdraw her guilty plea and a motion for bond in the criminal case. Judge Shirley Strickland-Saffold denied Schneider's motion to withdraw her plea and immediately re-sentenced her to 10 years incarceration. Schneider appealed this denial of her motion to withdraw her plea, and on August 18, 2011, the Appellate Court for the Eighth District of Ohio reversed Schneider's conviction and 10-year sentence, vacated her plea, and remanded the matter back to the trial court. The trial is currently pending.

**Michael A. Cox**

On September 9, 2010 after a referral from the Division, Michael A. Cox of Powell was indicted by a Franklin County grand jury on three counts

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of securities fraud and two counts of felony theft and filed as Case Number 10 CR 005269 in the Court of Common Pleas for Franklin County, Ohio. Cox owned The Mac Agency, LLC, located in Dublin, Ohio. On February 23, 2012, Cox pled guilty to one count of publishing a false statement in a securities transaction, a felony of the third degree. He was sentenced on April 27, 2012 to three years in prison and five years of community control.

**Isaac J. Castile, III**

On July 21, 2011, after a referral from the Division, Isaac J. Castile III of Columbus was indicted by a Franklin County Grand Jury and charged with nine counts of securities violations and three counts of theft. The indictment is filed under Case number 11 CR 003857 in the Court of Common Pleas for Franklin County, Ohio. The indictment alleges that Castille misappropriated approximately $275,000 in funds invested by three Ohio investors. Of the 12 counts, six are first-degree felonies, and six are third-degree felonies. The trial is scheduled to begin June 12, 2012.

## Noteworthy Administrative Orders

On January 6, 2011, the Division filed a Cease and Desist Order with Consent against **American Benefit Concepts, Inc.** ("ABC") and its President, **Jason E. Juberg** under Order No. 11-004. American Benefit Concepts, Inc. is an insurance company located in Portage, Michigan. During the period of April 2007 through March 2008, ABC and Juberg solicited sales of Secured Investment Notes issued by Diversified Lending Group, Inc., ("DLG"), based in Los Angeles, California. Neither ABC nor their affiliated insurance agents were licensed by the Division to sell securities in Ohio. In related actions, the Division issued Cease and Desist Orders against the seven insurance agents in late 2010.

On February 8, 2011, the Division entered Cease and Desist Order No. 11-010 against **Lochlainn Ohaimhirgin** whose principal place of business was in Highland Heights, Ohio. The Division found that Mr. Ohaimhirgin acted as an investment adviser without holding an active license with the Division.

On May 2, 2011, the Division entered a Cease and Desist Order with Consent under Order Number 11-022 against **IL Bridge Fund, LLC** and **Angelo M. Sferrazza.** IL Bridge Fund, LLC is located in Cincinnati, Ohio. The Division found that Sferrazza, through IL Bridge Fund, LLC, sold unregistered and unsecured investment demand notes and unsecured investment promissory notes which provided for interest rate returns of 12% or 15%. The Kentucky Department of Financial Institutions had previously entered a Stop Order Suspending the Sale of Securities against IL Bridge Fund, LLC in Case No. 2010-AH-033 on May 4, 2010. By consent and agreement, the Cease and Desist Order issues a lifetime ban against IL Bridge Fund, LLC and Angelo Sferrazza from selling any securities within or from the State of Ohio.

On May 19, 2011, the Division entered a Suspension and Cease and Desist Order with Consent No. 11-025 against **Jeffrey G. Best** whose principal place of business was Principled Investment Capital, LLC located in Westerville, Ohio. Mr. Best sold unregistered securities to at least 13 individuals in Ohio and Nevada. The securities were sold as promissory notes to Principled Investment Capital, LLC as a conduit for Natural Hospice. The note provided for a 35% return on the initial investment. Mr. Best did not disclose to investors that he was compensated in excess of $60,000 by Natural Hospice. Mr. Best consented to a finding by the Division that he had conducted fraudulent business and had acted unconscionably in selling securities. The Order suspended Mr. Best from the securities investment business for 14 days and further required him to cease and desist from further violations of Ohio securities law.

On July 28, 2011, the Division entered Cease and Desist Order No. 11-034 against **Curtis Allen Boggs** and **Cincinnati Grand Prix, Inc.** whose principal place of business was located in Cincinnati, Ohio. Mr. Boggs sold shares of preferred stock in Cincinnati Grand Prix, a new venture developed by Boggs. In order to induce investors to purchase the stock, Boggs made material misrepresentations to several investors, including misrepresentations that investments would be secured by gold bullion and that the Mayor of Cincinnati was a supporter and investor in the project. Boggs sold these securities to at least five individuals residing in Ohio for a total amount in excess of $325,000.

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## Get Monthly Enforcement Reports via e-mail

Would you like to receive our releases distributed on a monthly basis on the Division of Securities' criminal cases and Division orders?

You can do so by sending your e-mail address to:

karen.bowman@com.state.oh.us

While we will still be reporting the quarterly updates in our Bulletin, this is an opportunity to receive the information in a more timely fashion.

On September 29, 2011, the Division issued Cease and Desist Order No. 11-039 against **David B. Zuppan**, whose principal place of business was located in Warren, Ohio. The Division found that Zuppan conducted business under the name of Columbia Polymers, Inc. ("CPI") and Hydrolock Basements, Inc. to market a hydrolock system to prevent water intrusion into basements. The Division further found that Zuppan received funds from investors in exchange for investments in CPI but did not inform the investors that their funds would be used to purchase salon services for his wife, a wedding gift to his niece, college tuition for his daughter as well as payment for his personal tax debt to the IRS. The offering was never registered with the Division.

On October 19, 2011, the Division issued Cease and Desist Order No. 11-040 against **John P. Tonelli, Jr.**, whose principal place of business is located in Batavia, Ohio. The Division found that Tonelli, operating as Rapid Cash Flow Solutions, solicited and received $230,000 from insurance proceeds received by victims of Hurricane Katrina to invest in the ASM Financial Funding's Wealth Enhancement Club, a purported Joint Venture program of ASM Financial Funding Corporation. Tonelli told the investors that their investment was safe, not at risk, and he would pay returns between 10% and 20%. The investors have not been repaid principal or interest.

On October 19, 2011, the Division issued Cease and Desist Order No. 11-041, against and with consent from **Ohio Kentucky Oil Corporation** ("OKOC"), whose principal place of business is located in Lexington, Kentucky. The Division found that OKOC paid a commission to an unlicensed dealer based on a sale of a security to an Ohio resident, in contradiction to statements made in the Form D filed with the Division.

On October 28, 2011, the Division issued Cease and Desist Order No. 11-042 against **Universal Property Development and Acquisition Corporation aka Procore Group, Inc.** ("Universal Property") whose principal places of business were located in Juno Beach, Florida and University Heights, Ohio. The Division found Procore Group, Inc. sold securities to an Ohio resident that were neither registered or exempt from registration requirements.

On November 28, 2011, the Division issued a consent Cease and Desist Order, Order No. 11-046, against **Kevin Paul O'Brien, O'Brien Private Wealth Management,** and **O'Brien PWN, LLC**, whose principal place of business was located in Cincinnati, Ohio. The Division found that O'Brien was terminated from his employment with a licensed broker-dealer when he entered into 17 client agreement contracts whereby his clients executed 31 power of attorney forms authorizing O'Brien to access trade information and execute trades on behalf of these clients in exchange for compensation. During the relevant time period, O'Brien did not hold an active license with the Division of Securities. Through the Consent Agreement, O'Brien offered a refund of the fees earned for his unlicensed activity to each client.

On December 5, 2011, the Division entered Order No. 11-048 suspending the securities salesperson license of **David Trende** for a period of three months from December 5, 2011 through March 5, 2011. Trende entered a consent to the suspension, which ran concurrent with a suspension issued by FINRA based on the same conduct. The Division based its findings on FINRA's determination that Trende had falsified Federal Reserve forms for use by his clients and submitted those false forms to his employer.

On January 6, 2012, the Division entered Order No. 12-001 against and with the consent of **Valhalla Investment Advisory, Inc.** "Valhalla", whose principal place of business is located in Cincinnati, Ohio. The Division found that Valhalla did not properly maintain and supply financial records as required by O.A.C. 1301:6-3-15.1(E) et. seq. Through the Consent Agreement, Valhalla agreed to complete and submit to the Division complete audited financials on the tax basis of accounting for the years 2011, 2012 and 2013. Valhalla further agreed to provide notice to clients that their 2010 financial statements showed liabilities exceed assets.

On February 14, 2012, the Division entered Cease and Desist Order No. 12-005 against and with the consent of **Christopher Rupe** and **Brush Creek Capital Management, Inc.**, whose principal place of business is located in Loveland, Ohio. The Division found that, prior to receiving a license from the Division to act as an investment adviser, Rupe provided investment advice to 10 clients in exchange for compensation. Through the Consent Agreement, Rupe agreed to offer a refund to each of clients who paid investment advisor fees to Rupe during the period that he was unlicensed.

## Statute and Rule Update

In response to House Bill 86 and 153, as well as changes in the federal arena, three provisions of the Ohio Securities Act, Revised Code Chapter 1707 et seq., were modified. A Division licensing rule also received an update. The changes to the affected provisions, R.C. 1707.11, R.C. 1707.17(D), R.C. 1707.99, and O.A.C. 1301:3-6-16, are as follows:

- **R.C. 1707.11 - Consent to Service of Process No Longer Required for Rule 506 Filings**

House Bill 153, better known simply as "the Budget Bill," revised R.C. section 1707.11 so that the Form U-2 or Form 11 consent to service of process forms are no longer required to be submitted to the Division in conjunction with federal Regulation D Rule 506 offerings filed pursuant to R.C. section 1707.03(X). A consent to service of process form must still be submitted to the Division for other federal exemptions claimed under R.C. sections 1707.03(Q), 1707.03(W), and 1707.03(Y).

This statutory change became effective September 29, 2011. A Division rule at O.A.C. section 1301:6-3-03(G), which still refers to 1707.03(X) as among those sections for which a consent to service of process is required, will be revised to correspond with R.C. section 1707.11 in the next rule amendment enacted by the Division.

- **R.C. 1707.17(D) - Division to Waive Double Fee for "Switching" Advisers**

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires certain investment adviser firms having between $25 million and $100 million of assets under management (known as "mid-sized advisers") to "switch" from U.S. Securities and Exchange Commission ("SEC") regulation to state regulation.

As a complement to its other initiatives in assisting "switching" firms through this time of transition, the Division proposed a statutory change that would give it the ability to waive duplicate licensing fees for these firms. The double fee scenario occurs when an SEC-registered adviser pays the Division both a Notice Filing fee and a state registration fee.

This statutory change became effective September 28, 2011. Please contact Anne Followell, Licensing Chief, anne.followell@com.state.oh.us or 614-728-2840 with any questions.

- **R.C. 1707.99 - Increased Threshold Amounts for Securities Felonies**

The amendments contained within HB 86 included a change in the threshold amounts and potential fines for criminal violations of R.C. 1707 specifically set forth in R.C. 1707.99. This bill also provided increased threshold amounts for theft as set forth in R.C. 2913.02. Effective September 30, 2011, the new threshold amounts for criminal violations of Ohio securities law are in the table to the right.

| Value of Funds/ Loss to Victim | Felony Level | Maximum Fine |
|---|---|---|
| Less than $1,000 | F5 | $2,000 |
| $1,000 to $7,499 | F4 | $5,000 |
| $7,500 to $37,499 | F3 | $10,000 |
| $37,500 to $149,999 | F2 | $15,000 |
| $150,000 or more | F1 | $20,000 |

- **Oh. Adm. Code 1301:6-3-16 – Series 79**

Financial Industry Regulatory Authority's (FINRA) limited examination "Series 79, Investment Banking Representative" has been added as one of the examinations that the Division will consider for purposes of determining if an applicant satisfies the minimum qualifications for a securities salesperson license. In addition, the Division proposed amendments to Rule 16(A)(2) in order to make minor formatting changes (e.g. capital letters to lowercase; improper use of quotation marks, etc.). The modified rule became effective January 11, 2012.

***Watch for the next Ohio Securities Bulletin to be distributed June 25, 2012***