

# ohio securities bulletin

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## COMMENTS OF THE COMMISSIONER

1. *Regulatory Philosophy:* It is essential that an administrator establish, as a foundation for his agency's entire regulatory program, a definite point of view toward the basic posture his agency should assume vis-a-vis the industries and activities being regulated by it. Irrespective of the political affiliations of those persons responsible for setting policy, the regulatory philosophy of an agency should reflect an understanding of the basic purposes for enactment of the legislation which it implements and an assessment of the degree of success or failure of the various self-regulatory mechanisms contained within the respective industries in eliminating the abuses against which the agency is charged with protecting the public.

Quite often, administrators make the mistake of proceeding either on the assumption that an industry as a whole is virtuous and that no problems exist to be confronted, with the result that no meaningful regulation is pursued at all, or on the assumption that an industry is corrupt and that no one is to be trusted, with the result that all communication ceases and widespread resistance makes effective regulation impossible. In most regulatory situations, the subject industries are composed of both individuals and organizations which initiate or adopt the best of practices and those which initiate or adopt the worst. Those which follow good practices are generally interested to some extent in eliminating bad practices as a matter of self-interest. On the other hand, self-regulatory mechanisms set up by industry leaders or associations are often ineffective unless sufficient pressure is applied to the industry by government authorities to generate a meaningful response on a continuous basis.

If rather than dissipating its energies without direction throughout an entire industry, an agency focuses its regulatory activities upon publicly exposing and vigorously at-

tacking specific real abuses perpetrated by industry stragglers, and if at the same time the best elements of the industry are, from a proper distance, encouraged and importuned to mobilize their forces to implement higher industry standards and to give sufficient priority to compliance, then the impact of governmental efforts can be effectively magnified to produce results far beyond the capacity of the agency acting alone within the limitations of its own resources. This principle of regulatory leverage can be considered a keystone of the present regulatory philosophy of the Division of Securities.

During the past, neither of the two basic elements of this approach to regulation has been utilized to sufficient advantage. With respect to all of the industries regulated by the Division, vigorous attacks upon abuses have been for the most part either non-existent or insufficiently focused and the responsiveness of the leading elements of those industries has seldom been productively invoked. It will be the objective of the Division in the future to apply its energies to the simultaneous expansion of both of these avenues of approach and to thereby provide the kind of chain reaction which will hopefully assure the effective implementation of the regulatory standards being developed by this agency.

Recent experience of the Division with increased regulatory activity in the credit union and interstate land sales industries has indicated that real progress can be achieved by active and responsible regulation. Greg Seeley, the administrative staff attorney of the Division, has been acting as the *Jeb Stuart* of this agency in leading the attack upon abuses in selected areas. The Division has not and will not under any circumstances allow any situations to be contrived in order to trigger an industry response. Responsible industry representatives have acknowledged the existence of real abuses in the areas in which the Division has taken action to date and have expressed their willingness to help in future efforts to promote reform.

2. *Line and Staff Organization:* All effective organizations require the performance of both line and staff functions in order to both satisfactorily maintain current operations and make adequate plans for future changes. Organizations which are large enough to separate these functions find it more effective to concentrate responsibility for staff activities in persons whose attention is not subject to the distracting demands of day-to-day supervisory duties so that planning and development can be emphasized and not continually postponed.

Because the Division's greatest historic shortcomings have been the failure to develop regulatory standards and an efficient manner of implementing them, the administrative staff of the Division was created to devote its exclusive attention to (1) the development and publication of regulatory standards for all areas of Division regulation, (2) the leading of initial assaults upon abuses which have gone unchecked in areas where regulatory policy is being crystallized, and (3) the establishment and supervision of a system for uniform application of proper administrative practices in connection with increased regulatory activities.

Wherever line and staff organizations exist side by side, the potential for confusion and friction exists, and precautions must be taken to minimize this problem. In government, these difficulties are aggravated by the fact that line people tend to be experienced people who may have seen changes in policy come and go with very little long-term impact upon the organization, people with no particular personal loyalty to the head of the organization or affinity toward his program and with no particular incentive to bring about change, while staff people tend to be people who believe in a specific program and are attracted by the challenge of achieving immediate objectives in the form of changes from established policy or procedure.

Governmental organizations are particularly successful in frustrating new administrative programs because of the high rate of turnover of administrators and the resulting changes in objectives and because of the ability of people to wait out an administration which is attempting to get an agency moving. This fact results in a tendency among administrators to rely too heavily upon staff people to get something done. This phenomenon is unfortunate but, to some extent, it is a necessary fact of life. It is my intention that the Division *will* get something done in the way of change even if people who resist must be closely supervised or circumvented in some instances in order to do so.

Fortunately line officers of the Division, the seven section chiefs, have been for the most part extremely cooperative in efforts to move ahead on the new program. Some have taken the initiative in the development of new policies. Most have worked hard to implement new policies when they have been announced. Circumvention has been and will be the exception and not the rule, and where it occurs, the implementation of new policies will be returned to the particular individual as soon as his capability and willingness to proceed with the Division program is adequately demonstrated. A person will be closely supervised or circumvented only when he brings it upon himself by actively or passively resisting broad and clearly articulated objectives and

policies of the Commissioner. No one will be closely supervised or circumvented who is taking the initiative in developing and implementing policies not inconsistent with expressed elements of the Division program. Line officers will be given great latitude in the development and implementation of policy within the broad parameters of that program for it is they who, in their own capacity as government officials, have responsibility to the public for regulation in their areas of operations and it is upon their continuing initiative that the ultimate success and viability of the agency depends.

In order to establish an efficient division of labor at the administrative level, the internal management structure in the Commissioner's office will be organized in such a manner that the primary responsibility of the Deputy Commissioner will be to supervise all of the functional line operations of the Division and in so doing he will work most closely with the section chiefs on operational problems. The Commissioner will concentrate his attention as a matter of priority upon the development and implementation of regulatory policy and will work most closely in that endeavor with the administrative staff of the Division. As the Division program moves further toward the achievement of its expressed objectives, the need for emphasis upon staff to accomplish the bootstrap operation now underway will diminish and the degree of separation of functions can be reduced.

3. *Resources:* At the present time, the greatest needs of the Division are the development and implementation of regulatory standards. These are staff needs, and a greater proportion of the manpower resources of the Division must be devoted to these staff functions. Without such standards, many of the line functions of the Division are being performed without being directed toward meaningful objectives, and therefore a great proportion of the resources of the Division are inefficiently utilized.

At the beginning of this year, no resources of the Division at all (0%) were devoted to staff functions, including policy development. Fortunately budget surpluses for the fiscal year ending June 30, 1973, resulting from the existence of personnel vacancies, allowed new personnel resources to be channeled into staff functions during the past six months (along with the addition of line personnel greatly needed in the Enforcement and Registration Section) so that as of the first of June, with the Division operating for the first time in several years at full capacity, staff resources (4 persons) represented \$61,611.25, including fringes, or 6.0% of the level of total annual manpower expenditures of the Division of \$1,100,636.81 (90 persons).

By comparison, resources devoted to routine field examinations by the Broker-Dealer, Audit, Credit Union, and Consumer Finance Sections (31 persons) represented \$416,313.86 or 38.0%; in-house application and report examinations by all sections (13 persons) represented

\$168,972.07 or 15.0%; clerical functions in all sections (27 persons) represented \$201,954.84 or 18.0%; investigative and enforcement functions by the Enforcement Section (5 persons) represented \$66,059.12 or 6.0%; and supervisory functions in all sections including administrative (10 persons) represented \$185,725.67 or 17.0%.

Staff and enforcement functions, the two most critical for the Division, at this particular time when an expansion of policy development and implementation is greatly needed, together account for only 12% of Division manpower expenditures, while functions relating to the generating, processing, and hoarding of paper, which is in many cases not used in a meaningful way, together account for 53% of such expenditures plus, on a pro rata basis, a commitment of clerical resources amounting to an additional 9.7% of total expenditures. An agency which devotes over sixty per cent of its manpower budget to relatively meaningless activity needs to undergo a rather severe redistribution of resources.

Since the Division is currently operating at full budgetary capacity, any future increases in staff or enforcement manpower must, of necessity, be offset by corresponding decreases in manpower devoted to generation of paper. In this connection it will be a short-term objective of the Division to bring about an increase in expenditures devoted to staff and enforcement activities from 12% to approximately 20% of the total personnel budget (6 additional people). Accordingly, field and clerical expenditures have been frozen. Cutbacks in these areas to allow a transfer of resources will be accomplished primarily through natural attrition, although absorption of the Division's share (\$30,000 per year) of the recent cut in the Department's budget by the legislature may require a release of personnel in the least productive areas.

There is no reason why cutbacks in field personnel need necessarily be restored. The efficiencies which will be achieved by redirecting the field examination process to produce more relevant information and by devoting greater attention to the analysis and use of this information will greatly increase the effectiveness of the process despite the utilization of fewer people. To a certain extent the Division is being dragged down by its own weight. A more streamlined operation would ultimately achieve more effective results. This point was recently demonstrated to me by a visit to the Michigan Corporation and Securities Bureau, where Director Hugh Makens is doing a very effective job with only two field examiners (who handle enforcement investigation and broker-dealer field examiners) out of a total of nineteen people devoted to Securities. The Michigan Bureau does not perform regulatory functions with respect to foreign real estate sales, credit unions, or consumer finance companies as does the Ohio Division, and its workload in connection with securities registrations and broker-dealer licensing is considerably smaller, but every man hour is used to deliver the maximum in regulatory results, and paper shuffling is kept to a minimum.

**4. Possible Spinoff of Non-Securities Sections:** Two of the areas of responsibility vested in the Division of Securities involve regulatory considerations, including questions of

market limitation and public convenience and necessity, beyond those normally associated with securities regulation and more closely related to those encountered in connection with the regulation of ongoing financial institutions such as state chartered banks and savings and loan associations. For this reason, the functions performed by the Credit Union and Consumer Finance Sections of the Division of Securities might be more efficiently performed if the regulation of these two industries was transferred to a separate governmental agency charged with regulating all four types of financial institutions. In this manner, not only would the public be better served by a more consistent pattern of regulation of financial institutions, but in addition the regulation of securities could be carried out more effectively by a streamlined Division of Securities which could apply its efforts to a limited field of operations without a diversion of energy to dissimilar regulatory problems. Legislation would be required to accomplish this kind of reorganization. The Director of Commerce has given consideration to this question, and it is hoped that a change can be brought about during the current Administration.

**5. Foreign Real Estate Licensing:** During the month of June, the function of licensing foreign real estate broker-dealers and salesmen was shifted from the Foreign Real Estate Section of the Division to the Broker-Dealer Section in order to achieve the greater control and efficiency which will result from handling similar matters in the same manner. The clerical processes for foreign real estate licensing were already being handled by the Broker-Dealer Section. The change places decision-making with respect to the granting as well as the suspension of licenses into the hands of the Supervisor of that Section. Now the responsibility for regulating the substantive elements of registered offerings lies with the Registration Section for securities and with the Foreign Real Estate Section for out-of-state land, and the responsibility for regulating the marketing function for both lies with the Broker-Dealer Section, which has both the clerical and field support to police the operations of the market mechanism.

The Division will attempt to encourage the interstate land sales industry to establish a meaningful compliance program to detect and eliminate violations of law and unethical sales practices through stricter marketing supervision. The Division has recently instituted the practice of requiring the fingerprinting of all applicants for foreign real estate salesman's licenses. Other measures will be taken in the future, including the imposition of penalties for references forwarded to the Division which fail to disclose wrongdoing on the part of applicants, to more successfully screen out land salesmen who have been unwilling to operate within the law.

**6. New Approaches to Land Sales Regulation:** The regulation of abuses in the public sale of real estate development properties may turn out to be as significant a problem during the next few years as has been the regulation of pyramid sales schemes during the past. Both of these regulatory problems require extensions of doctrinaire securities concepts in order to provide avenues of attack by government against fraudulent marketing techniques used in industries not primarily related to securities and not

adequately regulated by other public protection laws or agencies. Although Ohio law vests express authority in the Division of Securities to regulate sales to Ohio residents of land located outside the state, there exists no parallel legislation which creates equivalent authority to regulate the sale of development property located within its borders, unless such property is developed and marketed in such a manner as to constitute the creation of an investment contract or the solicitation of risk capital.

More and more, wide public distribution of Ohio real estate in the form of various types of planned community projects is being undertaken with purchasers being solicited to buy properties on the basis of a myriad of planned common recreational features and amenities which do not exist at the time that sales are being made, and may not be completed for several years, if at all. It is not an uncommon practice to induce people to purchase on the basis of the investment potential of the property. Claims are made regarding substantial gains which can be expected upon resale within a relatively short period of time due in great measure to the efforts of the developers in completing the project. If proper safeguards upon the capacity and the clear commitment of the developers to provide the facilities referred to in sales presentations are not assured, purchasers may be not only disappointed, but also in many cases defrauded. This kind of unethical land sales activity has been going on in Ohio and is now under investigation by the Division of Securities. A fine line may exist between fraud and mere "puffing" and more legal precedent may be needed in this area. The Division intends to take action against companies fraudulently selling such development properties on "investment contract" grounds where representations of value enhancement are being made, and upon "risk capital" grounds in other instances where the need for public protection manifests itself.

Ultimately what is needed to arrest these frauds is a general land sales law similar to the one recently enacted by the State of Michigan and taking effect on October 1 of this year. If and when such a law is enacted in Ohio, it might be appropriate that the regulation of both domestic and foreign real estate sales be vested in a separate agency with special expertise in real estate matters. One important enforcement tool for such a regulatory effort would be the requirement that developers periodically file with the regulatory agency lists of all purchasers and offerees and that they distribute disclosure documents to such persons as well as complaint forms and questionnaires prepared by the agency. Close scrutiny at the point-of-sale will be essential for this type of regulation.

*7. Difficulties Facing New Securities Act:* Initial hearings on the proposed new Ohio Securities Act before the Senate Commerce and Labor Committee were concluded on the evening of Wednesday, June 6, and committee chairman Howard Cook announced that the full committee would be convened over the adjournment to conduct further hearings as a study committee in order to allow the kind of in-depth analysis which a bill of this magnitude deserves. Presentations in support of the bill by representatives of the Securities Advisory Board, the Bar, and the securities industry, who joined together to keep the legislation

moving forward despite some individual differences regarding certain of its provisions, were well received by the committee. Those testifying on June 6 included the following: A. A. Sommer, Jr.; Nicholas Z. Alexander; Frank R. Morris, Jr.; Lester Miller; Edward A. Schrag, Jr.; Avery S. Cohen; James M. Tobin; and Nicholas J. Kiraly.

With the easing of the time schedule on the bill following these hearings, two disturbing undercurrents have been detected which threaten to impede the further progress of this legislation. The first is a tendency toward a repolarization of the attitudes of certain segments of the Bar who are dissatisfied with one or another of the features of the bill but who had earlier set aside their differences in the recognition that this new bill was a vast improvement upon the existing securities act. The extreme form of this polarization is represented by some persons who want to consider abandoning altogether the two years of effort devoted to this bill and start again from scratch on a different kind of statute. The Division of Securities would like to discourage this type of movement because the resulting polarization will mean a loss of the broad basis of support which this bill must have in order to be seriously considered and the result will be no new securities act at all. The Division would find it necessary to publicly oppose any new act which radically departs from the balanced combination of regulatory authority and structural restraint which the Division's bill represents.

The second disturbing development is the existence of an almost "invisible opposition" to this bill which has presented itself in the legislature. Although some persons and groups with legitimate concerns about various provisions of the bill have come forward and presented their grievances openly to the Division or to Bar groups, it would appear that others with some degree of influence have chosen to remain in the shadows and take shots at the bill without presenting their grievances for consideration by the Division. It seems unfair that the fate of this legislation might be decided, even in part, by unseen opponents unwilling to expose their arguments, affiliations, and motivations to public scrutiny so that this legislation can be considered entirely on its merits in the best interests of all Ohioans. It would be particularly unfortunate if the entire bill would be discarded because of some opposition to a few specific provisions which may not be essential to the entire legislative framework. The Division of Securities invites all persons opposing any provision of this bill to express their objections directly to the Commissioner at the earliest date possible.

Both of the foregoing developments raise serious questions with respect to the degree of priority which the Division can afford to give to this bill in terms of man-hours of effort if the likelihood of passage is to be seriously reduced by factors to which it is not able to respond.

*8. Alternatives for Regulatory Standards:* The restatement of corporate fairness guidelines is continued in this issue of the Bulletin and will be concluded in the August issue along with a statement of the applicability of various NASAA and Midwest statements of policy to registrations in Ohio. At that point several alternatives will exist for priorities in the

application of Ken Royalty's considerable skills, as long as they remain available to the Division, to the development of additional statements of regulatory standards: (1) the restatement in a similarly comprehensive manner of general non-corporate registration guidelines, (2) the restatement of unwritten rules in various narrower specialized areas of registration, (3) the restatement of unwritten rules of the Broker-Dealer, Foreign Real Estate, and other sections of the Division (the supervisors of all sections have been asked to prepare and submit outline summaries of such unwritten standards by the end of July to provide a basis for drafting and publication); (4) the revision of the new corporate guidelines and any other guidelines similarly developed in order to reflect more reasonable regulatory policies; (5) the assembly of statutory interpretations under the existing securities act; and (6) the development of new rules for the implementation of specific rulemaking requirements under the proposed new statute. Further drafting efforts will be directed toward the foregoing areas of policy primarily in the order indicated above although departures will be made in certain instances. In particular, special priority will be given to the development of standards in areas such as Broker-Dealer activities where meaningful enforcement is being delayed by the absence of appropriate regulations.

In light of the enormity of the overall task, additional staff assistance will be applied to this policy development effort as soon as possible. One of the two new law school graduates now with the Division will hopefully be available to aid in this undertaking following a period of training in registration ending about the first of August. The Division also expects to re-enlist the aid of a number of law firms in the development of regulatory standards, but in order to correct shortcomings of the past, no specific requests will be made until the Division staff has been able to set out in a general summary specific policy directions to be taken in each area to be considered. In order to coordinate the Bar effort so that it will proceed in an efficient manner, the Division will attempt to organize a small (five attorneys) committee of participants to manage the operation of this project and to work directly with the Division staff on a regular basis. The Securities Bar has always been willing to give great assistance to the Division where an opportunity for the production of real results in the form of rules appears realistic. It is our intention to maximize the likelihood of producing a finished product by making arrangements for Division follow-through before this aid is solicited.

**9. Securities Conference:** At a recent meeting of securities practitioners in Cleveland, after having requested questions from the floor regarding any and all matters of Division policy and procedure which might be of interest to those present, I was distressed to discover that I was unable to satisfactorily answer many of the simplest questions directed to Registration, Broker-Dealer, and Audit Section practices. The Bar needs an opportunity to put the Division on the firing-line so that basic recurring areas of confusion can be clarified, but this will necessitate an accessibility to all Division section chiefs and staff who deal with specialized matters which do not always draw the attention of the Commissioner.

The Securities and Exchange Commission has experimented with a program of conferences entitled "The SEC Speaks" which involves the participation of SEC staff officials and provides the opportunity for an open give-and-take on a broad range of important questions. I am told that this program has proven very helpful to the securities practitioners who have attended. If a sufficient number of persons express an interest in attending in Columbus a one day conference with the Division of Securities, based upon the same type of format, the Division will make arrangements to present such a program on a Friday or Saturday between October 1 and December 31 of this year. A minimum of one hundred prepaid subscriptions at \$25.00 per person would be required to justify this type of undertaking. Subscriptions will not be solicited until a proposed program agenda has been circulated. Persons are urged to write to the Commissioner during the next thirty days to express their interest in participating in such a program. If sufficient interest materializes, a proposed agenda will be published in the September issue of the Bulletin.

**10. The Bulletin as an Internal Commitment:** In addition to performing a meaningful communications function for the Division, representing its dedication to a policy of openness and serving as the principal vehicle for the expression of Division policy as it develops, the Ohio Securities Bulletin is designed to serve as a public commitment by the Division to all of the policies expressed therein, to which the line and staff officers of the Division, present and future, should adhere until superseded by intentional departures which are formally announced. As such, it provides a mechanism for injecting internal discipline into Division operations in order to replace the mirage of the past with the basic structural elements of a reliable institution.

The Bulletin is a fixed foundation upon which an entire open regulatory mechanism can be constructed over a period of time if sustained effort is applied to the achievement of that objective. Its pronouncements are durable and not subject to continual modification as they are passed down from person to person and from year to year. It can survive as a useful link as people come and go. By continuing the use of this tool, each new administrative team at the Division can add to the whole regulatory fabric and not find it necessary to start from scratch again.

William L. Case, III

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## POLICY DEVELOPMENTS

### Penalty Filings Pursuant to Section 1707.39

The Division of Securities has, earlier this year, implemented several changes in policy with respect to penalty filings made pursuant to Ohio Revised Code Section 1707.39 of which the Bar and the securities industry should be made aware.

Under this section, the Division has the authority to permit, in the exercise of its sole discretion, securities which have been sold in violation of the Ohio Securities Act to be

qualified if it appears that no person has been by the violation or will be by the qualification defrauded, prejudiced, or damaged.

Applications filed pursuant to Section 1707.39 are most frequently filed by or on behalf of issuers who have sold securities in good faith without actual knowledge of the applicability of the Act and without the commission of any acts of fraud or other substantive violations. Too often, however, applicants represented by counsel have intentionally sold without compliance in order to avoid the time requirements of registration or the application of fairness policies or disclosure requirements by the Division, and too often qualification under this section has been sought to lend an element of legitimacy to transactions which have been tainted by fraud or other types of willful wrongdoing. It is in response to these abuses and in an attempt to more strictly conform to the purposes of Section 1707.39 that the following changes of policy have been implemented by the Division:

1. Every application filed pursuant to Section 1707.39 (i.e., Form 39) must, in order to be acted upon favorably by the Division, satisfy all of the requirements, including all regulatory standards and disclosure requirements, to which it would have been subject had the offering been properly registered in the first instance. Specifically, if the terms of the offering violate any regulatory standards of the Division, those terms must be reconstructed by the issuer with the agreement of those persons who will retain their investment so as to comply with such standards. Moreover, if the offering has been in excess of \$50,000 and if the securities have been sold to more than twenty-five (25) persons, an offering circular, satisfactory to the Division, containing current information must be prepared and distributed by the issuer to all purchasers in connection with the perfection of the qualification.

2. An offer of rescission acceptable to the Division, properly funded, accompanied by an offering circular where applicable, and expiring not less than thirty days from the date of its distribution must be extended by the issuer to all purchasers of securities which have been sold in violation. Such rescission offer or the accompanying offering circular must adequately disclose the effect, if any, of such violation or of any change in the terms of the offering or in the condition of the issuer upon the value of the securities subsequent to the date of their initial distribution. All purchasers choosing to accept such offer must be paid in full.

3. The Explanatory Statement called for by Form 39, Exhibit J or the accompanying offering circular must adequately disclose the nature of the violation involved. An additional statement in the form of an affidavit must be filed with the Division outlining the history of any and all other violations of the Ohio Securities Act by the issuer or any related persons, describing in detail the circumstances surrounding the violation, and stating that the acts described did not constitute a knowing or willful violation on the part of the issuer or any related persons. Such affidavit must be signed and sworn to by the representative of the issuer who is most familiar with the facts of the violation and must be acknowledged and notarized.

4. The Statement of Non-Prejudice called for by Form 39, Exhibits J, K, and X must be obtained by the issuer from all purchasers to whom securities have been sold in violation and a statement of the reasons for rescinding the transaction must be obtained from all persons who choose to accept the rescission offer. The Statement of Non-Prejudice shall qualify the expression of non-prejudice by including the words "to the best of my knowledge" and shall contain a statement that the signer does not intend to waive any rights which he may have against the issuer or any other person under the Ohio Securities Act or otherwise for violations of law other than the initial failure to register the securities which he has purchased. When the Division issues an order qualifying securities pursuant to Section 1707.39, the determination of the Division with respect to facts will be stated in the form "it appears to the Division that" and not in the form of a finding of the Division equivalent to that contained in orders issued pursuant to Section 1707.09.

5. The principal responsibility for examining and approving Form 39 applications has been transferred to the Enforcement Section of the Division which will consult with the Registration Section with respect to the regulatory standards and disclosure requirements of paragraph 1 above. Where appropriate, such as in the event of repeated violations, the Enforcement Section will conduct an independent investigation of the circumstances surrounding the violation. If it appears that knowing or willful violations are involved, not only will the application be rejected but the Enforcement Section will proceed with the appropriate remedial action, which may include criminal prosecution. To "Form 39" an offering of securities is not an acceptable alternative to registration prior to sale. Attorneys who knowingly and willfully advise their clients to sell prior to registration and file a Form 39 later will be considered to be participants in the violation and will be subject to action by the Division accordingly.

It is the interpretation of the Division that Section 1707.39 operates with respect to three basic types of violations (non-registration, non-compliance with regulatory standards, and fraud) and with respect to three basic types of remedies (administrative action including injunction, civil liability, and criminal prosecution) as follows:

A. Qualification pursuant to Section 1707.39 cuts off grounds for administrative action and civil liability but not grounds for criminal prosecution on the basis of non-registration.

B. Qualification pursuant to Section 1707.39 does not cut off grounds for administrative action, but the statute contains no specific provision for civil liability (see Section 1707.40) or criminal prosecution (see Section 1707.44) on the basis of non-compliance with regulatory standards except where a Division Order has been violated.

C. Qualification pursuant to Section 1707.39 does not cut off grounds for administrative action, civil liability (a rescission offer under Section 1707.43 cuts off only a right to rescission and not to damages), or criminal prosecution on the basis of fraud.

It is hoped that a better understanding of the operations of Section 1707.39 and of the policy of the Division of Securities with respect to applications under that section will prevent unfortunate miscalculations on the part of issuers and their attorneys.

#### Fractional Undivided Working Interests in Oil and Gas Leases

For some time Division examiners have been generally dissatisfied with historic Division policies relating to the sale of various oil and gas securities, especially interstate and intrastate offerings of fractional undivided working interests in single or multiple well oil and gas leases.

For many years, the unwritten regulatory standards of the Division applied to oil and gas offerings have reflected policies derived from the exemption requirements of Ohio Revised Code Section 1707.03(P). In particular, this section is the source of the infamous "25% rule" which has been so controversial. That standard requires that the total of all compensation to promoters and affiliates, including commissions and expenses for the sale of such securities, whether in the form of cash payments or profits or retained working interests, shall not exceed 25% of the aggregate interests in the leases, exclusive of landowner's rents or royalties, or 25% of all actual drilling and completion costs.

The "25% rule" has been troublesome to the Division for a number of reasons. Great concern has been expressed that the 10% remaining as compensation to oil and gas operators following deduction of 15% sales commissions and expenses, especially where the sales function is subcontracted to independent dealers, is inadequate in relation to the exploration, leasing, drilling, completion, and marketing services performed. This standard has been frequently circumvented by promoters taking additional compensation in the form of profits on equipment and services supplied in connection with drilling, completion, and operation of wells, especially by means of "turnkey" contracts. It has been considered by some to be in conflict with the policy relating to the economic commitment of the promoter reflected by the Securities and Exchange Commission's Regulation B and Rules thereunder. Some persons consider investments being sold in Ohio oil wells to be of very doubtful value except for tax shelter purposes, and the future status of various tax shelters including oil and gas is subject to question. The same rule is not applied to oil and gas programs in the form of limited partnerships. Moreover, it has been alleged, in particular in connection with the *Van Raalte* case (and facts confirming or contradicting such a claim are very difficult to reconstruct) that the "25% rule" has not been consistently applied by Division examiners during the past few years.

As a result of the foregoing considerations, the Division will be changing its policy with respect to the registration of interstate and intrastate offerings of fractional undivided working interests in single or multiple well oil and gas leases. The following new standards will become applicable beginning on August 1, 1973.

1. The total of all commissions and underwriting or selling expenses paid by the issuer in connection with an offering

shall not exceed 15% of the aggregate price at which the securities are sold by or on behalf of the issuer (see Section 1707.09(J) and paragraph 7 of Written Policy Guidelines 1973-2).

2. Additional compensation to the promoter and its affiliates in any combination of (A) a percentage, in working interests and overriding royalty interests, of the total aggregate interests in the leases, exclusive of non-affiliated landowners rents or royalties, and (B) a percentage, in direct cash compensation and profits, of all actual drilling and completion costs shall not exceed a total of 25% or, where a turnkey drilling contract is to be performed by a non-affiliated party, a total of 15%. In the event that a single well venture results in a dry hole, the total compensation to the promoter and its affiliates under this paragraph shall not exceed one-half of the maximum amounts otherwise applicable.

3. All compensation of the promoter and its affiliates under paragraph 2 above, in the form of direct cash compensation and profits on equipment or services supplied to the venture, in excess of 10% of the total actual drilling and completion costs, shall be subordinated to the distribution to investors of amounts sufficient to produce a return of 100% of their investments in a combination of cash and federal income tax benefits.

4. Every applicant shall file with the Division and shall supply to each offeree a Synopsis Sheet summarizing the estimated costs of leasing, drilling and completion of each well and the terms of all compensation to be received by the promoter and its affiliates and in the case of offerings not limited to ten or fewer purchasers, an offering circular following the format of Schedule D of Regulation B of the Securities and Exchange Commission.

5. Every applicant shall maintain a separate checking account and a separate set of books and records for each offering and in such manner as to be capable of rendering a separate accounting of actual costs, revenue, expenses, and compensation to promoters and affiliates for each individual well.

6. Every registrant shall submit to the Division, within thirty days following the completion of each well, a post-drilling report containing a certified schedule of all actual drilling and completion costs and charges and all actual compensation paid or to be paid to the promoter and its affiliates in the form of direct cash compensation, profits on equipment or services, working interest and overriding royalty interests with respect to such well.

7. Every registrant shall retain not less than 1/16 working interest in each well, whether purchased by the promoter or its affiliates or received by them as compensation.

8. The minimum investment of each purchaser of such securities shall be not less than the greater of 1/32 working interest or \$2,000.

9. Sales of such securities shall be limited to persons who are in a minimum federal income tax bracket of 40% and have a minimum net worth of \$20,000.

Following further refinement the standards outlined above will be published in this Bulletin in the form of Written Policy Guidelines of the Division. Separate guidelines will be developed with respect to the registration of oil and gas securities in the form of limited partnership interests.

William L. Case, III

### INTERPRETIVE OPINIONS

#### Refusal of Licenses Under Section 1707.19

With the increased emphasis the Division has placed on the requirements for licensing of securities and foreign real estate broker-dealers and salesmen, the Bar has inquired about the operation of Section 1707.19 as it relates to the refusal of an application for a license under Sections 1707.15, .16, and .331, of the Ohio Revised Code.

With respect to licensing of foreign real estate dealers and salesmen, Section 1707.331 makes it clear that an applicant *must* be afforded a hearing *prior* to refusal of its license; but such clarity is lacking in Sections 1707.15 and .16, the general licensing provisions.

Section 1707.19 states in relevant parts:

"An original license, or a renewal thereof, applied for by a dealer or salesman of securities, may be refused, and any such license granted may be suspended and, after notice and hearing in accordance with Sections 119.01 to 119.13, inclusive, of the Revised Code, may be revoked . . ." [for reasons enumerated in the statute].

Clearly, at some point in the refusal process, an applicant must be afforded the right to a hearing; but Section 1707.19 does not specify at what point the hearing is to take place, before or after refusal.

Both the Division and the Securities Section of the Attorney General's Office have concluded that the Administrative Procedure Act requires a hearing *before* the Division refuses an application. The reasoning is as follows. The refusal of a license would constitute an "adjudication order" within the meaning of Section 119.01(D) of the APA. As such, Section 119.06 would forbid the refusal of a license prior to a hearing, *unless* one of the exceptions enumerated in that section was applicable.

Section 119.06 provides in part as follows:

"The following adjudication orders shall be effective without a hearing:

(A) Orders revoking a license in cases where an agency is required by statute to revoke a license pursuant to the judgment of a court.

(B) Orders suspending a license where a statute specifically permits the suspension of a license without a hearing.

(C) Orders or decisions of an authority within an agency if the rules of the agency or the statute pertaining to such agency specifically give a right of appeal to a higher authority within such agency and also give the appellant a right to a hearing on such appeal."

It is our considered opinion that refusal orders authorized by Section 1707.19 do not fall within any of the exceptions to Section 119.06. Therefore, a hearing is necessary prior to the refusal of a securities dealer's or salesman's license.

The Division will proceed in the following manner with respect to Securities license applications that are defective in light of Section 1707.19. First, the Division will issue a pre-refusal statement informing the applicant of the alleged violations of Section 1707.19, and notifying it of the right to a hearing prior to a final determination of the matter. At that point, the applicant may avail itself of all the procedural safeguards outlined by the APA. After the hearing, if the Division determines that good cause exists to deny the license, a refusal order will be issued. The applicant may then exercise the right of appeal to a court of competent jurisdiction. We feel that this procedure adequately protects the rights of an applicant, while at the same time enabling the Division to satisfy its regulatory responsibilities.

**Note:** In order to correct the statement contained in the final sentence of the Interpretive Opinion appearing on Page 7 of the May issue of the Bulletin it should be clarified that Section 1707.14(B)(2) exempts from the licensing requirements of the Ohio Securities Act the sale by an issuer or its subsidiary of commercial paper and promissory notes not offered directly or indirectly to the public within the meaning of Section 1707.02(G).

Robert J. DeLambo

### ILLUSTRATIVE RULINGS

#### Offering Price — How Not to Justify It

Pursuant to the objectives of this portion of the Bulletin as stated in the June issue this month the offering price aspect of a particular application will be discussed from a perspective which, it is hoped, will shed some pedagogical light for the practicing attorney.

Corporation A is a small corporation. It has been in existence for three years, and has produced gross revenues of six million dollars during its most recent fiscal year. Based upon its net earnings per share, its securities would command a maximum offering price of \$10.00. Furthermore, Corporation A is a wholly owned subsidiary of Corporation B, a rather sizeable conglomerate which has decided to enter the pocket calculator market via this subsidiary. The management of Corporation A must have equated digital chips with blue chips because it has decided that \$22.00 or 55 times earnings more closely reflects the

value of the corporation's stock. A final note: there is no existing market for the stock.

An objection letter was sent to the attorney for the applicant informing him that \$10.00 was the maximum price at which the securities could be sold in Ohio unless he could provide the Division with a special justification for the inflated figure of \$22.00.

#### A. Offering Price Based on Prior Transactions

The attorney had anticipated this objection and quickly directed the Division's attention to the "Certain Transaction" section of the prospectus which indicated that two months prior to the filing of the S-1, Corporation A had been recapitalized and Corporation B had purchased all of the presently outstanding stock at \$22.00. The argument was then propounded that the transaction referred to above "justified" the \$22.00 public offering price.

At this point, it must be conceded that the above argument was rather novel, if not effective, and the Division rejected it on the following grounds. First of all, the transaction took place between two affiliated parties and the price was not the result of an arms length transaction. Second, although the number of shares involved was quite substantial, the Division could not accept the proposition that one sale could establish a meaningful market price. Even if it were to accept the transaction as bona-fide, the Division would apply the five point test used to determine whether the securities are publicly traded in an active market of substantial depth.

#### B. Offering Price Based on Industry Market Price Comparison

Undaunted by the above fiasco, the attorney then proceeded to attempt a justification of the offering price on the basis of an industry comparison. The Division was privileged to receive a *confidential memorandum* the secrecy of which had been so successfully guarded that the xerox copy was barely legible. Unfortunately for the attorney, his efforts helped to contribute to the statistic which clearly indicates that most of the applications which attempt to justify an offering price on the basis of PE comparison fail to do so. The attorney could not comprehend why the Division would not favorably entertain inadequate industry price information which was for some reason satisfactory to the underwriter.

It seems appropriate at this time to make some observations concerning the high attrition rate of attempted justifications of public offering price based on industry PE comparisons.

1. In most cases, the comparative statistical information is prepared by the lead underwriter to be distributed to potential members of his syndicate. Since it is not prepared to specifically answer objections raised by state regulatory agencies, the presentation is in many cases inadequate and unresponsive.

2. Moreover, the information presented will often compare apples and oranges instead of comparing companies that are in fact logically comparable. In the case at hand, the applicant was comparing its PE ratio with that of corporations which were substantially larger in terms of earnings or sales, corporations whose stock were listed on one or more of the recognized exchanges, and corporations that had unsuccessfully attempted to register with the Division.

To summarize, isolated transactions will not be considered sufficient in an attempt to justify an offering price in excess of 25 times the earnings, and industry price justifications should be based upon information that is reliable and relevant.

Bernard G. Boiston

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### REGULATORY STANDARDS

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#### WRITTEN POLICY GUIDELINES 1973-2 (Continued)

##### V. Escrow Requirements and Procedures

(A) Requirements for the Escrow and Subordination of Promotional Shares (or Cheap Stock)

*Applicability:* The requirements and procedures with respect to the escrow and subordination of promotional shares (or cheap stock) normally apply only to proposed public offerings of the equity securities of a promotional company. The issuance or sale of promotional shares by a going concern to persons who are underwriters, finders, promoters, or affiliates of the issuer (except as compensation paid to underwriters) or the sale of promotional shares by a selling shareholder within two (2) years of or in connection with a public offering of such issuer's equity securities is considered to be a justifiable basis for finding that the proposed offering is to be made on grossly unfair terms (see division IV(A) of these Guidelines).

1. **General Substantive Requirements:** In the case of a proposed public offering of the equity securities of a promotional company, in order to insure that the offering will not be made upon grossly unfair terms and that the purchasers of the securities to be sold to the public will be protected, all securities which are promotional shares within the meaning of division I(P) of these Guidelines and which are directly or indirectly owned, controlled, or held by, or are to be issued or sold to, persons who are underwriters, finders, promoters, or affiliates (other than employees) of the issuer shall, as a condition of registration by description or qualification, be subject to the following escrow and subordination requirements:

(a) *Escrow of Promotional Shares:* All such promotional shares shall, as of the first date on which other equity securities of the same issuer are proposed to be offered for sale to the public, be deposited in escrow with a bank or other escrow agent acceptable to the Division pursuant to a

written escrow agreement which meets the requirements specified in paragraph (2)(a) of this division, and shall be left with and held by such bank or other escrow agent until such time as the conditions respecting the duration of escrow (as specified in paragraph (1)(c) of this division) are satisfied and the shares are released from escrow with the approval of the Division.

(b) *Subordination of Promotional Shares:* All such promotional shares shall, as of the initial public offering date, be subordinated in favor of the securities to be sold to the public with respect to dividend rights or preferences and liquidation or other distribution rights or preferences in the event of a dissolution, liquidation, bankruptcy, receivership, or sale of all substantially all of such issuer's assets until such time as the conditions respecting the duration of escrow (as specified in paragraph (1)(c) of this division) are satisfied and the shares are released from escrow with the approval of the Division.

(c) *Conditions respecting the Duration of Escrow:* All such promotional shares shall remain subject to the foregoing escrow and subordination requirements until all of the following conditions are satisfied:

(i) the issuer has earned an annual net income from operations, after the deduction of an adequate allowance for taxes and exclusive of extraordinary, non-recurring income and expense items, equal to at least six per cent (6%) of the total amount of all shares outstanding for a period of at least two (2) consecutive fiscal years subsequent to the initial public offering date. For purposes of this standard, the "total amount of all shares outstanding" at the end of each fiscal year shall be determined by multiplying the total number of shares outstanding at the end of each fiscal year by the offering price of the securities sold to the public (i.e., the total amount shall be computed as though all of the shares outstanding were sold at the public offering price);

(ii) the registrant, issuer, or holder of any such promotional shares demonstrates to the satisfaction of the Division that the issuer is otherwise in a sound financial condition; and

(iii) the Division has given its written approval to the release of such shares from escrow.

## 2. Procedural Requirements:

(a) *Arrangements for the Escrow of Promotional Shares:* All certificates, instruments, or documents representing or evidencing any right, title, or interest in any securities which are required to be deposited in escrow as provided herein shall be legended in the manner described in paragraph (2)(b) of this division and shall be delivered to a bank or other escrow agent acceptable to the Division prior to or contemporaneously with the commencement of the public offering. Normally, in the case of an offering by an issuer which is organized under the laws of this state or whose principal place of business is located in this state, such depository should be a bank, trust company, savings association, or other independent corporate fiduciary lo-

cated in this state; and, in the case of an offering by an issuer which is organized under the laws of any other state and whose principal place of business is located in another state, such depository should be a bank, trust company, savings association, or other independent corporate fiduciary located in the state where such issuer is organized or maintains its principal place of business, or where its transfer agent is located.

All certificates, instruments, or documents which are required to be deposited in escrow as provided herein shall be delivered to the escrow agent pursuant to a written and properly executed escrow agreement, the form of which has been approved in advance by the Division and the terms of which, in substance, provide for the following, in addition to whatever other terms and conditions the Division may require:

(i) the designation of all parties to the agreement, who shall be the issuer, the holders of the securities subject to escrow, the escrow agent, and, to the extent stated herein, the Ohio Division of Securities;

(ii) the names of all owners and/or holders of such securities, the title or kind and the amount or number of securities to be deposited, the dates of issuance, and the certificate numbers thereof;

(iii) an acknowledgement of receipt by the escrow agent for the securities deposited thereunder;

(iv) a commitment or undertaking on the part of all of the holders of such securities to waive all rights to participate in any cash, property, or share dividends or in any other distribution of assets which may be made to the other security holders of the issuer, except to the extent permitted by paragraph (2)(c) of this division and by the express terms of the subordination provisions of the shares, the code of regulations, the by-laws, or similar controlling instruments, or any other written agreements to which the issuer and such security holders are parties;

(v) a commitment or undertaking on the part of all of the holders of such securities to deposit in escrow with the same escrow agent all certificates, instruments, or documents representing or evidencing any right, title, or interest in any other promotional shares which may be acquired from such issuer (whether received as a share dividend, as a result of the exercise of stock options, or otherwise) upon the same terms and subject to the same conditions as are set forth in the original escrow agreement;

(vi) a commitment or undertaking on the part of all of the holders of such securities not to sell, assign, pledge, hypothecate, transfer, or dispose of any right, title, or interest in any such securities (except by will, descent, or operation of law) without the prior written approval of the Ohio Division of Securities while the escrow agreement remains in effect, and, in the event that any such disposition is authorized by the Ohio Division of Securities, to sell, assign, pledge, hypothecate, transfer, or dispose of such securities only to a transferee who consents to execute and be bound by the original escrow agreement;

(vii) a statement describing the conditions respecting the duration of escrow and an acknowledgement by the escrow agent and all such security holders that all such securities shall be held by the escrow agent until those conditions are met, at which time the securities will be released therefrom uncanceled after the written approval of the Ohio Division of Securities has been obtained;

(viii) a statement to the effect that the Ohio Division of Securities is a party to the agreement solely for the benefit and protection of the other security holders of the issuer (i.e., the investors who purchased the equity securities which were sold to the public), and that the Ohio Division of Securities shall not assume any responsibility or incur any liability for the loss of the certificates, instruments, or documents delivered to the escrow agent, or for any loss, damage, or injury sustained by any person as a result of any action, omission, or failure to act by either the issuer, the escrow agent, any security holder, or the Ohio Division of Securities;

(ix) a statement to the effect that notice of any action taken by the Ohio Division of Securities may be validly given to the issuer, the escrow agent, or any security holder who is a party to the escrow agreement by mailing a copy of the notice by certified mail, postage prepaid, to the last known address of such person, and that any such notice shall be deemed to have been given when it is deposited in the mail.

(b) *Legend on Certificates:* The certificates for any securities which are required to be deposited in escrow as provided herein shall bear on their face or back a legend, prominently printed or stamped thereon, which shall in substance provide:

"THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN RESTRICTIONS, INCLUDING THE ESCROW AND SUBORDINATION REQUIREMENTS OF THE OHIO DIVISION OF SECURITIES, AND SUCH SHARES MAY NOT LAWFULLY BE TRANSFERRED WITHOUT THE PRIOR WRITTEN APPROVAL OF THE DIVISION OF SECURITIES. THE CORPORATION WILL MAIL TO THE SHAREHOLDER A COPY OF SUCH RESTRICTIONS WITHIN FIVE DAYS AFTER THE RECEIPT OF A WRITTEN REQUEST THEREFOR."

(c) *Arrangements for the Subordination of Promotional Shares:* Normally, all securities which are subject to the foregoing escrow and subordination requirements shall be subordinated in the following manner:

(i) the securities to be sold to the public and the promotional shares subject to these requirements shall be divided into two or more designated classes or series of securities, and the required subordination provisions shall be stated in the articles of incorporation, certificate of incorporation, declaration of trust, certificate of partnership, partnership agreement, or similar controlling instruments [hereinafter referred to as the "charter documents"] as the express terms of the designated class or series of securities representing the promotional shares;

(ii) the terms of the designated class of securities representing the promotional shares shall expressly provide that the securities of such class are subordinate or junior to the securities of the class to be sold to the public in respect of dividend rights or preferences, and that no cash, property, or share dividend may be declared or paid on the securities of the subordinated or junior class unless an equal or larger dividend is also declared and paid at the same time on the securities of the preferred or senior class;

(iii) the terms of the designated class of securities representing the promotional shares shall expressly provide that the securities of such class are subordinate or junior to the securities of the class to be sold to the public in respect of liquidation rights or preferences in the event of a dissolution, liquidation, bankruptcy, receivership, or sale of all or substantially all of such issuer's assets, and that, in such event, no portion of the assets of the issuer may be distributed to the holders of the securities of the subordinated or junior class unless a liquidating dividend or distribution equal to the public offering price of the securities of the preferred or senior class is first distributed to the holders of the securities of such class, after which the holders of the securities of the subordinated or junior class may receive a liquidating dividend or distribution equal to the consideration which they paid for their shares, whereupon the securities of both classes shall share ratably in any excess assets; and

(iv) the charter documents shall expressly provide that the securities of the designated class representing the promotional shares may not be converted or changed into securities of the class to be sold to the public, but shall remain subordinate or junior to the securities of such preferred or senior class, until such time as the conditions respecting the duration of escrow (as specified in paragraph (1)(c) of this division) are satisfied and the shares are released from escrow with the approval of the Ohio Division of Securities.

In the case of a proposed public offering of equity securities by an issuer which is a promotional company within the meaning of division I(O)(3) or I(O)(4) of these Guidelines, the required subordination provisions (as described above) may be set forth in the code of regulations, by-laws, or similar controlling instrument or in a written waiver-of-rights agreement between the issuer and the security holders of the promotional shares instead of in the charter documents if such code of regulations, by-laws, or similar controlling instrument or such waiver-of-rights agreement provides that the instrument or agreement containing required subordination provisions, or any terms or conditions respecting the same, may not be amended, revoked, rescinded, or terminated without the prior written approval of the Ohio Division of Securities and without the consent or affirmative vote of a majority of the outstanding voting securities of such issuer at a meeting of the shareholders held for such purpose.

**3. Modification or Waiver of Escrow and Subordination Requirements:** The Division may in its discretion modify or waive all or selected portions of the foregoing escrow and subordination requirements as to any particular issuer or as to any one or more of the security holders subject thereto at any time prior to or during the period of escrow when-

ever it determines that one or more of such requirements are not necessary for the protection of the public investors and/or that such requirement or requirements would impose an undue hardship, burden, or expense upon such issuer or a particular security holder.

**(B) Requirements for the Escrow (or Impoundment) of the Proceeds of Sale**

*Applicability:* The requirements and procedures with respect to the escrow (or impoundment) of the proceeds of sale apply only to proposed public offerings of equity securities which are to be underwritten or made on an all-or-nothing or a best-efforts basis, or which are to be made by the issuer of the securities. A proposed public offering of equity securities which is to be underwritten on a firm commitment basis is not subject to these requirements.

**1. General Substantive Requirements:** In the case of a proposed public offering of securities to which this standard applies, in order to insure that the offering will not be made upon grossly unfair terms and that the purchasers of the securities to be sold to the public will be protected, all or a specified portion of the proceeds to be received from the sale of subscriptions for such securities shall, as a condition of registration by description or qualification, be subject to the following escrow (or impoundment) requirements:

(a) *Escrow of Proceeds; All-or-Nothing Underwriting:* If the proposed offering is to be underwritten or made on an all-or-nothing basis, then, regardless of whether the issuer is a going concern or a promotional company, all of the funds representing the consideration or gross proceeds received from the sale of subscriptions for the securities shall, within a reasonable time after they are received by the selling agent, be deposited in escrow with a bank or other escrow agent acceptable to the Division pursuant to a written escrow agreement which meets the requirements specified in paragraph (2)(a) of this division, and shall be left with and held by such bank or other escrow agent until all of the securities being offered have been subscribed and paid for, and the proceeds are released from escrow with the approval of the Division. In the event that the underwriter or the issuer fails to receive payment for all of the securities being offered within the prescribed escrow period, then all of the funds representing the gross proceeds theretofore received and deposited with the escrow agent, plus any accrued interest thereon, shall be returned to the subscribers forthwith.

**(b) Escrow of Proceeds; Best-Efforts Underwriting and Issuer Distribution:**

(i) *Promotional Company:* If the proposed offering is to be underwritten or made on a best-efforts basis or if it is to be made by the issuer of the securities, and if the issuer of such securities is a promotional company within the meaning of division I(P) of these Guidelines, and if the amount of securities to be offered is in excess of \$50,000, then all of the funds representing the consideration or gross proceeds first received from the sale of subscriptions for the securities shall, within a reasonable time after they are re-

ceived by the selling agent, be deposited in escrow with a bank or other escrow agent acceptable to the Division pursuant to a written escrow agreement which meets the requirements specified in paragraph (2)(a) of this division, and shall be left with and held by such bank or other escrow agent until a sufficient amount of securities representing the specified portion or percentage of the proceeds of the offering subject to escrow has been subscribed and paid for, and the proceeds are released from escrow with the approval of the Division. The portion or percentage of the proceeds of the offering which shall be subject to escrow under this standard is the following: (1) at a minimum, at least twenty-five per cent (25%) of the total gross proceeds of the offering, plus (2) such additional portion or percentage of the total gross proceeds, up to and including one-hundred per cent (100%) thereof, as the Division may in its discretion specify in order to insure that a specific minimum amount of funds necessary to finance the proposed plan of business of the issuer will be obtained, and that the purposes of the offering will otherwise be fulfilled. In the event that the underwriter or the issuer fails to receive the amount of funds representing the proceeds required to be escrowed hereunder within the prescribed escrow period, then all of the funds representing the gross proceeds theretofore received and deposited with the escrow agent, plus any accrued interest thereon, shall be returned to the subscribers forthwith.

(ii) *Going Concern:* Ordinarily, in the case of a proposed public offering of the equity securities of a going concern, an escrow of the funds representing the gross proceeds of the offering will not be required even though the proposed offering is to be underwritten or made on a best-efforts basis, or even though it is to be made by the issuer of the securities. However, all or a specified portion of the proceeds of the offering may be subject to escrow, as provided in paragraph (1)(b)(i) of this division, if it appears to the Division that:

(1) the amount of securities to be offered to the public is unusually large in relation to the book value of the shareholders' equity in such issuer (e.g., where the amount of securities to be offered is more than seventy-five per cent (75%) of the book value of the shareholders' equity in such issuer at the time the registration application is filed);

(2) it is unlikely that the entire offering will be sold within one (1) year from the initial public offering date; or

(3) a specific minimum amount of funds necessary to finance a proposed plan of expanding the business of the issuer will be required in order to fulfill the purposes of the offering.

(c) *Time Period for the Escrow of Proceeds:* Normally, the Division will require that the escrow requirements be met (that is, that the specified portion or percentage of the proceeds of the offering subject to escrow be obtained) during the period of time that the registration remains in full force and effect, which will generally be a period of one (1) year. However, the Division may prescribe a shorter or longer time period for obtaining the required amount if it appears to the Division that the protection of the public investors so requires.

## 2. Procedural Requirements:

(a) *Arrangements for the Escrow of Proceeds:* All of the funds representing the consideration or gross proceeds which are required to be deposited in escrow, whether received in the form of cash or negotiable instruments, shall be delivered to a bank or other escrow agent acceptable to the Division within a reasonable time (not to exceed five days) after such funds are received by the selling agent. No consideration other than cash or negotiable instruments payable upon demand shall be accepted by the escrow agent or considered by the Division as being "proceeds" for purposes of determining whether the prescribed escrow requirements have been met. All such negotiable instruments shall be made payable to the escrow agent. Normally, in the case of an offering by an issuer which is organized under the laws of this state or whose principal place of business is located in this state, such depository should be a bank, trust company, savings association, or other independent corporate fiduciary located in this state; and, in the case of an offering by an issuer which is organized under the laws of any other state and whose principal place of business is located in another state, such depository should be a bank, trust company, savings association, or other independent corporate fiduciary located in the state where such issuer is organized or maintains its principal place of business, or where its transfer agent is located. However, if, in the opinion of the Division, the protection of Ohio investors so requires, the Division may require that all or a specified portion of the proceeds resulting from sales made to persons residing in this state be deposited with a bank or other escrow agent located in this state until the issuer receives the prescribed amount from the sale of such securities either in this state or elsewhere, even though the issuer is organized under the laws of, and maintains its principal place of business in, another state, and even though most of the securities are offered outside of this state.

All of the funds deposited in escrow shall be placed in a separate trust account and invested in short-term obligations of the United States government during the prescribed escrow period. No portion of such funds shall be used to pay the fees of the escrow agent or any other expenses incurred in connection with either the escrow or the offering.

All of the funds which are required to be deposited in escrow as provided herein shall be delivered to the escrow agent pursuant to a written and properly executed escrow agreement, the form of which has been approved in advance by the Division and the terms of which, in substance, provide for the following, in addition to whatever other terms and conditions the Division may require:

(i) the designation of all parties to the agreement, who shall be the issuer, the subscribers, the dealer or dealers underwriting or participating in the underwriting of the issue (if any), the escrow agent, and, to the extent stated herein, the Ohio Division of Securities;

(ii) a commitment or undertaking on the part of the issuer and any dealer underwriting or participating in the underwriting of the issue (if any) to deliver to the escrow agent

within a reasonable time after receipt all funds representing the consideration or gross proceeds received from the sale of subscriptions for the securities being offered, together with copies of all subscription agreements to which such funds relate;

(iii) a commitment or undertaking on the part of the escrow agent to place all such funds in a separate trust account and to invest such funds in short-term obligations of the United States government during the prescribed escrow period;

(iv) a statement describing the conditions of escrow and an acknowledgement by the escrow agent, the issuer, and all participating dealers that all such funds shall be held by the escrow agent until the escrow is terminated upon the occurrence of either of the following events:

(1) the conditions of escrow are met, the written approval of the Ohio Division of Securities for the release of such funds to the issuer has been obtained, and a copy of such authorization has been furnished to the escrow agent; or alternatively,

(2) the escrow agent is given written notice by the Ohio Division of Securities that all such funds, plus any interest which has accrued thereon, shall be returned directly to the subscribers by the escrow agent;

(v) a commitment or undertaking on the part of the issuer and/or any participating dealer to pay the fees of the escrow agent and any other expenses incurred in connection with the escrow;

(vi) a commitment or undertaking on the part of the issuer or any participating dealer that, within ninety (90) days after the effective date of the registration and semi-annually thereafter, such issuer or participating dealer shall file with the Ohio Division of Securities a Form 23 so as to report on and disclose the progress of the offering;

(vii) a statement to the effect that the Ohio Division of Securities is a party to the agreement solely for the benefit and protection of the subscribers (i.e., the investors who subscribed for the equity securities which are to be sold to the public), and that the Ohio Division of Securities shall not assume any responsibility or incur any liability for the loss of the funds delivered to the escrow agent, or for any loss, damage, or injury sustained by any person as a result of any action, omission, or failure to act by either the issuer, any participating dealer, the escrow agent, any subscriber, or the Ohio Division of Securities; and

(viii) a statement to the effect that notice of any action taken by the Ohio Division of Securities may be validly given to the issuer, any participating dealer, the escrow agent, or any subscriber by mailing a copy of the notice by certified mail, postage paid, to the last known address of such person, and that any such notice shall be deemed to have been given when it is deposited in the mail.

(b) *Subscription Agreements:* Normally, when all or a specified portion of the proceeds of an offering is required

to be deposited in escrow as provided herein, the issuer shall not issue any certificates for the securities, other than copies of the approved subscription agreement, until the proceeds are released from escrow with the approval of the Division. A copy of each executed subscription agreement shall be given to the subscriber and to the escrow agent. In the event that the issuer is required by the terms of the underwriting agreement or by the laws, rules, regulations, or orders of the securities administrator of any other state to issue certificates for the securities prior to the termination of the escrow arrangement in this state, then all of the certificates for the securities whose proceeds are subject to escrow in this state shall be delivered to the escrow agent and shall be held by such escrow agent until the conditions of escrow are met and the proceeds are released from escrow with the approval of the Division.

(c) *Extension or Other Modification of Escrow Conditions:* A request for an extension of the prescribed escrow period or for any other modification of the conditions of escrow will normally not be granted unless the registrant establishes to the satisfaction of the Division that the original escrow conditions will probably be met if additional time is allowed and/or that there has been a substantial change in circumstances which justifies such modification.

(d) *Termination and Release of Proceeds from Escrow:*

(i) In the event that the specified portion or percentage of the proceeds of the offering subject to escrow has not been obtained within the prescribed escrow period, the registrant shall so advise the Division in writing at the expiration of the escrow period. In addition, the registrant shall request that the Division notify the escrow agent to terminate the escrow and return all funds representing the gross proceeds, plus any accrued interest thereon, to the subscribers.

(ii) In the event that the specified portion or percentage of the proceeds of the offering subject to escrow has been obtained within the prescribed escrow period, including any extension thereof, the Division will approve the release of the proceeds from escrow upon the receipt of a written application requesting authorization for such a release and containing the following statements, in addition to any other information which the Division may require in a particular case:

(1) a statement of the registrant that all of the proceeds resulting from the sale of subscriptions for the securities have been delivered to the escrow agent in accordance with the terms and conditions of the escrow agreement and that there have been no material changes in the financial condition of the issuer and no changes in the plan of operation or other circumstances of the issuer that would render the amount of proceeds inadequate to finance the proposed plan of business; and

(2) a statement of the escrow agent signed by an appropriate officer verifying the aggregate amount of funds representing the proceeds and interest on deposit at such time.

**3. Modification or Waiver of the Escrow of Proceeds Requirements:** The Division may in its discretion modify or

waive all or selected portions of the foregoing escrow of proceeds requirements as to any particular issuer, applicant, or registrant or as to any participating dealer at any time prior to or during the period of escrow whenever it determines that one or more of such requirements are not necessary for the protection of the public investors and/or that such requirement or requirements would impose an undue hardship, burden, or expense upon such issuer, applicant, registrant, or a particular participating dealer.

## VI. Selling Expenses and Underwriters' Compensation

### (A) Limitations on Selling Expenses and Compensation Paid to Underwriters

*Applicability:* The limitations set forth in this standard with respect to the amount of expenses which may be incurred or paid in connection with the offering and sale of securities, including any commission or other compensation which may be paid to underwriters in connection therewith, apply to all offerings of securities sought to be registered by description under sections 1707.05 and 1707.08 of the Ohio Revised Code or by qualification under section 1707.09 of the Ohio Revised Code, regardless of whether any such offering is to be made by or on behalf of a going concern, a promotional company, or an underwriter, and irrespective of the type of security sought to be registered or the plan of distribution proposed to be followed; but, such limitations shall not apply to an offering to be made by or on behalf of a selling shareholder. All offerings of securities sought to be registered by description under sections 1707.06 and 1707.08 of the Ohio Revised Code shall be subject to and governed by the statutory expense limitations specified in each respective division or subsection of section 1707.06 of the Ohio Revised Code.

*Terminology:* For purposes of this standard, the following definitions shall apply:

The term "total selling expenses" means the total amount of all expenses incurred or paid by or on behalf of an issuer and any underwriter in connection with the offering and sale of securities. The term includes both the commission or other compensation paid or to be paid to an underwriter and the selling expenses of the issuer.

The term "underwriter" has the same meaning as it has in sections 1707.03(N) and 1707.09(J) of the Ohio Revised Code. A security holder who purchased securities from an issuer (or from an underwriter who was in privity of contract with an issuer) more than one (1) year prior to the date a registration application is filed, and who is not a "dealer" within the meaning of section 1707.01(E) of the Ohio Revised Code, is conclusively presumed to be a "selling shareholder" rather than an "underwriter".

The terms "commission" and "compensation", when used to refer to the commissions or other compensation to be paid to an "underwriter", means the amount of all commissions, discounts, fees, expenses, or other remuneration directly or indirectly paid or given, or proposed to be paid or given, by an issuer to or on behalf of an underwriter, any

affiliate of an underwriter, or any finder in connection with the sale of the securities being offered. Such terms include, but are not limited to, the following: (1) the gross amount of any underwriting or selling discount or commission; (2) cash; (3) the value of any securities, including any options, warrants, or rights to purchase or subscribe to any other securities of the issuer or any other person; (4) the amount of any finder's fees; (5) the amount of any expenses incident to the offering which are incurred, paid, allowed, or reimbursed by the issuer to or on behalf of an underwriter (whether accountable or non-accountable) and which would customarily be paid by an underwriter, including, for example, the underwriter's (i) attorney's fees and expenses, (ii) financial consulting and advisory fees, (iii) salaries, (iv) overrides, (v) salesman's commissions, (vi) direct clerical and administrative expenses, (vii) printing, advertising, traveling, and promotional expenses; and (6) any other thing of value directly or indirectly accruing to an underwriter or his affiliate in respect of the sale of the securities being offered. Such terms do not include any of the expenses incident to the offering which are customarily borne by the issuer, particularly those which are identified as being the issuer's selling expenses within the meaning of this standard. For purposes of this paragraph, any securities, options, or warrants issued or transferred by an issuer to an underwriter within the one (1) year period preceding the date a registration application is filed are considered to have been paid or given to such underwriter in connection with the sale of the securities being offered.

The term "selling expenses", when used to refer to the selling expenses of an issuer, means the amount of all expenses incident to the offering (other than underwriters' commissions and other compensation) which are customarily incurred, paid, or borne by or on behalf of the issuer in connection with the sale of the securities being offered, even though such expenses are paid through an underwriter or a selling shareholder. Such term includes, but is not limited to, the following: (1) the cost of preparing, printing, and filing registration applications, registration statements, prospectuses, offering circulars, and other documents used in registering securities, including any registration fees and other expenses associated therewith; (2) the amount of any attorney's fees and expenses (except those charged by an underwriter's counsel) incurred or paid in connection with the offering; (3) the amount of any accountant's or auditor's fees and expenses incurred or paid in connection with the offering; (4) the amount of the fees and charges of any transfer agents, registrars, indenture trustees, escrow agents, depositories, engineers, appraisers, or other professional or technical experts; (5) the cost of authorizing, preparing, and printing certificates for securities and other documents relating thereto, including taxes and stamps; (6) the salaries of all affiliates of the issuer whose employment activities consist primarily of registering or selling securities; (7) the amount of all direct clerical and administrative expenses incurred or paid by the issuer in registering or selling securities; (8) the amount of all printing, advertising, traveling, and promotional expenses incurred or paid by the issuer in registering or selling securities; and (9) any other cost directly or indirectly borne by the issuer in respect of the sale of the securities being offered.

"Aggregate Selling Price" means the total amount of securities which will have been sold in an offering or, alternatively stated, the total consideration or gross proceeds which will have been received from the sale of securities being offered.

**1. Limitations on Underwriters' Commissions and Other Compensation; Issuer and Underwriter Distributions:** In the case of a proposed offering of securities to which this standard applies, the total amount of all commissions and other compensation paid or to be paid by an issuer to one or more underwriters in connection with an offering of securities to be made by or on behalf of an issuer or an underwriter shall not exceed an amount equal to fifteen per cent (15%) of the aggregate selling price of all securities which will have been sold at the completion of the offering or at the termination of any required escrow arrangement, if applicable, regardless of whether such securities are sold in this state or elsewhere.

In determining the total amount of underwriting compensation to be paid by the issuer and in computing the aggregate selling price of all securities which will have been sold by or on behalf of the issuer, the underwriting compensation to be paid by a selling shareholder and the aggregate selling price of any securities which will have been sold by or on behalf of any selling shareholder shall be excluded.

An offering of securities to be made by or on behalf of a security holder who is a "dealer" within the meaning of section 1707.01(E) of the Ohio Revised Code and an "underwriter" within the meaning of sections 1707.03(N) and 1707.09(J) of the Ohio Revised Code is deemed to be, and shall be treated as, an offering to be made by or on behalf of an issuer for purposes of this standard (see Administrative Ruling No. 23, CCH Blue Sky Law Rep. ¶138,723; with respect to an offering to be made by or on behalf of a security holder who is not a "dealer", see Administrative Ruling No. 21, CCH Blue Sky Law Rep. ¶138,721 and the definition of the term "underwriter" in this division).

Restated, if an application to register securities by qualification under section 1707.09 of the Ohio Revised Code is filed with the Division for an offering to be made by or on behalf of an issuer or an underwriter, and if the Division finds that such issuer will receive, at or prior to the delivery of such securities, less than eighty-five per cent (85%) of the aggregate selling price at which all such securities are sold by or on behalf of such issuer (whether sold in this state or elsewhere), then the registration application will automatically be denied on the ground that division (J) of section 1707.09 of the Ohio Revised Code applies and has not been complied with. If an application to register securities by description under sections 1707.05 and 1707.08 of the Ohio Revised Code is filed with the Division for an offering to be made by or on behalf of an issuer or an underwriter, and if the Division finds that such issuer will receive, at or prior to the delivery of such securities, less than eighty-five per cent (85%) of the aggregate selling price at which all such securities are sold by or on behalf of such issuer (whether sold in this state or elsewhere), then such offering will be deemed to be made upon grossly unfair terms and will be subject to immediate suspension under

section 1707.13 of the Ohio Revised Code (see Regulation COs-1-05(A), formerly Regulation R-5A, of the Division of Securities, CCH Blue Sky Law Rep. ¶138,641).

**2. General Standards on Total Selling Expenses; Issuer and Underwriter Distributions:** A proposed offering of securities to be made by or on behalf of an issuer or an underwriter is presumed to be grossly unfair to purchasers under this standard if the total selling expenses to be incurred or paid in connection with the sale of all securities which will have been sold at the completion of the offering or at the termination of any required escrow arrangement, if applicable, exceed the limits set forth in the following schedule on the maximum amount of expenses which may be incurred or paid:

Aggregate Selling Price	Maximum Total Selling Expenses (Underwriters' Commission* plus other Selling Expenses)
under \$250,000	20%
\$ 250,000 - \$ 500,000	19%
\$ 500,001 - \$1,000,000	18%
\$1,000,001 - \$1,500,000	17%
\$1,500,001 - \$2,000,000	16%
over \$2,000,000	15%

\* Underwriters' compensation in issuer or underwriter distributions shall not exceed fifteen per cent (15%) in any event (see Paragraph 1).

**3. Secondary Distributions:** A proposed offering of securities to be made by or on behalf of a selling shareholder is not subject to the limitations set forth in paragraphs (1) and (2) of this division with respect to the amount of expenses which may be incurred or paid in connection with the offering and sale of securities, including any commissions or other compensation which may be paid to underwriters in connection therewith.

**4. Limitations on Offerings by Issuers and Selling Shareholders:** A proposed offering of securities to be made by or on behalf of an issuer in conjunction with one or more selling shareholders is considered to be grossly unfair to investors under this standard if:

(a) the issuer pays or agrees to pay all or a substantial portion of the total selling expenses attributable to the offering to be made by or on behalf of the selling shareholders; or

(b) the amounts paid by the issuer for or on behalf of the selling shareholders, when added to the total selling expenses incurred or paid by or on behalf of the issuer in connection with the offering, exceed the limitations set forth in paragraphs (1) and (2) of this division.

(B) Issuance or Sale of Securities to Underwriters

**Applicability:** The requirements and limitations with respect to the issuance or sale of securities (other than options and warrants) to underwriters and finders apply to the extent stated herein to all proposed offerings of securities.

**1. General Standards on the Treatment and Valuation of Securities Issued or Transferred to Underwriters in Connection with an Offering:** Where an issuer has issued or transferred securities (other than options and warrants) to an underwriter or a finder within the one (1) year period preceding the date a registration application is filed, or where an issuer proposes to issue or transfer securities (other than options and warrants) to an underwriter or a finder in connection with a proposed offering of securities, the difference between the maximum offering price of the securities to be offered (or the market price of the securities so issued or transferred, if they are not of the same class as the securities being offered) and the purchase price of the securities so issued or transferred (if any) shall be considered and treated, for purposes of division VI(A) of these Guidelines, as part of the compensation paid or to be paid to such underwriter or finder, and not as promotional shares within the meaning of divisions I(P) and VI(B)(2) of these Guidelines.

**2. General Standards on Promotional Shares Issued or Sold to Underwriters:**

(a) *Going Concern:* A proposed public offering of the equity securities of a going concern is presumed to be grossly unfair to public investors under this standard if the issuer has issued or sold promotional shares (or cheap stock) to an underwriter or a finder within the two (2) year period preceding the first date on which such equity securities are proposed to be offered for sale to the public; but, this standard shall not apply to any securities which are considered and treated as part of the compensation paid to such underwriter within the meaning of paragraph (1) of this division.

(b) *Promotional Company:* In the case of a proposed public offering of the equity securities of a promotional company, the issuance or sale of promotional shares (or cheap stock) by such issuer to an underwriter or a finder prior to such proposed offering (excluding, for this purpose, any securities which are considered and treated as part of the compensation paid to such underwriter, as provided in paragraph (1) of this division) is not considered to be grossly unfair to purchasers unless:

(i) the price at which such promotional shares were issued or sold to such underwriter or finder is less than one-fifth (1/5) of the proposed public offering price;

(ii) the amount or number of promotional shares issued or sold would cause or result in a dilution in the value of the securities to be sold to the public which is in excess of fifty per cent (50%) of the proposed public offering price;

(iii) the amount or number of promotional shares issued or sold to underwriters or finders, together with the amount or number of promotional shares issued or to be issued to promoters and affiliates of the issuer, is more than fifty per cent (50%) of the total amount or number of equity securities which will be outstanding at the completion of the proposed offering or at the termination of any required escrow arrangement, if applicable;

(iv) the promotional shares held by underwriters and finders are not deposited in escrow with a bank or other escrow agent under the terms and subject to the conditions prescribed in division V(A) of these Guidelines; or

(v) the terms of any such promotional shares or of any instruments or agreements relating thereto fail to provide for the subordination of such securities in favor of those to be sold to the public with respect to dividends and liquidation rights or preferences in the event of dissolution, liquidation, bankruptcy, receivership, or a sale of assets, as specified in division V(A) of these Guidelines.

### (C) Options and Warrants to Underwriters

*Applicability:* The requirements and limitations with respect to the issuance or sale of options or warrants to underwriters or finders apply to all proposed offerings of securities.

**1. General Standards on the Treatment and Valuation of Options and Warrants to Underwriters:** Where an issuer has issued or transferred any options, warrants, or rights to acquire securities to an underwriter or a finder within the one (1) year period preceding the date a registration application is filed, or where an issuer proposes to issue or transfer any such options, warrants, or rights to an underwriter or a finder in connection with a proposed offering of securities, the difference between the current fair value of such options, warrants, or rights (as determined by the grantor thereof) and the amount paid by the underwriter or finder as consideration for the same (if any) shall be considered and treated, for purposes of division VI(A) of these Guidelines, as part of the compensation paid or to be paid to such underwriter or finder, and not as promotional shares within the meaning of divisions I(P) and VI(B)(2) of these Guidelines (see Regulation COs-1-07(V), formerly Regulation OW-1, of the Division of Securities, CCH Blue Sky Law Rep. ¶138,682).

For purposes of this standard, the "current fair value" of an option or warrant (as determined by the grantor) should be the same as, or closely related to, the market value of such option or warrant, if any; and, in cases where there is no existing market for the option or warrant, a presumed "current fair value" of twenty per cent (20%) of the maximum offering price of the security covered by the option or warrant should be used, unless the grantor or the applicant establishes or demonstrates to the satisfaction of the Division that a different presumed valuation should be used.

**2. General Standards on the Issuance or Sale of Options and Warrants to Underwriters:** The issuance or sale of options or warrants to an underwriter as all or a part of such underwriter's compensation for the sale of the securities being offered is not considered to be grossly unfair to purchasers under this standard if the terms of the options or warrants, or the circumstances under which they are issued, meet all of the following requirements:

(a) the options or warrants are non-exercisable for a period of at least eleven (11) months after the date of issuance;

(b) the exercise period of the options or warrants does not exceed five (5) years in duration;

(c) the number of shares covered by the options or warrants issued to underwriters, together with the number of shares covered by the options or warrants issued or to be issued to all other persons (except financial institutions and except in connection with acquisitions), does not exceed ten per cent (10%) of the total number of shares which will be outstanding at the completion of the proposed offering or at the termination of any required escrow arrangement, if applicable; and

(d) the initial exercise price of the options or warrants is at least equal to the public offering price of the securities of the same class which are the subject of the offering (or the market price of the securities, if they are not of the same class as the securities being offered).

(See Regulation COs-1-07(V), formerly Regulation OW-1, of the Division of Securities, CCH Blue sky Law Rep. ¶138,682).

### VII. Senior Securities: Preferred Stock and Debt Securities

(A) Issuance and Sale of Senior Securities by Going Concerns and Certain Promotional Companies

*Applicability:* The requirements and limitations with respect to the issuance and sale of senior securities apply to all proposed public offerings of either preferred stock or debt securities (including notes, bonds, debentures, etc.) which are to be made by a going concern, and to proposed public offerings of the types of preferred stock or debt securities described in division (B)(2) of this standard which are to be made by an issuer which is a promotional company within the meaning of divisions I(O)(3) and (4) of these Guidelines. However, such requirements and limitations shall not apply to issuers which are organized not for profit, but exclusively for religious, educational, social, recreational, athletic, benevolent, fraternal, charitable, reformatory, or cooperative marketing purposes.

#### 1. General Standards Concerning Earnings or Cash Flow Capability for Dividend or Debt Service:

(a) *Prior Net Earnings or Cash Flow:* A proposed public offering of either preferred stock or debt securities (including notes, bonds, debentures, etc.) which is to be made by a going concern or a promotional company of the type described above is considered to be grossly unfair to public investors under this standard if:

(i) in the case of preferred stock, the average annualized net earnings of the issuer for the most recently completed accounting period is insufficient to cover the annual dividend requirements on all such securities, plus the annual dividend, interest, and principal amortization requirements on all other debt obligations and securities of prior or equal rank which will be outstanding if all of the securities being offered or proposed to be offered (whether or not they are proposed to be registered or offered in this state) are issued; or

(ii) in the case of debt securities, the average annualized cash flow of the issuer for the most recently completed accounting period is insufficient to cover the annual interest and principal amortization requirements on all such securities, plus the annual interest and principal amortization requirements on all other debt obligations and securities of prior or equal rank which will be outstanding if all of the securities being offered or proposed to be offered (whether or not they are proposed to be registered or offered in this state) are issued.

For purposes of this standard, the "average annualized net earnings" or "average annualized cash flow" of an issuer refers to the net income or cash flow from operations, after the deduction of an adequate allowance for taxes and exclusive of extraordinary, non-recurring income and expense items, for the most recently completed accounting period adjusted to reflect such net earnings or cash flow on a twelve (12) month basis; provided, however, that, if the net income or cash flow from operations during such accounting period is not reasonably indicative of the issuer's prior earnings history, then the average annualized net earnings or cash flow of the issuer may be computed on the basis of the net income or cash flow from operations during the three (3) fiscal years preceding the date on which the registration application is filed.

If the issuer has made any material acquisitions or dispositions during the most recently completed accounting period, the computation of net earnings or cash flow shall, for purposes of this standard, be made on a *pro forma* basis so as to account for such acquisitions or dispositions.

(b) *Substantiated Future Net Earnings or Cash Flow:* A standard based upon the substantiated future net earnings or cash flow capability of the issuer may be applied in lieu of the foregoing prior net earnings or cash flow standards to a proposed public offering of either preferred stock or debt securities, even though the prior net earnings or cash flow of the issuer did not meet the standards set forth in paragraph (1)(a) of this division, if the issuer or applicant establishes or demonstrates to the satisfaction of the Division that such issuer has made material contracts, acquisitions, or other significant changes in its business operations which will result in future net earnings or cash flow sufficient to cover the annual dividend, interest, and principal amortization requirements on all such securities, plus all other outstanding senior securities of prior or equal rank (as specified in paragraph (1)(a) of this division).

**2. General Standards on Debt-to-Equity Ratio:** A proposed public offering of either preferred stock or debt securities which is to be made by a going concern or a promotional company of the type described above is considered to be grossly unfair to public investors under this standard if the aggregate amount of all preferred stock (other than convertible, participating preferred stock) and the aggregate principal amount of all long-term debt obligations and securities to be outstanding at the completion of the proposed offering exceeds the product of three (3) times the net book value of the issuer's tangible assets as of the end of the most recently completed quarter of the issuer's current fiscal year.

For purposes of this standard, the phrase "net book value of the issuer's tangible assets" means the difference between (a) the book value of the issuer's tangible assets and (b) its liabilities, plus the aggregate amount of all preferred stock outstanding (other than convertible, participating preferred stock), as of the end of the most recently completed quarter of the issuer's current fiscal year.

Restated, a proposed public offering of either preferred stock or debt securities by a going concern or a promotional company of the type described above is presumed to be grossly unfair to public investors under this standard if the proposed debt-to-equity ratio of the issuer, determined by the aggregate amount of senior securities to be outstanding at the completion of the proposed offering and the net book value of the issuer's tangible assets as of the end of the most recently completed quarter of the issuer's current fiscal year, exceeds a ratio of three-to-one (3:1).

The Division may in its discretion modify the foregoing standards if the issuer or applicant demonstrates to the satisfaction of the Division that the financial condition, character of the business, or other circumstances of the issuer warrant such modification.

**3. General Standards on Sinking Fund Requirements for Debt Securities:** In the case of a proposed public offering of the debt securities (including notes, bonds, debentures, etc.) of either a going concern or a promotional company of the type described above, where the maturity date of the securities to be offered is more than ten (10) years from the date of issuance, such proposed offering is considered to be grossly unfair to public investors under this standard if the charter documents, trust indenture, or other controlling instruments pursuant to which such debt securities are proposed to be issued fail to provide for the following:

(a) a sinking fund requirement whereby the issuer must contribute in regular installments at least ninety per cent (90%) of the principal amount of the issue to such fund prior to maturity in order to provide for the retirement of the issue; and

(b) a requirement that such issuer must commence making regular contributions to such sinking fund by no later than the beginning of the sixth (6th) fiscal year following the date of issuance, and must continue to do so at least annually thereafter.

The Division may in its discretion modify the foregoing requirements if the issuer or applicant demonstrates to the satisfaction of the Division that the financial condition, character of the business, or other circumstances of the issuer warrant such modification.

(B) *Issuance and Sale of Senior Securities by Start-Up Companies and Certain Other Promotional Companies.*

*Applicability:* The limitations on the issuance and sale of senior securities by a promotional company apply to all proposed public offerings of preferred stock or debt securities to be made by such companies, except for offerings to be made by issuers which are organized not for profit, but

exclusively for religious, educational, social, recreational, athletic, benevolent, fraternal, charitable, reformatory, or cooperative marketing purposes.

**General Standard:**

1. **Start-up Companies:** A proposed public offering of either preferred stock or debt securities by an issuer which is a start-up company within the meaning of divisions I(O)(1) and (2) of these Guidelines is considered to be grossly unfair to public investors under this standard, regardless of whether such issuer can demonstrate a substantial future net earnings or cash flow capability.

2. **Other Promotional Companies:** A proposed public offering of either preferred stock or debt securities by an

issuer which is a promotional company within the meaning of divisions I(O)(3) and (4) of these Guidelines is not considered to be grossly unfair to public investors under this standard if:

(a) the issuer meets all of the requirements and comes within all of the limitations set forth in division (A) of this standard;

(b) the preferred stock or debt security is convertible into common stock on a fair and equitable basis; and

(c) in the case of preferred stock, such stock is participating preferred stock and is non-redeemable (to the same extent as is the common stock of such issuer).

*(To be continued)*

**SENATE BILL 338  
Securities Exemptions**

As is the case with all modern securities statutes, the impact of the securities registration sections of the OSA can only be appreciated after the securities and transactions exemptions have been reviewed in some detail. Accordingly,

in order to aid the reader in studying these exemptions, the following two-column, side-by-side summary comparing the central provisions of the securities exemptions contained in the existing statute (§ 1707.02) with those contained in the proposed new Ohio Securities Act (S.B. 338) has been prepared and is set forth below.

**Comparison of the Securities Exemptions contained in the Present Law with those in the proposed new Ohio Securities Act**

**Proposed New OSA (S.B. 338)**

**Existing Securities Act (§ 1707.02)**

**OSA § 1707.03(A) Domestic Governmental Securities**

**§ 1707.02(B) Governmental Securities**

- (1) Any security, including a revenue obligation, issued or guaranteed by the U.S., any state, any political subdivision of a state, or any agency or instrumentality of one or more of the foregoing, or any CD for any of the foregoing, is exempt; also
- (2) any security which is an industrial development bond, as defined in § 103(c)(2) of the Internal Revenue Code of 1954, the interest on which is excludable from gross income under § 103(a)(1) of such code, is exempt if, by reason of the application of paragraph (4) or (6) of § 103(c) of such code [determined as if paragraphs (4)(A), (5), and (7) were not included in such § 103(c)], paragraph (1) of such § 103(c) does not apply to such security; and
- (3) any bond issued under authority of Chapter 165. or 761. or § 4582.06, is exempt.

Generally, all governmental securities are exempt if the issuer or guarantor has the power of taxation or assessment for the purpose of repaying the obligation or is specifically empowered by state law to issue securities payable out of revenues collected or administered by such issuer, i.e., those issued or guaranteed by:

- (1) the U.S. government;
- (2) any foreign government with which the U.S. is, at the time of sale, maintaining diplomatic relations; and
- (3) any political subdivision or other governmental body, corporation, or agency of the U.S., any state (including Canadian provinces), territory, or of any foreign government with which the U.S. is, at the time of sale, maintaining diplomatic relations.

There is a pre-sale informational filing and fee requirement for any security which is not payable out of the proceeds of a general tax.

**OSA §1707.03(B) Foreign Governmental Securities.**

Any security issued or guaranteed by Canada, any Canadian province, or any political subdivision or agency thereof is exempt; also any security of any foreign government (but not a political subdivision or agency thereof) with which the U.S. currently maintains diplomatic relations is exempt.

**§1707.02(K) Bonds issued under Chapters 165. or 761. or §4582.06**

All bonds issued under authority of Chapter 165, 761 and §4582.06 are exempt.

**OSA §1707.03(C) Securities of Banks and Certain Other Financial Institutions**

Any security issued by and representing an interest in or a debt of, or guaranteed by, any of the following is exempt:

- (1)(a) any bank, S & L or credit union supervised under federal law;
  - (b) any bank, savings institution, trust company, S & L, B & L, or credit union supervised under Ohio law;
  - (c) any bank, trust company, savings institution, S & L, B & L or credit union whose deposits are insured or guaranteed by FDIC, FSLIC, or the Federal Credit Union Administration.
- (2) also, the deposits (i.e., insured debt or share accounts) of any such financial institution are exempt, if such institution is organized under, and examined and supervised pursuant to, the laws of *any* state.

**§1707.02(C) Bank Securities**

Any security issued by and representing an interest in or an obligation of a national bank or a corporation or agency created by or under federal or Canadian law, or of any state bank, is exempt if such bank, etc. is supervised or subject to regulation by such government or state.

A "bank" is defined in §1707.01(O) as being any bank, trust company, B & L, or savings association organized under U.S., Canadian, or state law and subject to regulation or supervision by such country or state.

**OSA §1707.03(D) Securities of Railroads, other Common Carriers, Public Utilities and Holding Companies**

Any security issued or guaranteed by any railroad, other common carrier, public utility, or holding company is exempt if such issuer or guarantor is subject to the jurisdiction of the ICC, or if it is a registered holding company under the Public Utility Holding Co. Act of 1935 (or a subsidiary thereof), or if it is regulated in respect of its rates and charges or the issuance or guarantee of its securities by a governmental authority of the U.S. or any state (or Canada, or any Canadian province, in the case of the issuance or guarantee of its securities).

**§1707.02(F) Public Utilities's Securities & Equipment-Trust Certificates**

Securities issued or guaranteed as to principal, interest, or dividends by a corporation owning or operating "any public utility" are exempt if the utility is supervised or regulated as to its rates and charges or as to the issuance or guaranteeing of its securities by a public commission, board, or officer of the U.S., Canada or any state or municipality; also, certain equipment-trust certificates, if based on a security interest in vehicles or rolling stock, or vehicles mortgaged, leased, sold or furnished to a public utility, etc., are exempt.

**OSA §1707.03(E) Certain Exchange Listed Securities**

Any security listed or approved for listing upon notice of issuance on the NYSE, AMEX, Midwest stock exchange or such other stock exchange as the Commissioner may by rule specify is exempt; also, any other security of the same issuer which is of senior or substantially equal rank is exempt; also, any securities called for by listed warrants or rights, or any warrants or rights to purchase or subscribe to such securities, are exempt.

**§1707.02(E) Certain Exchange Listed Securities**

Any security which is listed or listed upon notice of issuance on the NYSE, AMEX, Midwest and Cincinnati stock exchanges and any other stock exchange approved by the Division of Securities is exempt; also, any security senior to any security so listed is exempt; but, the exemption applies only so long as such security and exchange remain so listed and approved, etc., and the Division has the power to revoke the approval of any exchange (including any exchange actually specified in this exemption) and to suspend or revoke the exemption of any particular security so listed.

**OSA § 1707.03(F) Memberships in Non-Profit Organizations**

Any security which represents or evidences *membership* in any non-profit charitable organization (i.e., one organized and operated not for private profit but exclusively for charitable or similar purposes), including a chamber of commerce or a trade or professional association, is exempt if the financial gain which may inure to any member is neither a purpose for which the entity is organized nor an inducement accompanying the offer of membership, and if membership represents no financial interests in the entity other than a right to payment upon dissolution equal to such member's pro-rata share of the entity's assets.

**§ 1707.02(I) Memberships in Non-Profit Organizations**

Any security, *except* debt obligations (i.e., notes, bonds, debentures, or other evidences of indebtedness or of promises or agreements to pay money), which is issued by a non-profit charitable organization (including a marketing cooperative etc.), is exempt if no part of the net earnings of such issuer inures to the benefit of any shareholder, member or individual and if the total commissions, expenses, etc. payable in connection with the sale of such securities do not exceed 2% of the total sale price plus \$500.

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**OSA § 1707.03(G) Commercial Paper**

Any commercial paper which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which evidences an obligation to pay the full amount due and payable in cash within nine months of the date of issuance, or any separately negotiated renewal of such paper which is likewise limited, or any guarantee of such paper or of any such renewal is exempt.

See also, OSA § 1707.04(L), which exempts sales of notes, bonds and other evidences of indebtedness which are secured by security interests in property if such bonds, etc. and security interests are sold as a unit.

**§ 1707.02(G) Commercial Paper and Promissory Notes**

Commercial paper and promissory notes are exempt when they are not offered for sale to the public.

See also, existing § 1707.03(H) which is comparable to OSA § 1707.04(L).

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**OSA § 1707.03(H) Investment Contracts Issued in Connection with Employees' Benefit Plans**

Any investment contract issued in connection with an employees' stock purchase, savings, pension, profit-sharing, or similar benefit plan is exempt.

There is no comparable provision in the existing law.

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**OSA § 1707.03(I) Agricultural and Farmers' Co-operatives**

Any security issued by any agricultural co-operative association organized under §§ 1729.01 to 1729.27, O.R.C., or by any farmers' co-operative organization exempt from federal income tax under § 521 of the Internal Revenue Code of 1954 (or by any related tax-exempt corporation, etc.) is exempt.

There is no comparable provision in the existing law [except to the extent that membership shares in "co-operative marketing" associations are exempt under existing § 1707.02(I)].

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There is no comparable provision in the OSA; but see, the transaction exemption for preorganization certificates or subscriptions [OSA § 1707.04(I)] and the "sophisticated investor" and private offering exemptions [OSA § 1707.04(F), (G) & (H)].

**§ 1707.02(D) Interim Certificates**

Any "interim" certificate is exempt if the securities to be delivered therefor are themselves exempt, or are the subject matter of an exempt or registered transaction or are registered.

There is no comparable provision in the OSA

#### § 1707.02(H) Insurance Securities

Securities issued or guaranteed by an insurance company, except as provided in § 1707.32, are exempt from existing Chapter 1707, if such company is supervised, and the issuance of such securities are regulated by, a state (note that the Superintendent of Insurance regulates their issuance and sale).

There is no comparable provision in the OSA; but see, the trading transaction exemptions specified in OSA § 1707.04(A) through (E).

#### § 1707.02(J) Securities Outstanding for 5 years or more

Any securities outstanding for a period of not less than 5 years are exempt if there has been no default in the payment of principal, interest or dividends for the 5 year period immediately preceding the sale, or if, in cases where the securities have no specified dividend or interest rate, the issuer has paid dividends of 4% thereon for the 5 year period preceding the sale.

### Discussion of Securities Exemptions

As the foregoing summary indicates, there are nine general securities exemptions in the proposed new act, all of which are found in OSA § 1707.03. They are as follows:

(1) *Domestic Governmental Securities*: The first exemption, OSA § 1707.03(A), is for governmental securities, including revenue obligations, of the United States, any state or any political subdivision of a state, or any agency or other instrumentality of any such public authority. Clause (1) of this subsection, which is nearly identical to USA § 402 (a)(1) and the first two clauses of § 3(a)(2) of the Securities Act of 1933, exempts the securities of the same issuers as existing § 1707.02(B), at least insofar as domestic governmental issuers are concerned (although in cases where a particular governmental issuer is not "in specific terms empowered . . . [by state law] . . . to issue securities payable . . . out of revenues collected or administered by such issuer", the OSA provision would appear to be broader in scope). There is one notable difference in these two sections, however. Existing § 1707.02(B) provides that, if the security involved "is not payable out of the proceeds of a general tax", the issuer must file an information statement with the Division [Form 2(B)] before the security may be sold in the state. Since this filing requirement was not believed to serve any useful purpose, it has been dropped from the OSA; and thus the filing of Form 2(B) would no longer be a pre-condition to the availability of this exemption for the sale of government revenue bonds.

Clause (3) of OSA § 1707.03(A), like existing § 1707.02(K), exempts all bonds issued under the authority of Ohio Revised Code Chapter 165. (industrial development bonds issued by the state and certain Ohio counties and municipalities), Chapter 761. (industrial and economic

development bonds issued by Ohio municipalities) and section 4582.06 (construction bonds issued by port authorities). In addition, clause (2) of this section follows the language of § 3(a)(2) of the Securities Act in exempting certain other industrial development bonds, i.e., those issued otherwise than under the authority of Chapters 165., 761. and § 4582.06, which would include the industrial development bonds issued by the public agencies and instrumentalities of other states. This provision is necessary because of the "two-security" theory applicable to such bonds [i.e., where the non-governmental issuer is considered to have issued a "separate security" because its rental payments are to be used to amortize the bonds; see, e.g., SEC Rule 131 and IV *Loss, Securities Regulation* pp. 2588-89 (Supp. 1969)]. As is true of § 3(a)(2) of the 1933 Act, clause (2) would only exempt an industrial development bond issue if the interest on the bonds is excludable from gross income under § 103(a)(1) of the Internal Revenue Code by reason of the application of paragraphs (4) and (6) of § 103(c) (i.e., bonds used to finance the construction of certain types of facilities and certain small bond issues). Hence, if the bonds do not come within this category, and if they are not issued under authority of Chapters 165. or 761. or § 4582.06, the "separate security" of a non-governmental issuer may have to be registered [see IV *Loss, supra* at p. 2589].

(2) *Foreign Governmental Securities*: OSA § 1707.03(B) follows the Uniform Securities Act language of § 402(a)(2) in exempting a variety of foreign governmental securities, namely, those issued by Canada, Canadian local governmental units and any other foreign government with which the U.S. currently maintains diplomatic relations. Unlike existing Ohio law, however, OSA § 1707.03(B) would not exempt securities issued by the local governmental units of any foreign government except those of Canada. Also, because of the fact that, historically, foreign governmental securities have often proven to be unsafe, it was decided to

give the Commissioner the rule-making power under OSA §1707.06 to modify or further condition this exemption with respect to any security or transaction if he detects abuses in the use thereof [compare USA §402(c), which only applies to the securities exemptions for commercial paper and the securities of non-profit charitable organizations].

(3) *Securities Issued by Certain Financial Institutions:* OSA §1707.03(C) exempts all securities issued by banks, trust companies, savings and loan associations, building and loan associations, credit unions, etc. which are supervised under either federal or Ohio law, or whose deposits are insured by one of the federal agencies insuring such institutions (i.e., FDIC, FSLIC, or the Federal Credit Union Administration). Deposits in certain other financial institutions which are organized, examined and supervised pursuant to the laws of any state are also exempted.

By and large, this exemption is designed to cover the same securities as those exempted in § 402(a)(3), (4) & (6) of the uniform act and §§1707.02(C) & 1707.01(O) of the existing law, with the principal distinctions being as follows: (a) the availability of the exemption for those financial institutions which are not supervised under either federal or Ohio law would depend not upon whether such institutions were supervised under the laws of any other state, but rather upon whether the deposits of such institutions were insured by the Federal Deposit Insurance Corporation or related-type federal agencies; hence, the exemption would probably not be available for the capital stock of newly-formed or uninsured financial institutions; (b) the exemption would not be available for Canadian bank securities as it now is under existing law [see existing §§ 1707.02(C) and 1707.01(N) & (O)]; note that OSA §1707.01(R) does not include Canadian provinces within the definition of the term "state" as does existing §1707.01(N); compare, e.g., USA §402(a)(3)]; (c) shares in locally chartered credit unions - whose "securities" are not now exempt under existing law, although the "sale" thereof is exempt under §1707.03(J) if the 2% profit limitation is met - would be exempted from the registration provisions of the OSA; (d) the exemption for credit union securities would technically be extended to out-of-state credit unions whose deposits are federally insured; and (e) unlike existing law, which exempts the *sale of any securities* by a federally or locally chartered "bank" or credit union [see existing §§ 1707.03(J) and 1707.01(O)], OSA §1707.03(C) would only apply to securities "representing an interest in or a debt of, or guaranteed by" any bank or other specified financial institution; and presumably this would not include participations in a commingled investment trust account established by a bank. [For a more detailed discussion of the meaning of the quoted phrase, see the Official Code Comment to USA §402(a)(3); *1 Loss, Securities Regulation* pp. 564-566 and related supplement and the 1970 amendments to §3(a)(2) of the Securities Act; compare existing §§ 1707.02(C), 1707.03(J), 1968 *Ohio Atty. Gen. Opinions* No. 68-089 (June 6, 1968) and OSA §1707.47(B)].

(4) *Common Carriers and Public Utilities:* For common carriers and public utilities the Uniform Securities Act

formula, as expressed in USA §402(a)(7), has been followed. Thus an exemption for the securities issued or guaranteed by such carriers and utilities may be premised on any one of several specified grounds, e.g., the issuer being subject to the jurisdiction of the ICC, or being a registered holding company, or being regulated in respect of its rates or charges or the issuance or guarantee of its securities by a governmental authority of the United States or any state (or, in the case of the issuance or guarantee of its securities, by Canada or any Canadian province as well) [see OSA §1707.03(D)]. This is essentially the same exemption as that provided for in existing §1707.02(F), although the latter also exempts the securities of any Canadian carrier or utility which is regulated "in respect of its rates and charges" by a Canadian local governmental unit, whereas the USA and OSA do not. In addition, the exemption for equipment-trust certificates, which are used to finance railroad rolling stock and related transportation equipment, has been deleted [see USA §402(a)(7) and *1 Loss, supra* at pp. 465-66].

The definition of the term "guaranteed" is significant in this context because securities "guaranteed" by any of the aforementioned governmental authorities, financial institutions or public utilities are expressly exempted from the registration provisions of the OSA. The term "guaranteed" is defined in OSA §1707.01(F) to mean "guaranteed as to payment of principal *and* interest, or as to payment of dividends". This modification of the USA definition of the term is designed to make it clear that the foregoing exemptions would apply only to an obligation which is guaranteed as to both principal and interest, and not just to either principal or interest [compare existing §1707.02(F)]. On the other hand, these exemptions would be available for a security which is guaranteed as to the payment of dividends, even though it would not be guaranteed as to a return of capital.

(5) *Certain Exchange-Listed Securities:* OSA §1707.03(E) exempts any securities listed or approved for listing upon notice of issuance on the New York, American, and Midwest stock exchanges and on any other stock exchange designated by a rule of the Commissioner. This would exempt both issuer and non-issuer transactions in such securities. Also exempt under this provision would be any other securities of the same issuers which are of senior or substantially equal rank, including warrants and subscription or purchase rights therefor, and any securities of the same issuers which are called for by listed warrants or subscription rights.

This provision is essentially the same exemption as that found in USA §402(a)(8) and existing §1707.02(E) except that: (a) under the USA, there is no statutory authority for adding exchanges to the approved list, whereas such authority is expressly provided for in the existing statute and in OSA §1707.03(E); (b) under the Ohio statute, only listed securities (which would include listed warrants and rights) and securities senior to any security so listed are exempt, whereas under the USA and OSA, securities of the same issuer which are of substantially equal rank, unlisted warrants and subscription rights for such securities, and securities of the same issuer called for by listed warrants and rights would also be exempt; and (c) under existing

§1707.02(E)(3), the Division has the authority to revoke the approval of *any* exchange, even an exchange actually specified in the statute; but no such withdrawal authority is included in either the USA or the OSA.

(6) *Memberships in Non-Profit Charitable Organizations:* OSA §1707.03(F) exempts membership interests in most non-profit charitable (i.e., religious, educational, benevolent, social, recreational, etc.) organizations, including chambers of commerce and trade associations, (a) if financial gain is neither a purpose for which the entity is organized and operated nor an inducement accompanying the offer of membership, and (b) if membership represents no financial interest in the entity other than a right to payment upon dissolution in an amount equal to such member's pro-rata share of the entity's assets. This provision, which is considerably more limited than its counterpart in §3(a)(4) of the federal Securities Act and §402(a)(9) of the USA, is comparable to existing §1707.02(I) in terms of the scope of the exemption to be afforded to such securities. Thus, obligations such as church bonds, etc. would not be exempted under this provision.

(7) *Short-Term Commercial Paper:* What is substantially the Uniform Securities Act version of the exemption for commercial paper is included in the proposed new act as OSA §1707.03(G); it covers any commercial paper which arises out of a current transaction and the terms of which provide for full payment in cash within nine months of the date of issuance [compare USA §402(a)(10), §3(a)(3) of the federal Securities Act, and existing §1707.02(G), which exempts "commercial paper and promissory notes" if they are not offered "for sale to the public"]. The primary purpose of this exemption is to permit financial institutions to trade with each other in such paper — which trading ordinarily does not involve a public offering. The nine-month maturity limitation on such paper is designed to make it clear that the exemption is available only for short-term, "prime" quality, negotiable commercial paper, i.e., the type which is usually eligible for discount at a Federal Reserve Bank [see, e.g., 1 *Loss, supra*, pp. 566-68, Sec. Act Rel. #4412 (1961) and the Report of the OSBA Committees' on Corporation and Blue Sky Law, OHIO BAR Vol. 1, No. 42, p. 35 (Jan. 15, 1929)].

(8) *Employees' Benefit Plans:* OSA §1707.03(H) provides that any "investment contract" issued in connection with one or more of the specified employees' benefit plans are exempted. This provision, which has no analog in the existing Ohio law, is based upon USA §402(a)(11), although the pre-sale notice requirement of the USA provision was deleted. The official Comments to the USA make it clear that:

"This exemption is designed to solve the problem which arises in those states whose Administrators take the position, also taken by the SEC, that employees' benefit plans of various kinds involve an offer of a security in the nature of an "investment contract", at least if participation is voluntary with each employee and he must contribute under the plan in order to participate. See *Loss, Securities Regulation* [pp. 506-511 and related supplement at pp. 2551-56.]"

[See also, the 1970 amendments to §3(a)(2) of Securities Act of 1933.]

(9) *Agricultural Co-operatives' Securities:* Securities issued by agricultural co-operative associations organized under Chapter 1729. of the Revised Code or by any other, out-of-state farmers' co-operative organizations which are exempt from federal income tax would be exempted from the OSA's registration provisions [OSA §1707.01(I)]. This is consistent with the treatment of such securities under §3(a)(5) of the federal Securities Act and the laws of a number of other states [compare existing §1707.02(I)].

*Existing Securities Exemptions not carried forward into the OSA:* A few of the securities exemptions found in the present law do not appear in S.B. 338. One such exemption is that for "interim" certificates [see existing §1707.02(D)]. In view of the fact that a "security" would be looked upon under the OSA as the "interest" which an investor has rather than the "certificate" which he receives, this exemption would no longer appear to be necessary. However, to the extent that this exemption was ever relied upon for anything other than the issuance of preliminary, temporary certificates for more formal certificates which were to be issued at a later date, other exemptions would be available for such situations. For example, the OSA contains a transaction exemption for preorganization subscriptions or certificates, provided that the total number of subscribers is limited to fifty or less persons, and provided further that the certificates are not binding upon the subscribers. Also, preorganization certificates could be issued under any one of the expanded private offering or sophisticated investor exemptions. Further, to the extent that "interim" certificates evidence or represent the underlying securities sold or to be sold, they would be treated as though they were, or were part of, the underlying securities themselves. And, under the OSA, one could, in a public offering, register both the "interim" certificates and the underlying securities in a single registration statement.

In addition, there is no securities exemption comparable to that contained in existing §1707.02(J) for securities which have been outstanding for five years or more, as transactions in such securities would be covered by the "trading" (transaction) exemptions (i.e., to the extent that transactions in such securities should be specially exempted).

Finally, as stated in the preceding article on S.B. 338, the proposed new act does not contain an exemption for the equity and debt securities to be issued by insurance companies (although it would exclude from regulation variable annuities as well as the more traditional forms of insurance policies and annuity contracts). While the OSA would place the administration of such securities in the Division of Securities, the Commissioner would, where appropriate, be expected to coordinate with the Superintendent of Insurance, who would continue to administer the insurance statutes.

In the next article, some of the transaction exemptions will be reviewed.

Kenneth M. Royalty

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## OTHER DEVELOPMENTS

### Comings and Goings

On Wednesday, June 14, Nick Kiraly visited the Division to discuss with the new examiners in the Registration Section the Ohio Securities Act, the origins of its statutory gloss, and the rationale of historic Division policies developed and applied in the process of its implementation. Nick's presentation, which was based upon his 32 years' service as the Dean of Ohio Blue Sky Administrators, was equally beneficial to those of us who have had a longer period of time to ponder the elements of confusion inherent in many provisions of the Act. He has agreed to continue this discussion at a later date and we will look forward to it. This session was the first in what is hoped will be a series of presentations to the registration staff by experienced practitioners, law professors, and industry representatives designed to promote within the Division a better understanding of the increasingly complex business transactions manifesting themselves in current securities offerings.

Earlier in the month, Alan P. Baden and Nelson Genshaft joined the Registration Section of the Division following graduation from Case-Western Reserve Law School. Both served on the Law Review and have studied Securities Law under Professor Coffey. After a period of training in registration, one or both may choose to join the Commissioner's staff in policy development and implementation roles. Both are very able and their addition to the team at such an important time is a welcome event.

On June 12, Fred Elefant left the Division to enter private law practice in Jacksonville, Florida. On July 6, Greg Seeley left to enter practice in Cleveland. Both contributed heavily this year in a variety of roles to the Division's resurgence of relevancy. Both will be very difficult to replace. Those of us remaining at the Division wish Fred and Greg the best of success, both as continuing friends and as potential future adversaries.

The Division will have several positions available within the next two or three months for both attorneys and financial analysts. Recent law school graduates will be considered as well as attorneys with experience in government or private practice. Only college graduates with a background in business or accounting will be considered for financial analyst positions. Readers of the Bulletin are urged to refer persons who might be interested in employment with the Division to Mr. Nicholas J. Caraccilo for further information regarding the positions available.

William L. Case, III

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## THE SECTIONS

### BROKER-DEALER SECTION

#### Expedited Procedure For Corporate Reorganizations

Depending upon the circumstances, persons selling securities pursuant to a merger or consolidation may be required by the provisions of Ohio Revised Code Section 1707.14 to be licensed as securities dealers even though the offering may be exempt from registration under one of a number of provisions of Section 1707.02. This point is of particular importance for those issuers choosing not to rely upon the Division's no-action position with regard to the applicability of Section 1707.03(K)(2) following the revocation during 1971 of Ruling No.2.

While the Division, of course, does not have the authority to alter the law, it may exercise its discretion as to the manner in which securities registrations and dealer's licenses may be obtained. Recognizing this fact, several parties submitting comments to the Division have suggested that a short form securities registration process and an abbreviated dealer licensing process be instituted for use in merger or consolidation transactions.

In response to these suggestions, the Division has adopted a truncated licensing procedure for individuals who effect transactions pursuant to a specific plan of merger or consolidation and seek a securities dealer's license exclusively for that purpose.

The licensee should be the decedent-constituent corporation itself or the individual who is the principal executive responsible for representing the decedent-constituent to the merger or consolidation in the solicitation of votes in favor of a plan of merger or consolidation. Since the decedent-constituent to the merger or consolidation is the entity which solicits proxy statements which constitute offers and conducts shareholders' meetings where the "point of sale" occurs, it is considered to be selling the securities as agent for the survivor-constituent which is considered to be the issuer. The decedent-constituent soliciting the approval of the plan may, of course, employ a regularly licensed securities dealer rather than arranging for special licensing of a representative of management.

To apply for this special license, the applicant should submit the usual form to the Division, noting clearly thereon that the application is for the exclusive purpose of effecting a specific plan of merger or consolidation. The Division will then forward to the applicant by mail an open book examination which the applicant will be permitted to take with the aid of any reference materials which he chooses but without the aid of any other person. The examination must be returned to the Division together with a statement under oath that the examination was completed by the applicant alone. The examination will be materially different from the examinations given to applicants for other types of securities dealer's licenses, and will be designed to assure that the applicant has a general familiarity with the Ohio Securities Law, particularly the provisions relevant to the prohibition of fraud and other types

of violation. All other requirements of restricted dealer license applicants, except minimum capital requirements, must be met by applicants for these special licenses.

If a dealer licensee will require the assistance of others in effecting the transactions, they must be licensed as salesmen. A procedure for expedited licensing similar to the one outlined above applies to applicants for special salesman's licenses in connection with mergers and consolidations.

Elbridge Lewis

### Net Capital, Liquidity, And Broker-Dealer Compliance

One of the purposes of the "Net Capital" rule is to require a broker-dealer to have at all times sufficient liquid assets to cover current indebtedness. For this purpose, an asset is considered as lacking liquidity if it is "not readily convertible into cash".

The need for liquidity has long been recognized as vital to the protection of investors. It is predicated on the belief that accounts are not opened and maintained with broker-dealers in anticipation of relying upon suit, judgment and execution to collect claims, but rather on the expectation that upon reasonable demand one can liquidate his cash or securities positions.

The broker-dealer should maintain an accessible place of business open to the public during regular business hours. He should maintain a regular set of broker-dealer books and records. The records should remain on the premises and be available for inspection by Division examiners at all times. Broker-dealers should not attempt to justify lack of compliance with these requirements on the basis of inactivity. The issuance of a license to a broker-dealer implies that he is and will be active. The statute contains no provision for "on the shelf" or inactive licenses. The principles spelled out in Regulation DS-6, *Records of Dealers*, still apply. Therefore, the broker-dealer who becomes inactive should surrender his license for cancellation.

In subsequent articles, we will attempt to amplify the ideas in this area touched upon by the Commissioner in the June issue of the Bulletin.

Gordon Stott

### CONSUMER FINANCE SECTION

#### "New Concepts of Convenience and Advantage"

Under Section 1321.04(B), Revised Code of Ohio, one of the requirements for the issuance of a license to engage in the "small loan" business is as follows: "... That allowing such applicant to engage in such business will promote the

convenience and advantage of the community in which the licensed office is to be located." The small loan laws of most states contain this prerequisite in the same or similar phraseology. Books have been written on the interpretations of these various provisions.

*Annotations On Small Loan Laws* (Russell Sage Foundation 1938 pp. 53, 54) states in part: "Where competition was too intense, events demonstrated that the public interest was not well served. There is a tendency for excessive competition to increase costs of lending, and consequently, to restrain competitive rate reductions. Licensees were not operating efficiently or were inadequately financed... harsh collection practices resulted..."

Interpretation of the Ohio statute resulted in a "rule of thumb" requiring a county population of 8,000 or more persons per licensee and a municipal population of 4,000 or more persons. In 1965, due to the movement of commerce and population to suburban shopping centers, the municipality "rule of thumb" was eliminated by A.G. opinion No. 65-83, but the county "rule of thumb" was continued. However, until 1972 the county "rule of thumb" was often disregarded since a multitude of small "independents" discontinued business, and major chains opened branches in areas where large numbers of borrowers were without service.

Since the convenience and advantage prerequisite remains in Ohio law and cannot be ignored, in addition to retaining the 8,000 person county policy, I should like to propose new interpretations which will incorporate some of the concepts contained in the recommendations of the National Commission On Consumer Finance:

1. FULL SERVICE CONCEPT. The licensee must be willing and able to make loans in accordance with its credit standards in small or large amounts pertinent to the needs and capacities of the borrower and without self-imposed ceilings such as a \$2,000 limit. Credit standards must be non-discriminatory as to race, sex, religion, marital status or residence. Loan interviewers must be experienced in credit counseling and offer meaningful advice to present and prospective borrowers. Licensees must be willing to promote consumer credit education in schools, churches, or other community centers.
2. LOCATION. Operations should be centered in the service area to maximize accessibility and should incorporate parking facilities. The office should be easily identifiable and be situated so as not to impair the health, safety or welfare of the populace.

Applicant's Schedule 18 exhibit should be responsive to these new requirements.

Robert Fickell

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## CREDIT UNION SECTION

### 30-Day Compliance Procedures

The recent increase in the strict enforcement of credit union laws has resulted in a burdensome backlog of Division hearings and reports. Alternatives to the present form of formal suspension in appropriate circumstances are required to insure the speedy resolution of credit union difficulties and to provide a more efficient means to communicate to the industry the need for a comprehensive review of credit union operations in connection with the new regulatory policy of the Division.

Presently this section relies very heavily upon post-examination letters of exception, calling to a credit union's attention minor errors of omission or commission which warrant comment. Exceptions most frequently noted are pointed out by form letter. These are typical in-house violations of procedure and frequently are matters readily resolved by boards of directors acting upon their own authority. More serious exceptions are subject to the more strict remedy of suspension of operations pursuant to Section 1733.36, Ohio Revised Code and the requirement of a formal plan of corrective action. Under the statute, the suspension authority is not mandatory and the legislators intended a wide use of discretion in the regulation of credit unions.

The Credit Union Section will soon begin implementing a procedure whereby the correction of some exceptions which might otherwise involve a suspension will instead be ordered pursuant to a formal letter of compliance. This procedure will be used only where no actual or potential risk of loss to shareholders exists, in the form of capital impairment or otherwise. It will be used, for example, in cases involving poorly functioning boards of directors or committees, inadequate attendance at annual or special meetings of members, or when, in the judgment of the Supervisor of the Credit Union Section, the operation of the credit union appears to be generally deficient in comparison to other credit unions of similar size and membership fields. Under this procedure, the failure to correct all deficiencies or to furnish a satisfactory plan of corrective action to the Division within thirty days following the date of the compliance letter will result in a formal suspension of the operations of the credit union.

Although it might appear that this compliance letter is similar to the 15-day show cause order or notice of intent to suspend operations contained in the previous credit union statute, it should be pointed out that the previous procedure was used in cases where financial jeopardy was involved. The institution of this 30-day compliance letter procedure should not be construed as an extension to the credit union industry of the olive branch of peace and tranquility or an accedance to the demands of the industry for leniency. Rather, it should be viewed as a positive and constructive tool which the industry may use to aid in the reconstruction and preservation of the credit union system in this state.

John Gouch

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## ENFORCEMENT SECTION

### Enforcement Objectives, Standards, and Remedies

Progress has recently been made on the development of more meaningful standards for the selection of enforcement cases to which priority will be given in the allocation of Division resources, and a brief overview of Division considerations can be stated at this time.

The principal objectives of the Division's enforcement activities will be (1) the cessation of specific acts constituting securities violations, (2) the prevention of loss, or further loss as the case may be, to investors, (3) the restoration to investors of funds already lost as a result of violations, (4) the prevention of future violations by the same persons, by removal of violators from the securities business, if necessary, (5) the public deterrence of similar violations by other persons, and (6) the establishment of precedents for taking action against particular types of violations.

The criteria for selecting specific cases for full investigation and for proceeding with administrative action or prosecution will include (1) the extent to which the violations are continuing to occur, (2) the degree of risk of loss or additional loss involved and the likelihood that such loss can be prevented by Division action, (3) the extent of the injury already sustained in terms of the number of dollars involved and the likelihood that lost funds can be restored to the investors, (4) the breadth of the violation in terms of the number of investors involved, (5) the degree of sophistication and the financial position of the investors, (6) the ability of the investors to fend for themselves through civil action or the exercise of control over their investment, (7) the materiality of the violation—whether fraud or a technical violation is involved, (8) the degree of wilfulness or knowledge on the part of the violator and the existence of repetitive violations, (9) the degree of clarity of the applicability of the securities laws to the acts claimed to be violations, as opposed to the existence of unethical or otherwise wrongful acts not clearly prohibited by the securities laws, and (10) the extent of the passage of time subsequent to the violation and the availability and quality of evidence upon which to base a case.

The specific remedies which will be applied by the Division as the individual situation warrants will include (1) the gathering of information and the encouragement of voluntary compliance by the use of questionnaire or informal conference, (2) the issuance of a formal compliance letter requiring the justification of specific acts or the cessation of such acts and correction of the damage sustained, (3) the convening of a formal pre-suspension or pre-injunction show cause record hearing leading to corrections or to administrative or legal action, (4) the issuance of a pre-hearing suspension order, (5) the issuance of a post-hearing denial or revocation order, (6) the seeking of a court injunction, (7) a petition for receivership, and (8) the recommendation of criminal prosecution. In many of the situations where these remedies are utilized, the additional remedy of rescission will be vigorously pursued to repair losses sustained by investors.

The Abdulla case notwithstanding, the selection of cases to be pursued on the basis of the criteria outlined above and the application of the appropriate enforcement remedies will involve applications of human judgment which cannot be eliminated, but a carefully prepared record of actions taken over a period of time will serve as a guide for future decision-making which will greatly aid in the pursuit of consistency.

The Enforcement Section of the Division will begin immediately utilizing the above criteria to eliminate the extreme backlog of cases currently pending. The great majority of matters which constitute lower priority items will be handled by means of questionnaires and compliance letters. No-action letters will be issued where completely satisfactory remedial responses are forthcoming. Complainants will be advised to pursue other remedies where Division action is not contemplated within the near future. Once this backlog is cleared, a better organized enforcement effort can proceed on an up-to-date and responsible basis.

A major difficulty for the Division in proceeding with aggressive enforcement activities has been the past history of Division laxity in all areas of regulation. The Abdulla case notwithstanding, the Division will not consider itself estopped from taking action against violators merely because similar action has not been taken consistently in the past. Nor will the Division be estopped from revoking gross ultra vires acts of past Division employees. The Division will take into consideration the lack of clear Division policies in areas of potential violation, but will not allow the absence of rules to prevent it from taking action against practices which are violative of the basic regulatory principles of the Securities Act.

Veronica Dever

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#### **FOREIGN REAL ESTATE SECTION** **A Comparative Analysis of State Regulatory Fees**

The sale of foreign real estate in Ohio and the regulation thereof is governed by the provisions of Section 1707.33 and 1707.331, Ohio Revised Code. The Ohio Securities Act is a policing statute and not a tax or revenue generator. Registration and licensing fees should therefore be commensurate with operational and servicing expense. If consideration is given to the fees of other regulatory states, it becomes evident that the equivalent fees for registration and licensing of foreign real estate sales in Ohio should be reconsidered with a view toward revision upward.

Kansas, which regulates foreign real estate and securities by means of the same agency, includes fees for foreign real estate within its schedule for securities registration, with a minimum filing fee of \$10.00 and a maximum of \$510.00, based on the aggregate amount to be sold. Florida, which regulates foreign real estate through the Division of Florida Land Sales, requires a minimum filing fee of \$250.00 plus \$1.00 per lot over 100 lots, and a \$200.00 annual renewal fee. New York State, which regulates through a subagency

of the Secretary of State's Office, is a revenue producer. For the first 100 lots a \$500.00 filing fee is required plus \$5.00 per lot for each lot over 100.

At the other extreme can be found Arkansas and Indiana with no registration fees, but with a charge to the registrant of the actual expenses of on-site inspections by administrative personnel. Arkansas requires licensing of brokers and salesmen with fees of \$25.00 for a broker and \$15.00 for a salesman.

New Jersey, which regulates through a Real Estate Commission, requires only a \$50.00 filing fee with no limit as to number of lots under registration. It requires broker and salesman fees of \$10.00 each. New Jersey is one of approximately 14 states in the process of either revising or initiating interstate land sales legislation. Illinois requires only a \$250.00 filing fee and a \$250.00 annual renewal fee without restriction as to number of lots registered. Michigan will administer a new Act to become effective October 1, 1973. It will require a \$250.00 filing fee for the first 50 lots and an additional \$1.00 for each lot above that number. It will also require an annual renewal fee of \$100.00 plus \$25.00 per additional lot. The broker license fee will be \$30.00

Some states, including Florida, New York and Michigan, require special fees of up to \$25.00 per item (New York) to accompany the advertising materials submitted for review and clearance.

Where then does Ohio fall in relation to this fee structure? Under existing statutory requirements, Ohio requires a \$150.00 filing fee without regard to the number of registered lots or parcels and a similar \$150.00 fee for amendment of registration. Broker and salesman license fees are \$75.00 and \$15.00. In addition, testing fees of \$25.00 for brokers and \$15.00 for salesmen are required. Developer-Registrants must be licensed as brokers whether or not they engage independent Ohio licensed broker-dealers to participate in the offering. All applicants for registration must submit to on-site inspections which have been consistently required for over 20 years. The applicant bears the actual expense of the inspection plus a per diem salary reimbursement to the State of Ohio for the examiner's out-of-state inspection time. Ohio makes no charge for advertising material submitted for review.

A large subdivision registration in New York may produce fees of up to \$30,000.00. The same registration in Ohio would not exceed \$250.00.

It must be concluded that the foregoing disparities indicate that an increased fee schedule would be appropriate for Ohio. The increased revenue might justify a larger budget for the regulation of foreign real estate sales by the Division.

George A. Ward

## REGISTRATION SECTION

### Form 39 Not a Substitute For A Timely Filed Registration

The Division has taken notice of a recent increase in the number of registrations that are being filed pursuant to Section 1707.39. Moreover, the circumstances surrounding many of the transactions which are submitted for registration pursuant to this section would lead the Division to believe that some attorneys are erroneously interpreting Section 1707.39 as providing an *alternate* form of registration rather than as being a *remedial* provision.

Therefore, in an attempt to help the practicing attorney determine whether or not a particular transaction should be registered pursuant to Section 1707.39, the following observations should be made.

First and most important of all, Section 1707.39 was merely intended as a remedial form of registration and certainly is not to be considered an alternative method for registering a sale of securities. The Division is aware that in certain circumstances business considerations might dictate that time is of the essence with respect to a particular sale of securities. However, the Division has implemented new procedures (see S.O.P. 1973-2 published in the May issue of the Ohio Securities Bulletin, page 10-12) in order to be more responsive to the time requirements of the businessman. Steps have been taken to insure that an applicant filing pursuant to Section 1707.09 will be contacted by the examiner assigned to his application within ten days after the date of filing. Therefore, instead of adopting a "sell now and file later" attitude, an attorney who is approached by a businessman who would like to sell securities should determine under which section of the Ohio Securities Act the sale should be registered (assuming no exemption is available), make the appropriate filing, obtain a certificate or a Division Order, and then inform his client that he is authorized to sell.

Second, it is appropriate to mention that examiners are instructed to analyze a Form 39 filing in the same manner as if the sale of securities had been registered on time. The same Division policies will be applied to an offering filed on a Form 39 as would have been applied had it been registered under Section 1707.06 to 1707.09, respectively. The Division will not be forced into sanctioning a deficient transaction by accepting a Form 39 filing. The Division does recognize that Form 39 filings have a legitimate purpose, if not made in an attempt to violate the spirit of the Ohio Securities Act, and it will continue to accept these filings under appropriate circumstances. However, a person who intends to become a Form 39 "specialist" should insure that he fully comprehends the posture of the Division enunciated above.

The task of the Division will be greatly reduced and the processing of a Form 39 application will be expedited accordingly if it is accompanied by a cover letter summarizing the circumstances surrounding the sale of the unregistered securities. A tie-in sheet keyed to Item 12 of the Form will be most helpful to the examiner. Such a sheet should itemize all of the subsections of Item 12(F) and indicate whether or not each particular subsection is appli-

cable. This will enable the examiner to immediately determine that a particular exhibit is not included because the subsection is inapplicable and not as a result of an omission on the part of the attorney.

### Use of Projections in Private Placements of Securities Not Involving an Investment in Real Estate.

Recently, the Division informed an applicant that it could not include projections in an offering circular that was submitted in connection with a particular corporate private placement registered pursuant to 1707.09. Shortly thereafter, several inquiries were made to this office to determine whether it was true that projections could not be utilized in connection with private placements of interests in real estate limited partnerships.

In order to clarify the above misunderstanding, the Registration Section would like to reiterate its position on use of projections. Provided they are accompanied with the proper caveats and a description of the underlying assumptions upon which they are based, projections will be allowed in private placements, the proceeds of which will be invested in real estate, regardless of the organizational form of the enterprise, and will not be allowed under any other circumstances.

Although the Division is fully aware of the limitations and shortcomings of projections, it is the Division's position that in the context of a real estate investment, properly qualified projections are extremely valuable to a sophisticated investor to enable an informed investment decision. Moreover, due to the widespread use of these financial tools in the industry, the Division would be deluding itself if it thought that a prohibition would eliminate the presentation of projections in one form or another to prospective investors in real estate private placements. The result would merely be that the Division would not have an opportunity to examine the projections to determine their accuracy.

However, the Division takes a totally different view toward the use of projections in private placements not involving real estate. The Division draws a distinction on the grounds that in a real estate investment the unknown factors are comparatively limited and subject to a greater degree of control on the part of the sponsor, whereas in other types of investment, the vagaries of supply and demand are present to a much greater degree and, since the number of variables are more numerous, deviations from the projections are likely to be more frequent and more severe. With respect to the latter, the Division considers projections to involve a much higher likelihood of a misrepresentation of the results of an investment. The caveat and disclosure that would be necessary to prevent misrepresentation would cause the projections to be totally meaningless and would confuse any prospective investor.

The Division is fully cognizant of the SEC's position on this subject and is carefully awaiting the next pronouncement of that agency on the use of projections. However, until strong and convincing arguments can be propounded to the Division which would induce a change in its present policy, projections will be allowed only in private placements of real estate investments.

Bernard G. Boiston.

**ADMINISTRATIVE ACTIONS**

**Summary of Credit Union Regulatory Activity for June, 1973.**

Suspensions of Normal Operations

<u>Name of Credit Union</u>	<u>Date</u>
Friendly Credit Union, Inc.	6- 5-73
Gentel Central Credit Union, Inc.	6-25-73

Vacations of Suspension Orders

Youngstown I.P. Employees Credit Union, Inc.	6-21-73
A.S.F. (Alliance) Employees Credit Union, Inc.	6-21-73
Olivet Credit Union, Inc.	6-26-73

**Summary of Consumer Finance Activity for June, 1973**

	<u>Issued</u>	<u>Cancelled</u>
Small Loan Licenses	4	5
Second Mortgage Licenses	11	2
Premium Finance Licenses	4	1

Note: 260 Examinations Made

**Foreign Real Estate Broker-Dealer Suspension in June**

Abbott and Associates	6-15-73
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**STATISTICS**

<u>Registration</u>	<u>Certificates</u>
3-0	529
5-A	0
6-A1	172
6-A2	86
6-A3	43
6-A4	9

	<u>Applications Received</u>	<u>Orders</u>
Interstate Corporate	21	7
Stock-Option & Pur. Plan	7	5
Intrastate Corporate	6	3
Investment Companies	15	16
R.E.I.T.	2	14
R.E. Ltd. Partnerships	15	12
Oil & Gas	26	9
Other Non-Corporate	4	7
Form 39	26	4

Note: Eleven (11) Withdrawals

**Securities Broker-Dealer Applications (Form 15) Received in June**

REC Investments	6- 8-73
ARLTRU Bancorporation	6-11-73
Lloyd R. Downward	6-13-73
Swiss American Corporation	6-14-73
Associates Corp. of North America	6-15-73
Bateman Eichler, Hill Richards, Inc.	6-18-73
PB Investments	6-25-73
Sovereign Management Corp.	6-28-73
North American Equity Corp.	6-29-73

**Securities Salesmen's Applications Received in May - 254**

**Foreign Real-Estate Broker-Dealer Applications (Form 331A) Received in June**

Agatha Horrigan Landy & Sons, Inc.	6- 4-73
South Mountain Properties, Inc.	6- 7-73
The Baca Grande Corporation	6-12-73
The Baca Grande Angel Fire Corporation	6-12-73
Robert D. Holloway dba Leisure Land Sales Co.	6-15-73
Fred'k A. Schmidt, Inc.	6-15-73
Gulf Coast Diversified Developers, Inc.	6-25-73

**Registration Statistics for the Month of May\***

	<u>Certificates</u>	<u>Applications Received</u>	<u>Orders</u>
3-0	439		
5-A	0		
6-A1	98		
6-A2	40		
6-A3	13		
6-A4	5		
Interstate		22	4
Stock Option & Pur. Plan.		4	1
Intrastate		1	0
Investment Companies		18	17
R.E.I.T.		4	4
R.E. Ltd. Partnerships		11	4
Oil & Gas Partnerships		18	14
Other Non-Corporate		0	1
Form 39		12	9

\*Inadvertantly omitted from the June issue of the Bulletin

**EDITOR'S CORNER**

We have received numerous requests for reprints of specific issues of the Ohio Securities Bulletin from both subscribers and nonsubscribers. The cost per copy including postage is \$3.00. Xerox copies of specific items will also be furnished at \$.25 per page with a minimum charge of \$1.00 per order. Please make checks payable to the Ohio Department of Commerce.

Subscribers are urged to submit requests for topics to be discussed in future issues of the Bulletin.