

Ohio Securities Bulletin



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Commissioner's Comments

Change will be the order of the day as we adapt our operation to new broker-dealer rules, new rules pertaining to registration by description and qualification, and legislation revising the Ohio Securities Act. The rules hearings are behind us, and the deadline for additional comments has expired. Senate Bill 139 has been signed by Governor Rhodes and will become effective on July 20, 1978. This legislation will have significant impact on the activities and responsibilities of the Securities Division.

We are in the process of analyzing its contents to determine how we must change our procedures to comply with the new requirements. However, our timetable was altered due to the deposition taken, of key staff members, by parties involved in the REIT One and REIT Two lawsuits. Rules, forms and explanatory materials relating to Senate Bill 139 are presently being prepared. This information will be published in a special issue of the Bulletin.

Broker-Dealer Rules

It now appears that the new broker-dealer rules will be adopted as proposed, with only minor changes. This means that each broker-dealer will be required to submit an audited statement to the Division each year on or before March 1. The Division may require additional reports in any calendar year and may require such reports to be audited. A Division audit may single out one area of a broker-dealer's activities for special scrutiny. The net worth requirement for dealers will now vary between \$10,000 and \$25,000, depending upon the nature of the business conducted by the dealer or applicant for a dealer's license. A dealer will have ten calendar days to request the Division to cancel a salesman's license and to notify the Division of the effective date of resignation or discharge. The new rules define "good business repute." The Division shall interpret this term as used in Sections 1707.15 and 1707.19 of the Ohio Revised Code to mean that the applicant or licensed dealer or seller has not engaged in any practice found to be fraud-

ulent by courts of law, state or federal law, or by the code of ethics of any association of securities salesmen or dealers.

Oil & Gas Guidelines

The proposed oil and gas guidelines which were reviewed during the April 19 hearing will function as guidelines rather than formal rules. We believe that Senate Bill 139, pending federal energy legislation, and new IRS decisions could drastically alter the operation of Ohio oil and gas offerings. The uncertainty created by these impending changes indicates to us that we can best regulate the changing oil and gas industry in Ohio through guidelines rather than formal rules which allow less flexibility in interpretation and application.

We plan to keep the 2% rule intact. Under this rule, when the budget estimate costs exceed the actual drilling and completion costs by more than 2%, the promoter or sponsor shall refund to purchasers the portion of the proceeds which represents the amount of such excess over the actual drilling and completion costs.

We may, however, change the requirement that persons must be in at least the 40% federal income tax bracket to meet suitability requirements as an investor. This should allow far more flexibility for investors and sponsors.

Any other changes will be recorded in the guidelines as they are prepared in final form.

Staff Changes

Scott Musheno, Supervisor of Examinations Section, left the Division on April 21 to enter private industry. Scott joined the Securities Division as an examiner five years ago, and was promoted to Supervisor in 1975.

Dale Jewell has been named Supervisor. Dale has been an examiner in the Division for three years.

Time Runs Out for Uninsured Credit Unions

As we have previously reported in this Bulletin, in accordance with the Ohio Credit Union Act all state-chartered credit unions currently operating in the state of Ohio must have share insurance by no later than December 31, 1978. Despite the fact that this deadline is quickly approaching, 40 credit unions are still uninsured at the time of this writing. To assist these credit unions in obtaining share insurance, Credit Union Supervisor Bob Cassady, offers the following information and advice.

The American Credit Union Guaranty Association (ACUGA) and the National Credit Union Administration (NCUA), are in no way obligated to insure a credit union. It has been brought to the Division's attention that several credit unions believe that these share insurance companies will be forced to insure them by the end of the year. This will not happen.

We recommend that every uninsured credit union submit an application to both NCUA and ACUGA. While we realize that some credit unions may have a preference for one or the other, we stress that it is essential that you get share insurance from whichever source is available.

Merger and liquidation are the only two alternatives for this office for credit unions which are not insured by December 31, 1978. The law requires share insurance by that deadline, and any credit union operating after that date without share insurance is in violation of the law and *must be suspended*.

This office is willing to offer aid and assistance, within the limits of the Credit Union Act, in bringing a credit union into an insurable status. Past experience indicates that suspensions by this office of uninsured credit unions may adversely affect the existing, insured credit unions, and therefore we are encouraging all insured credit unions to help the other credit unions qualify for share insurance.

Impact of New Legislation

Governor Rhodes on June 9, 1978, signed into law Sub. H.B. 356 which will insure the creation of two new divisions in the Department of Commerce.

This legislation, creating a Division of Consumer Finance and a Division of Credit Unions, was supported by Governor Rhodes and the Department of Commerce. This legislation was originally proposed by the Governor in January 1977 in his State of the State Address and eventually became Sub. H.B. 356. It will become effective in January of 1979.

The regulation of consumer finance companies and credit unions has been the responsibility of the Division of Securities. This legislation will separate these functions and allow for the appointment of Superintendents to head the two new divisions.

Director of Commerce, J. Gordon Peltier, will announce a plan of reorganization providing for the adequate staffing of the new divisions with competent and qualified personnel. That announcement is expected late in the year.

Consumer Finance Reports Available

The Consumer Finance Section is in the process of finalizing the 1977 basic annual reports for Small Loan and Second Mortgage Loan companies. Copies of these reports will be available from the Consumer Finance Section after July 31, 1978. When requesting copies, please specify which report you want.

Worms Turn

Mr. James C. Kirkpatrick, Missouri Secretary of State, sent the following letter to the Securities and Exchange Commission on April 18, 1978:

"At the recent winter conference of the Midwest Securities Commissioners Association in Brownsville, Texas, there was considerable discussion about a new investment medium that poses enormous problems to state securities administrators in the enforcement of our securities laws. This investment medium, earthworm growing, involves the sale of earthworms to investors through a sales contract containing a guaranteed buy back provision whereby the seller of the earthworms agrees to repurchase all worms grown by investors.

"The buy back provision takes several forms. In some cases, it is specifically included in the worm sales contract. In many cases, the buy back provision is entered into verbally or may be implied by virtue of the relationship established between seller of the earthworms and the grower/investor in the terms of the contract.

"Our investigation into these programs divulges potentially large sums of money being invested in earthworm growing arrangements which promise lucrative profits to the grower/investor in return for his money and effort. Representations are made that lucrative markets are available to the seller to market the worms grown by investors in such areas as waste treatment, organic gardening, pet food processing, and bait shops.

"We have been unable, as yet, to substantiate the existence of these markets. Without these markets to obtain the necessary capital to purchase worms grown by investors, the buy back provision in the sales contract amounts to nothing more, in our opinion, than false sales gimmickry. The only alternative source of capital available to the seller to purchase worms from investors would be new investors. Consequently, the

scheme continues to mushroom until the new investor market dries up.

"Under the applicable securities laws of the member states of Midwest Securities Commissioners Association, these contractual arrangements constitute a security in the nature of an "investment contract". Being fully aware of the potential risks which may face investors in our states, each member is attempting to initiate the necessary action against these earthworm sellers for the protection of investors.

"However, the jurisdictional obstacles to state enforcement action are proving, in many cases, to be insurmountable. Very few of these earthworm companies have offices within our respective jurisdictions thereby hindering meaningful investigative and enforcement efforts.

"Speaking on behalf of the State of Missouri, we currently have under investigation 19 different earthworm sellers soliciting investors in our state. We have issued administrative cease and desist orders against five such persons and their distributors in this state. However, we have yet to receive a response from any of the five companies subject to these orders.

"Generally speaking, we are finding it difficult to identify investors who have entered into contractual arrangements with earthworm sellers in this state and we are unable to subpoena the books and records of the earthworm sellers as most of the major distributors are outside the State of Missouri.

"Because of the proliferation of earthworm growing schemes throughout the United States and because of the jurisdictional difficulties faced by the members of the Midwest Securities Commissioners Association in enforcing state securities laws with respect to the offer and sale of earthworm contracts in our states, I have been requested by Dwight Keen, Securities Commissioner for the State of Kansas and Chairman of the MSCA Enforcement Committee, to request, on behalf of all members of the Midwest Securities Commissioners Association, the assistance of the Securities and Exchange Commission in dealing with the apparent violations of federal and state securities laws perpetrated by these earthworm sellers. The members of the Midwest Securities Commissioners Association stand ready to provide any assistance we possibly can to aid the Commission and its staff in any actions which might be undertaken to deal with this problem.

"We cannot understate the importance of intervention by the Commissioner in this matter and look forward to receiving a response in the near future."

According to the Minnesota Division of Securities, within the last six months, Minnesota investors have lost more than \$1 million in the same or similar schemes. Minnesota,

North Dakota, South Dakota, Alabama, Iowa, Tennessee and Arkansas have all issued cease & desist orders against a variety of entities selling worm investments in those states. The Minnesota Division warned that sales meetings are scheduled for Cleveland sometime in June. Any information about sales of worm investments should be directed to the Ohio Division of Securities, Enforcement Section.

Requests for Information

We will evaluate each request for information concerning applications and other documents on file with the Division to see if the request conforms with the requirements set forth in 1707.12:

"All applications and other papers filed with the division of securities shall be open to inspection at all reasonable times, except for unreasonable or improper purposes, but information obtained by the division through any investigation shall be retained by the division and shall not be available to inspection by persons other than those directly interested in it."

Every person requesting access to information from the Division must submit a letter stating his or her direct interest and the purpose for which the information will be used or fill out a form provided by the Division.

Billing

Let us begin with procedure — specifically, billing for copies of documentation. In past issues we have requested your written statement of interest, which gives the purpose for review, and payment in advance of posting copies. Although generally we must hold to that policy, when the charge is under \$5.00 we will send copies with a billing. The major difficulties arise when the files are extensive. Since it is unlikely that you would be thrilled to send a blank check (copies of some filings can run into hundreds of dollars), a procedure for ascertaining what is available and what is relevant should be established. We will discuss each of these topics in more detail, but for now, let's stick primarily to billing procedure. We've concluded that there are two reasonable options for handling requests for copies:

1. If you have, in your request, given us authority to call collect, we can convey over the telephone the kinds of information available and the charge. A check for the designated amount can then be forwarded, and upon receipt of payment, copies will be posted.
2. Without authorization to phone about the matter, we will send a letter containing the relevant information. You can send payment and, accordingly, copies will be posted.

Please Be More Specific

This brings us to relevant information. Frequently we receive requests for "everything available on ABC company." Often one company will have numerous and extensive filings rendering the copying charge prohibitive. In an attempt to expedite the matter, detailed lists describing the documents available, along with the corresponding number of pages, have been prepared and forwarded. However, we have expended much time and effort only to discover that after being enlightened as to what, specifically, was available, many of those who had requested "everything" then wanted nothing. To avoid this waste of everyone's time, we are asking that requests for documents be more specific. If you can give us a clearer notion of the kinds of information relevant to your needs, we can search the files to determine if such data exists. Further, if the information you need could be obtained from another source, often we can direct you there.

Types of Information Available

Since we are requesting that you be more specific, it is our responsibility to provide some clarification regarding what is available. The type of filing often dictates the type of information we have, since information of public record involves that which has been submitted in regard to a filing. Generally we will have the following:

1. Name of company
2. Address of company (at time of filing)
3. Name and address of Statutory Agent
4. Brief description of type of business in which issuer intends to engage
5. Date of filing
6. Date of incorporation
7. Number of shares registered and/or type of issue.

Depending on the type of filing you *may* have:

1. List of shareholders (usually for Form 3-O only)
2. Prospectus or Offering Circular
3. Articles of Incorporation
4. Contract, Subscription Agreement, etc.

Occasionally, of course, we will have additional data, but this will give you a fair idea of the kinds of things available. (Reviewing blank applications for various types of filings would enable you to determine precisely what information is filed for each type of registration.)

Authorized vs. Registered

Another source of confusion seems to be with shares authorized versus shares registered. We have spoken to many disgruntled attorneys who were certain we must have a registration for a corporation because they had "authorized" shares. Often, Articles of Incorporation on file with the Secretary of State will reflect a given number of shares

authorized. This is common procedure, and occurs whether or not the company intends to issue shares at the time of incorporation. Only when the company decides to issue shares are those shares registered with the Division of Securities. At that time they may or may not register all of the authorized shares. It's not necessary to expand on this, we merely want to emphasize the point that authorized shares are not necessarily registered shares!

Status-Existence

Other requests we receive are for the "status" of a company or for verification of its existence. In regard to status of a company, we neither determine nor have established criteria for determining the status of a company. Neither do we regulate the day-to-day operation of a company. In that regard, if a company should go out of business, it's likely that we would have no record of it. Occasionally it would be noted in our files, but this is not data we collect and record automatically. The most reliable source from which to ascertain status of a company or to verify its existence is the office of the Secretary of State, Corporation Division (614/466-3910).

We hope that this discussion of requests for information has helped pinpoint major problem areas and has provided sufficient explanation to enable you to coordinate what you want with what we've got and to obtain it most expeditiously.

Enforcement

Suspensions

On February 2, 1978, the Division suspended the brokers license held by King-Adler, Inc. Pursuant to Section 1301:3-6-15(E) OAC, King-Adler failed to maintain a net worth sufficient for the protection of investors. Additionally, King-Adler failed to submit an audited financial statement to the Division in accordance with the provisions of Section 1301:3-6-15(I). On February 23, 1978, Counsel for the licensee requested a hearing on the suspension. Subsequent to the request for a hearing, King-Adler, Inc. agreed to resign its brokers license and withdrew its request for a hearing. As a result, the Division terminated its action against King-Adler, Inc.

On October 4, 1977, the Securities and Exchange Commission filed a complaint in the U.S. District Court for the Northern District of Ohio, Eastern Division, alleging that Price, Allen & Stevens Securities Corp., a broker/dealer licensed in Ohio was, among other allegations, insolvent and unable to meet its obligations to its customers. On October 5, 1977, the court appointed Anthony J. Celebrezze, Jr., temporary receiver and enjoined Price, Allen & Stevens from further operations.

Cease and Desist

Shortly thereafter, the Division issued an order suspending the brokers licence of Price, Allen & Stevens Securities Corporation. The Division Order outlined a number of violations including unlicensed sales by seven salesmen, non-payment of checks to the Division, and the fact that the corporation was not licensed to do business in Ohio. On February 15, 1978, the Division convened a hearing on this suspension. On March 17, 1978, the hearing examiner submitted his findings of fact and conclusions of law to the Commissioner. On April 13, 1978, a Division Order was issued revoking the brokers license of Price, Allen & Stevens Securities Corporation.

On May 15, 1978 the Division suspended Daley, Coolidge & Company for five days. The terms of the suspension require that Daley, Coolidge & Company not solicit new business during the terms thereof. The Division Order states that Daley, Coolidge & Company failed to supervise the issuance of salesman's licenses for employees of two of its branches.

A partial, rather than full suspension was imposed, as the Division did not find that Daley, Coolidge had engaged in any fraudulent acts or had conducted business in such a way as to jeopardize the protections afforded Ohio investors under the Ohio Securities Act.

Takeover Statute

On March 17, 1978, the Division filed suit against Telephone & Data Systems, Inc. ("TDS"), an Iowa corporation, a telephone holding company located in Chicago, Illinois. The complaint sought to enjoin TDS from any acts or practices in violation of Ohio's takeover statute, Section 1707.041 of the Revised Code. The complaint alleged that TDS was attempting to gain control of Community Telephone Company, ("CTC") an Ohio corporation, located in Leipsic, Ohio. CTC is engaged in the business of providing telephone services in the Leipsic area.

On or about July 5, 1977, TDS purchased 3,380 shares of CTC at an estate auction. Subsequent to that acquisition, TDS purchased additional shares bringing its total of shares owned to 3,500 shares or 28.6% of the outstanding common stock of CTC. Throughout 1976, 1977 and continuing into 1978, TDS approached CTC shareholders offering to acquire this common stock. It was the Division's belief that TDS was engaged in a takeover bid. It was believed that its attempts to acquire CTC shares was an attempt to gain control of CTC.

Subsequent to the filing of the lawsuit, TDS represented to the Division that it was not its intention to gain control of CTC, but instead was attempting to protect its original investment by acquiring up to 33-1/3%, plus one share of CTC. On April 24, 1978, the Division entered into a stipulation with TDS terminating the lawsuit. Telephone Data Systems, Inc. agreed to fully comply with Section 1707.041 of the Revised Code, should it decide to acquire more than 33-1/3%, plus one share, of Community Telephone Company.

On March 31, 1978, the Division notified Lone Star Petroleum, Inc., a Texas oil and gas syndicator, that its solicitations directed to Ohio attorneys were in violation of the Ohio Securities Act. Lone Star was advised to register its investments in Ohio, to stop soliciting Ohio investors until the approval of such a registration, or to expect to suffer the legal consequences of its present course of conduct found to be in violation of Chapter 1707 of the Revised Code. Copies of the Division's notification were sent to the Securities and Exchange Commission and to the Texas Commissioner of Securities. Lone Star chose to comply with the Ohio Securities Act.

Also on March 31, 1978, the Division notified Nova* Care Marketing Limited, a Texas limited partnership, organized to operate as a marketing organization for a health maintenance organization, to stop soliciting Ohio investors without first complying with the Ohio Securities Act. Copies of the Division's letter were sent both to the Securities and Exchange Commission and to the Texas Commissioner of Securities.

On April 7, 1978, the Division notified Impact Mining Company, Inc., a West Virginia corporation, offering tax sheltered investments in coal properties to Ohio investors to cease its Ohio activities, without benefit of registration, or legal action would be undertaken against Impact. Copies of the Division's notification were sent to the Securities and Exchange Commission, to the West Virginia Commissioner of Securities and to the Kentucky Commissioner of Securities.

Criminal Prosecutions

Franklin County

On August 26, 1977, the Division referred its case, Hydrocarbon Energy Corporation, to the Franklin County Prosecutor for action. The corporation sold well interests and was to initiate a drilling program. However, none of the wells were ever drilled. None of the money raised by the corporation was ever returned to investors. The corporation was subsequently sold. The Division alleged the misappropriation of corporate assets by both the original principals and the subsequent purchaser. Indictments in the cases of *State of Ohio vs. Eugene Walsh*; *State of Ohio vs. Paul Plunkett*; *State of Ohio vs. Chester Plunkett* and *State of Ohio vs. Richard Klunk*, Case No. 77-CR-12-3160, A to D, were handed down on November 30, 1977. The case will be tried beginning in July, 1978.

Summit County

On May 2, 1978, Division personnel testified in *State of Ohio vs. James E. Tolleson and David F. Pearson*, Case No. 77-12-1304, to be heard beginning on Monday, May 1,

1978, in the Summit County Court of Common Pleas. Tolleson and Pearson were indicted by the grand jury on December 5, 1977. It is alleged that Tolleson and Pearson sold unregistered securities and sold securities without being licensed in Ohio. The Division has worked closely with the Summit County Prosecutor's office in the preparation of this action. On June 7, 1978, James E. Tolleson was sentenced to one to five years in prison, David K. Pearson was placed on probation.

Columbiana County

On March 21, 1978, the Division referred its case, Vickers Exploration, Ltd., to the Columbiana County Prosecutor for action. Unregistered shares of common stock and promissory notes of Vickers Exploration, Ltd. were sold to Ohio investors. Instead of receiving Vickers shares, investors received shares of a different corporation which were held

"in trust" for them by one of the Vickers principals. In addition to the foregoing, the Division alleged that the sale of these shares involved a number of material misrepresentations and omissions. During the week of April 24, 1978, the Columbiana County grand jury indicted Gerald Cain. The case of *State of Ohio vs. Gerald Cain* has not yet been set for trial.

Additional Action

On April 26, 1978, the Division entered into a supplemental consent decree in the case of *J. Gordon Peltier, Director, Department of Commerce, State of Ohio et al. vs. Consumer Companies of America, Inc. et al.* The supplemental consent restricts the business activities of CCA and its principals and provided for the funding of a rescission offer made to the shareholders of record of CCA common stock as of March 31, 1977.

STATISTICS

Summary of Statistics for March and April, 1978

<u>Registration Section</u>			<u>Registration Section (cont.)</u>	<u>March</u>	<u>April</u>
<u>Applications Received</u>			<u>Certificates and Orders Issued</u>		
2(B)	64	39	2(B)	21	69
3-O	788	593	3-O	778	551
5(A)	0	2	5(A)	1	2
6(A)(1) & 6(A)(2)	266	181	6(A)(1) & 6(A)(2)	225	182
6(A)(3)	62	28	6(A)(3)	31	21
6(A)(4)	9	10	6(A)(4)	8	15
Interstate Corporate	25	23	Interstate Corporate	15	19
Stock Option and Purchase Plan	3	8	Stock Option and Purchase Plan	2	6
Intrastate Corporate	7	0	Intrastate Corporate	0	3
Investment Companies	41	36	Investment Companies	3	5
R.E.I.T.	0	0	R.E.I.T.	0	1
Real Estate Ltd. Partnerships	21	19	Real Estate Ltd. Partnerships	19	18
Cattle Funds	0	0	Cattle Funds	0	0
Other Non-Corporate	1	1	Other Non-Corporate	2	1
Oil & Gas Offerings	26	19	Oil & Gas Offerings	26	26
Form 33's	10	1	Form 33's	3	20
Form 39's	20	9	Form 39's	7	101