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COMMISSIONS AND REMUNERATION, DIRECT AND INDIRECT

by JOSEPH C. LONG

This issue's "Perspective" column has been submitted by Joseph C. Long, Professor of Law at the University of Oklahoma and Special Counsel for the North American Securities Administrators Association, Inc. The Division invites continued contributions from readers of the Bulletin of articles for publication on a space-available basis.

Professor Long discusses the topic of direct and indirect commissions and other remuneration paid with regard to sales of securities. This topic has recently received much attention and consideration from the Division's staff. The Division appreciates Professor Long's thoughtful review of the recent case law on this subject and invites Bulletin readers to address comments to William Leber, Staff Attorney, Ohio Division of Securities.

During the last several years there has been substantial litigation over the issue of whether certain payments made in connection with the offering of private placement tax shelter securities constitute the payment of commissions or other remuneration, direct or indirect, for the sale of these securities. This issue is extremely important for the Ohio practicing bar, both issuer counsel and those attorneys engaged in plaintiffs' practice.

It is important to issuer counsel because the availability of three of the major transactional exemptions under the Ohio Securities Act is tied to limiting the amount of commissions or other remuneration, which is paid in the sale of the securities sold under these exemptions. Ohio Revised Code (O.R.C.) Section 1707.03(O) provides a registration exemption for the sale of equity securities by the issuer to not more than ten persons in any one year, provided that sales are made to no more than twenty-five purchasers over the five year period beginning with the corporation's date of incorporation. No public advertising may be used, and the purchasers must take for investment purposes. Most important for our purposes, the "aggregate commission, discount and other remuneration, . . . paid or given directly or indirectly (cannot) exceed ten percent of the initial offering price." (Emphasis Added.) Further, this commission or remuneration may only be paid to dealers or salesmen registered under the Ohio Act. Finally, the issuer must file a report with the Ohio Division of Securities which identifies the commissions or discounts paid and pay a fee.

O.R.C. Section 1707.03(P) provides an exemption from registration for Ohio single well oil and gas interests, having no more than five beneficial owners, where the "maximum commission, compensation for services, cost of lease, and expenses with respect to the sale of such interests and with respect to the promotion, development, and management of the oil and gas well" does not exceed twenty-five percent of the aggregate interests in the wells excluding landowner's royalty interests. An offering document or other certificate has to be delivered to the purchaser, and the sales cannot be for the purposes of avoiding the Ohio Act.

Finally, O.R.C. Section 1707.03(Q) provides an exemption for offerings which are exempt under Section 4(2) of the Securities Act of 1933,[1] old Rule 146,[2] or section 506 of new Regulation D.[3] "The aggregate commission, discount, and other remuneration, . . . paid or given directly or indirectly does not exceed ten percent of the initial offering price," and this commission or remuneration is paid only to Ohio registered dealers or salesmen. Again the issuer or dealer must file a report with the Ohio Division of Securities which identifies the commissions and discounts paid.

These securities are also often sold in states bordering Ohio and beyond. The corresponding exemptions under the laws of these states often limit the amount of commissions which can be paid, as do the Ohio exemptions, or prohibit their payment entirely.[4]

This issue is also of primary significance to the plaintiff's bar because one of the easiest ways to rescind a purchase under O.R.C. Section 1707.43 or similar statute of another state is to defeat the defendant's claim to an exemption by showing that excessive commissions or remuneration were paid.[5] Further, both the O.R.C. Section 1707.03(O) and (Q) exemptions require the filing of reports disclosing the amount of the commissions or remuneration paid. Failure

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to file these reports would clearly seem to cause the loss of the exemption.[6] Filing an incomplete report might also be grounds for rescinding the purchase.

The purpose of this article is to briefly review the recent cases dealing with the commission or remuneration issue and identify areas where problems exist which might not be apparent to the practitioner who does not deal in this area on a daily basis.

It should be obvious that the payment of any cash commission will have to be accounted for against the maximum commissions allowed by O.R.C. Sections 1707.03(O), (P), and (Q).[7] In many states outside Ohio the payment of a cash commission will cause the loss of the exemption.[8] Further, once the entitlement to these cash commissions has attached, the injury done by their payment cannot be undone by having the salesman refund the commissions or cancelling his right to receive the commission.[9]

But what is not so obvious is that these commissions or other remuneration may take forms other than direct cash payment. Two recent cases will illustrate this point. In McCarney v. Johanneson,[10] the court held that the right to invest money received from others and to retain the interest made, created a triable issue of fact as to whether a forbidden commission has been paid. Even more important is the recent Michigan case of Prince v. Heritage Oil Co.[11] Here the promoter of an oil and gas tax shelter retained an interest in the well without paying for it. Under the retained interest the promoter had a right to share in the profits of the well without having to contribute his pro rata share of the drilling or development costs. This case is extremely significant since virtually every oil and gas deal involves retained interests. Frequently, the investor will contribute a third of the costs of the well, but will receive only a fourth of the oil and gas produced. The promoter will retain a fourth of the well free and clear for "putting the deal together". The court held that this retained interest was indirect remuneration for the sale of the oil and gas interests. If this case is followed in Ohio, the value of the retained interest will have to be counted against the maximum commission allowed and will severely limit the amount of cash commissions that can be paid.

In dicta, the Prince court also indicated that it felt that the same principle would apply to cheap stock in a corporation received by the promoters.[12] The commission here would be the difference between the public market price and the price at which the insiders or promoters acquired their stock.

Other courts and agencies are becoming concerned about hidden commissions or remuneration. As the saying goes, there is no free lunch. Tax shelter deals are not purchased, they are sold, and the selling is not free. To the extent that the promoter or salesman does not make money in the form of an identified commission, he will hide his profit by selling goods or services to the enterprise at an inflated rate. As the Georgia Attorney General said in 1974:

> The question of how, when, and in what form the syndicator will be compensated is a purely formal one which is entirely under the syndicator's control. If a part of the syndicator's efforts are directed toward

promoting and marketing the syndication, his compensation or profit is, at least in part, directly related to his sales efforts. Only if the syndication is successfully marketed can there be any possibility of a profit on the sale of the land to the syndication, a real estate commission, management fees or any other remuneration to the syndicator.[13]

Similar reasoning caused the Arkansas court in dicta in Schultz v. Rector-Phillips Morse, Inc.,[14] to question both front-end and annual "consultation fees" paid to the promoter on a 221 low-income housing project, as well as the commissions paid to an affiliated insurance agency for insuring the project.

The Massachusetts Securities Division has stated that it will consider any of the following to be indirect remuneration:

(1) any profits on the sale or lease of any services to a program or venture by promoter or sponsor;
(2) any profit on services provided to a program or venture by any promoter or sponsor;
(3) any management, consulting or other fees charged to a program at a rate above the customary rate for similar services; and
(4) any payment made to any person connected with a program or venture, which is based upon a percentage of the funds to be raised from investors.[15]

The Alaska Securities Division in In re Cold Sea Fisheries, Inc.,[16] even questioned whether the legal fees paid to one of the promoters for legal services rendered could not be classified as indirect remuneration.

These cases should not be read as saying that all charges for supervision, consultation, or management, or all real estate or insurance commissions should be, or will be, found to constitute indirect remuneration. The key here would seem to be the substance of the transaction rather than the form in which it is cast. If the charges represent a charge for services actually rendered other than for the sale of the securities and are fairly valued in light of charges for similar services performed by persons unrelated to the promoter, then the courts should allow the charges, and their payment should not be treated as indirect remuneration chargeable against allowable commissions or causing the loss of the exemption in those states where commissions are not allowed.[17]

Finally, there is a series of cases which have extended the concept of commission or remuneration to cover improper profits made by the issuer or promoter of the tax-shelter rather than his employees and salesmen. The first of these cases was Schultz v. Rector-Phillips Morse, Inc.,[18] where the court held that the difference between what was collected from the investors and actually spent on building the project when retained by the promoter would be indirect remuneration which would cause loss of the exemption under the Arkansas statute. The Schultz case was followed in Petroleum Resources Development Corp. v. State ex rel. Day,[19] where the court held that the difference between the amount collected from investors in an oil and gas well and the amount paid by the promoter to the actual driller who drilled the well on a turn-key basis, i.e., drilled the well for a fixed price and assumed the risk of any cost overrun, was indirect remuneration. The promoter charged the investors some $63,000 and entered into the turn-key contract at $28,000. A $35,000 profit, not bad! Most recently the Fifth Circuit approved this approach in Upton v. Trinidad Petroleum Corp.,[20] another turn-key oil and gas case.

The last group of cases deals with the issue of to whom commissions or remuneration is paid. This is extremely important under the Ohio exemptions because the O.R.C. Section 1707.03(O) and (Q) exemptions limit the payment of commissions or remuneration to persons licensed under the Ohio Act. The key here is that the limitation or prohibition on the payment of commissions applies only to commissions or remuneration paid for the selling of the securities. However, as with other areas under the Securities Act, the concept of "selling" securities has been given a broad interpretation. Probably the leading case in this area is Caldwell v. Trans-Gulf Petroleum Corp.[21] There the defendant claimed that the commissions received were not for selling the securities, but rather for locating individuals who were interested in buying the securities. The defendant claimed that the actual sales were made by others. The court rejected this claim and held the exemption unavailable because of the payment of commissions.

From this it would follow that the payment of "finder's fees" should be treated as commissions or remuneration within the limitation or prohibition. The author is aware that at least two state securities staffs, Pennsylvania and Massachusetts, have so concluded.[22] Further, it follows that payments made to others who participate in the sales process, but who are not dealing directly with the client also will be treated as commissions or remuneration.[23] This will become a serious problem where a broker-dealer not licensed in Ohio shares in the commission received or where an unlicensed employee manages a customer's account where the actual trades are executed by the locally licensed representative, but both share in the commisssions generated.

There are many problems but few answers in the area of direct or indirect commissions or remuneration. However, the number of cases which are beginning to deal with the problem suggest that issuer counsel should give serious consideration to whether their clients have administrative or civil liability exposure for some of their current practices. On the other side of the fence, plaintiff's counsel should begin considering the issue because the courts have clearly started a trend, the extent of which is yet unknown. This leaves much room for creative thinking and argument by plaintiff's counsel.[24]

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[1] 15 U.S.C. Section 77d(2) (1980).
[2] SEC Rule 146, 17 C.F.R. Section 230.146 (1981).
[3] SEC Rules 501-506, 17 C.F.R. Sections 230.501-.506 (1983). Regulation D became effective April 15. Rule 146 was repealed as of June 30, 1982. However, offerings commenced prior to June 30, 1982, will be exempt if they qualify under either Rule 146 or Regulation D, even though an offering claiming Rule 146 is filed after April 15 and the offering is not completed until after June 30.
[4] See e.g., Michigan Securities Act Section 402(b)(9), MCL Section 451-802(b)(9) construed in the recent case of Prince v. Heritage Oil Co., 311 N.W.2d 741 (Mich. App. 1981). The Michigan Act defines commissions or remuneration in MCL Section 451.801(r).

[5]Ameropan Oil Co. Ltd. v. Moore, 1978-81 transfer binder Blue Sky L. Rep. (CCH) Paragraph 71,636 (W.D. Okla. 1980). It should be remembered that in most states the burden of proving the entitlement to an exemption is on the person, usually the defendant, claiming it. See e.g., Prince v. Heritage Oil Co., 311 N.W.2d 741 (Mich. App. 1981).

[6]James v. Erlinder Mfg. Co., 80 Ill. App. 3d 4, 398 N.E.2d 1225 (1979); Sanchez v. Wells, 59 Ill. App. 3d 75, 375 N.E.2d 138 (1978).

[7]See e.g., Rzpeka v Farm Estates, Inc., 269 N.W.2d 270 (Mich. App. 1978); In re Haig, 1971-78 transfer binder Blue Sky L. Rep. (CCH) Paragraph 71,254 (Wis. Sec. Comm. 1975).

[8]Id.

[9]Rzpeka v. Farm Estates, Inc., supra; Petroleum Resources Development Corp. v. State ex rel. Day, 585 P.2d 346 (Okla. 1978).

[10]315 N.W.2d 470 (N.D. 1982). See also, Commonwealth v. Harrison, 137 Pa. Super. 279, 8 A.2d 733 (1939); Cal. Corp. Comm'r Official Op. No. 75/23C, 7 Cal. Corp. Comm'r Ops (Sept. 19, 1975).

[11]311 N.W.2d 741 (Mich. App. 1981).

[12]See also, In re Cold Sea Fisheries, Ltd., (Alas. Sec. Div. Int. Op. May 1, 1980).

[13]Op. Atty. Gen. (Ga.) No. 74-75, 1971-78 transfer binder Blue Sky L. Rep. (CCH) Paragraph 71,227 (June 6, 1974).

[14]552 S.W.2d 4 (Ark. 1977).

[15]2 Mass. Sec. Bull. (No. 2) 9, 1A Blue Sky L. Rep. (CCH) Paragraph 31,603 (Nov. 1981).

[16]Alas. Sec. Div. Int. Op. May 1, 1980.

[17]This is the approach taken by the Oklahoma Commission in Rule R-410(a)(1), 2 Blue Sky L. Rep. (CCH) Paragraph 46,419.

[18]552 S.W.2d 4 (Ark. 1977).

[19]585 P.2d 346 (Okla. 1978).

[20]652 F.2d 424 (5th Cir. 1981), aff'ing 468 F. Supp. 330 (N.D. Ala. 1979). The case was decided under Alabama law.

[21]322 So.2d 171 (La. 1975).

[22]1 Mass. Sec. Bull. 7 (Apr. 1981).

[23]Cf. In re Merrill, Lynch, Pierce, Fenner, & Smith, 1971-78 transfer binder Blue Sky L. Rep. (CCH) Paragraph 71,394 (Wis. Sec. Comm. 1977).

[24]For a general discussion of the commission or remuneration issue, see J. Long, Cases and Materials on State Securities (Blue Sky) Regulation 4-92-4-111 (5th ed. 1982).

NEW REGULATIONS AFFECT PRIVATE AND SMALL BUSINESS SECURITIES OFFERINGS

by Janet D. Gibson

Effective April 15, 1982, the Securities and Exchange Commission adopted Regulation D as a revision of certain issuer exemptions for transactions involving limited offers and sales. Such limited offerings were formerly exempted from the federal registration requirements by virtue of Rules 240, 242, or 146. As part of the adoption of Regulation D, the S.E.C. will repeal Rules 240, 242, and 146 as of June 30, 1982.

An S.E.C. study had revealed a concern that the registration requirements and exemptive scheme of the 1933 Securities Act impose disproportionate restraints on small issuers. The intent of the S.E.C. in drafting the new regulation was to expand the availability of the existing exemptions, clarify those exemptions, and achieve uniformity between federal and state exemptions in order to facilitate capital formation consistent with the protection of investors. Regulation D was enacted as part of the Small Business Investment Incentive Act.

Prior to the release of Regulation D in its final form, the Corporation Law Committee of the Ohio Bar Association submitted proposed statutory amendments to the Ohio Securities Laws, Chapter 1707, designed to adapt the law to benefit from Rule 242 in an effort to encourage capital formation and especially to provide capital to small businesses. These amendments relate principally to Ohio Revised Code (O.R.C.) sections 1707.03 and 1707.06. As of this date, these amendments have cleared the Senate legislative committee and are awaiting floor vote, having already passed the House Committee 95-0.

Regulation D contains six sections, numbered 501 to 506. Sections 501 through 503 set forth definitions, general conditions and filing requirements which relate to sections 504 through 506. Sections 504, 505 and 506 replace rules 240, 242, and 146, respectively.

Section 501 sets forth definitions and terms applicable throughout Regulation D. The most significant change created by section 501 is found in the definition of accredited investor. This new term alters the concept of accredited person in Rule 242 and expands that term to include, among others:

1. Purchasers of $150,000.00 of the securities being offered but only where the total purchase is less than 20% of the purchaser's net worth. The purchase price can be made up of cash, marketable securities, certain installments payable within 5 years, and cancellation of indebtedness owed to the purchaser by the issuer. Although not specified, it is anticipated that the $150,000.00 minimum purchase price will not include amounts which may be assessed of the investor either on a mandatory or voluntary basis.
2. Purchasers who have net worth in excess of $1,000,000.00, measured as of the time of purchase. Such purchaser must be a natural person. The $1,000,000.00 net worth requirement does not exclude any specific assets from the net worth calculation.
3. Natural persons with $200,000.00 or more in income in each of the last two years who expect such income in the current year. The S.E.C. notes that the term "income" is not equivalent to gross adjusted income for tax purposes but states that it will adopt a more flexible approach in determining the investor's income.
4. Certain entities made up of accredited investors.

The issuer must have a reasonable belief that the investor's representations as to net worth and income are correct. However, the offeror is no longer required to ascertain the qualification for accreditation of all offerees since section 501 requires only that an investor, rather than an offeree, be "accredited." In calculating the maximum number of investors permitted to be sold for section 505 and 506 purposes, the issuer may exclude all investors who satisfy the accreditation requirements.

Further, section 501 makes it clear that a purchaser representative may be one who has such knowledge and experience to enable him to evaluate the merits and risks of an investment either a) alone, b) along with other purchaser representatives of the purchaser, or c) together with the purchaser. He must be acknowledged by the purchaser with reference to each prospective investment, and if he has a material relationship with the issuer, he must disclose such relationship. However, such disclosure does not relieve him of his obligation to act in the interest of the purchaser.

Section 502 is entitled General Conditions to be Met. It sets forth principles of integration, specific disclosure requirements, limitations on the manner of conducting the offering (i.e., it prohibits general solicitation and advertising) and limitations on resale of the securities. All these conditions apply to the exemptions provided in sections 504, 505 and 506, unless otherwise specified.

If an issuer sells securities under section 504 or only to accredited investors, section 502 requires no disclosure. However, if securities are sold under sections 505 or 506 to any non-accredited investor, then section 502 requires that the information furnished to the non-accredited investors must be furnished to all investors. The type of information which must be disclosed for a section 505 or 506 offering depends on the size of the offering, i.e., whether the offering exceeds $5,000,000.00, and the nature of the issuer, i.e., whether the issuer is subject to reporting requirements.

Section 503 sets forth the requirements for the filing of the notice of sales.

Section 504 expands rule 240 by increasing the amount of securities permitted to be sold in a 12 month period from $100,000.00 to $500,000.00, less the aggregate offering price for all securities sold within the twelve months prior to the start of and during the offering under this section in reliance on any section 3(b) exemption or in violation of section 5(a) of the Act. Section 504 contains no ceiling on the number of investors, no disclosure requirement, and no prohibition on payment of commissions or similar remuneration. The restrictions on the manner of the offering and resale may be avoided where the entire offering is offered and sold only in states that require registration and delivery of disclosure documents, and sales are made in accordance with those provisions. Section 504 is not available to issuers who are subject to reporting requirements or to investment companies, as it is designed for small offerings made by small issuers.

The Division anticipates that issuers using section 504 will file with the Division under O.R.C. section 1707.06(A)(1), if the offering is sold without commissions or remuneration. Under the proposed rules, an O.R.C. section 1707.06 offering which does not exceed $250,000.00 will not require an offering circular. The proposed O.R.C. section 1707.06(A)(1) will be expanded to include foreign corporations, but commissions, remuneration, expense, and discount incurred in connection with the sale may not exceed 3% of the initial offering price. Section 504 offerings with commissions, etc. in excess of 3% may attempt to claim the O.R.C. section 1707.03(O) or (Q) exemptions or register under O.R.C. section 1707.06(A)(2) or (3), if the offering otherwise meets the requirements of those sections, or under O.R.C. section 1707.09 or .091.

Section 505 replaces rule 242 and increases the offering limit from $2,000,000.00 in six months to $5,000,000.00 in 12 months, less the aggregate offering price for all securities sold within the twelve months prior to the start of and during the offering under this section in reliance on any section 3(b) exemption or in violation of section 5(a) of the Act. It permits sales to 35 non-accredited investors and to an unlimited number of accredited investors.

Similarly, the proposed changes to O.R.C. sections 1707.06 (A)(2) and (3) will expand their availability and permit sales to a maximum of thirty-five (35) investors. However, the proposed amendments will exclude only purchasers of at least $100,000.00 of the offered securities and certain other parties, such as directors and executive officers of the issuer. These exclusions may not mirror the Regulation D qualifications for accreditation. Like O.R.C. sections 1707.03(O) and (Q), the aggregate commission, discount or other remuneration, excluding legal, accounting, and printing fees, may not exceed 10% of the initial offering price.

Section 506 replaces rule 146 and provides an exemption without regard to dollar amount. Sales may be made to only 35 non-accredited investors. Sales to accredited investors are unlimited in number. Whereas rule 146 contained both a sophistication and a wealth requirements for all offerees, section 506 has modified these offeree qualification principles so that purchasers (not merely offerees) must meet only sophistication requirements. The wealth or economic risk test has been completely eliminated.

O.R.C. section 1707.03(Q) is keyed to the private offering exemption of section 4(2) of the Securities Act of 1933 and any rule of the S.E.C. made to carry out such section. Since section 506 was adopted pursuant to section 4(2), a section 506 filing will be accepted under O.R.C. section 1707.03(Q). However, in an effort to discourage 3-Q filings due to their past abuse, the Division has recommended an increase of the fee for an initial 3-Q filing to $100.00 and an increase to $50.00 for subsequent filings. The fees for all form 6 filings will be reduced to $50.00. Due to the similarity between .03(Q) and proposed .06(A)(2) and (3), a Form 6(A)(2) or (3) might be a more desirable alternative for the issuer since it provides for registration rather than a claim of exemption.

In addition to the recommended statutory changes, the Division is considering adoption of rules under O.R.C. section 1707.06 which detail the minimum contents of an offering circular to comply with section O.R.C. 1707.06 and which contain specific requirements for offering circulars relating to the sale of oil and gas interests. As proposed, the legislation includes an addition to O.R.C. section 1707.03 which will allow the Division to add new exemptions by rule rather than by statutory amendment.

REGISTRATION BY COORDINATION POLICY STATEMENT ON SHELF REGISTRATION

by Don Meyer

On March 3, 1982, the Securities and Exchange Commission adopted the Integrated Disclosure System as set forth in Release No. 306. This release included among other items Rule 415 which sets forth certain parameters governing the delayed or continuous offering and sale of securities, known as "shelf registration". Unless extended further, Rule 415 will be effective until December 10, 1982.

The Division is interested in achieving coordination between federal and state securities regulation where it can be

accomplished without sacrificing investor protection; therefore, Ohio is adopting a policy whereby such shelf registrations in compliance with Rule 415 will be granted effectiveness which will be substantially similar to the type of effectiveness which is granted by the Securities and Exchange Commission. Only those registrants which qualify for filing a Form S-3 under the Federal Securities Act will be able to qualify for an Ohio shelf registration. At present the Division will not grant shelf registration to registrants which are required to file either Federal Forms S-1 or S-2. However, the matter will be continually monitored to evaluate the merits of permitting shelf registration for those registrants which are required to file either a Form S-1 or S-2.

The Division will grant a two year effectiveness period for qualifying shelf registrations. This two year effectiveness period parallels Rule 415 but for certain exceptions contained in Rule 415 which permit, for example, continuous registration for secondary market transactions, dividend or interest reinvestment plans and employee benefit plans. Ohio will continue its longstanding policy of granting a maximum two year effectiveness for all registrations including those which are given a continuous period of effectiveness pursuant to Federal Rule 415.

The shelf registration statement shall be filed pursuant to Ohio Revised Code (O.R.C.) section 1707.091. The information provided must be sufficiently definite and complete so as to enable the Division to adequately review the registration statement. The registration statement shall be deemed sufficiently definite and complete if all information concerning the registrant and material terms of the transaction are submitted and the only open items are price, interest rate and underwriter's compensation. As required by O.R.C. section 1707.091(C)(3), the maximum offering price or maximum interest rate, in the case of debt securities, and the maximum underwriting and commissions must be specified before the registration statement can be declared effective. If the securities sought to be registered pursuant to the new shelf registration process are debt securities, the registrant may specify up to six alternative types of debt financing plans and indicate the impact of each upon the issuer. To minimize complexity of the offering document if there are more than six different forms of debt financing plans, a separate primary registration statement shall be prepared and submitted for additional financing plans in excess of six.

The fees for shelf registrations filed within Ohio shall be determined as provided for by O.R.C. section 1707.091(C)(4) and shall be paid at the time of the initial registration. The fee shall be based upon the aggregate dollar amount of all securities which are anticipated to be sold within the two year period for which effectiveness will be granted. Under Ohio's present fee structure, the maximum Coordination fee of $1,000 applies to all registrations in excess of $1,000,000. If the maximum fee is paid no additional fee will be required at the time the registrant moves into the market to sell a block of securities within the two year period.

The Division Order granting effectiveness to the shelf registration will recite that the Division has made the following findings:

1. That the business of the issuer is not fraudulently conducted;
2. That the proposed offer or disposal of securities is not on grossly unfair terms;
3. That the plan of issuance and sale of the securities, referred to therein, would not defraud or deceive, or tend to defraud or deceive purchasers.

Registrants are cautioned that during the period of effectiveness there exists an obligation under Rule 1301:6-3-09 (H) to notify the Division of any material change, including the following changes:

1. Any material adverse change in the financial condition of the issuer;
2. Any material change in the compensation agreement between the issuer and a dealer licensed to sell its securities;
3. Any material change in the proposed use of proceeds;
4. The occurrence of any event or series of events which has caused any statement contained in the prospectus or offering circular to be false or misleading in any material respect.

If a registrant is required to notify the Division of a material change in accordance with Rule 1301:6-3-09(H), the registrant will be required to request a written confirmation of continued effectiveness five business days before entry into the market.

At least two full business days before entry into the market, the registrant will be required to file with the Division all post effective amendments and a copy of the registrant's most recent forms 10K and 10Q. All stickered supplements used in connection with the offering must also be filed with the Division at least two full business days before an entry into the market. The registrant shall state that there have been no material changes within the ambit of Rule 1301:6-3-09(H). The registrant shall notify the Division by telex or graphic scanner each time a block of securities is sold.

To coordinate with Rule 415, this policy statement will remain in effect until December 10, 1982. Shelf registrations will be closely monitored in order to determine whether this policy statement should be continued and if so whether or not any modifications will be warranted.

JURISDICTION
by Nancy Ivers Ferguson

Subscribers to the Ohio Securities Bulletin may recall reading an article by David LeGrand entitled "Jurisdiction Under the Ohio Securities Act after Martin vs. Steubner."[1] The article summarized a recent Federal District Court decision[2] holding that the Ohio Securities Act can require registration of an "out-of-state offering" when it is sold to an Ohio resident.

Plaintiffs were Ohio residents who purchased interests in a Minnesota real estate development at the invitation of defendants. Plaintiffs sought rescission of the sale of certain limited partnership interests as provided in Ohio Revised Code Section 1707.43, based on defendants' failure to register under the Ohio Securities Act. Although the

Division of Securities was not a party to the action, its jurisdiction to govern "out-of-state offerings" was made the primary issue in the case. Defendants claimed they were not required to register under the Act since their contacts with Ohio were minimal. The district court, however, found for plaintiffs and provided a lengthy discussion of the issue.

Shortly after Mr. LeGrand's article was published, the case was appealed to the Sixth Circuit Court of Appeals. The court stated, ". . . the only issue on appeal relates to the failure of defendant to register the transaction with the Ohio Division of Securities."

The court identified defendants' contacts with Ohio to be:

(1) An ad placed in the Midwest Edition of the Wall Street Journal soliciting purchasers.
(2) A request by the plaintiff for more information (mailed from Ohio).
(3) Two letters mailed to plaintiff in Ohio supplying more information.
(4) A transfer of money from plaintiff's Ohio broker to defendant's bank in Minnesota.
(5) A subscription agreement mailed to plaintiff in Ohio, which was signed and returned to defendants in Minnesota.

Defendants argued that the requirement to register with the Ohio Division of Securities and defend in an Ohio federal court violated the constitutional guarantee of due process and the prohibition against unreasonable burdens on interstate commerce.

The Court of Appeals was not persuaded and referred to the lower court's concern for "the state's interest in protecting its citizens." In affirming the lower court's decision, the Court of Appeals concluded:

> . . . there were sufficient contacts with the state of Ohio to permit Ohio to require registration of this transaction without infringing constitutional rights of the defendant.

[1]1980 Ohio Securities Bulletin, Issue 3.
[2]Martin v. Steubner, 485 F. Supp. 88 (1980).
[3]Martin v. Steubner, 652 F. 2d 652 (6th Cir. 1981).

SECURITY ISSUES OF CERTAIN FINANCIAL INSTITUTIONS NOW REGULATED BY DIVISION OF CONSUMER FINANCE

by Paul Tague

The securities issued by certain financial institutions in Ohio are no longer regulated by the Ohio Division of Securities. Securities of small loan companies, second mortgage lenders, insurance premium finance companies and pawnbrokers are now registered with and regulated by the Division of Consumer Finance of the Ohio Department of Commerce. On May 10, 1982, Amended Substitute House Bill 580 became effective which transferred the regulation of these securities from the Division of Securities to the Division of Consumer Finance, both of which Divisions are in the Department of Commerce.

Under the enacted bill, Ohio Revised Code (O.R.C.) section 1707.02, which lists exempt securities, is amended to add the following:

> (L) Any security issued by a person licensed or registered under sections 1321.01 to 1321.19, 1321.51 to 1321.60, 1321.71 to 1321.83 or Chapter 4727. of the Revised Code is exempt.

O.R.C. sections 1321.01 to 1321.19 deal with small loan company licensees; sections 1321.51 to 1321.60 are concerned with second mortgage registrants; sections 1321.71 to 1321.83 apply to premium finance companies; Chapter 4727. relates to pawnbrokers.

The new statutes permit the Superintendent of Consumer Finance to request a financial institution issuer to provide notice to the superintendent of the intent to sell securities in Ohio in reliance upon an exemption listed under Division A to K of O.R.C. section 1707.02. When the request is made, the securities shall not be sold without furnishing the required notice. Any other securities sold by a financial institution issuer must have the written approval of the superintendent in accordance with newly enacted O.R.C. section 1321.92(A).

An application for approval to sell such securities should be filed with the Superintendent of Consumer Finance on forms prescribed by the superintendent and accompanied with a filing fee of one hundred dollars. Within thirty days of receipt or within any later time to which the applicant agrees in writing, the superintendent shall approve the application subject to certain determinations and to the provisions of the Administrative Procedures Act. The determinations to be made by the superintendent are:

> the business of the issuer is not fraudulently conducted; the proposed offer or disposal of securities is not on grossly unfair terms; the plan of issuance and sale of the securities referred to in the proposed offer or disposal would not defraud or deceive, or tend to defraud or deceive, purchasers; no part of the securities to be sold is issued directly or indirectly in payment or exchange for intangible property not located in this state; and the total commission, discount, and selling costs do not exceed three per cent of the total sales price.

An application that is not approved within the prescribed time period is deemed disapproved.

The issuer may be required to advance funds to pay all or part of the expenses of any investigation or examination which the superintendent determines is required in connection with a financial institution issuer of securities. Further, the enforcement and regulatory authority granted to the Division of Securities in Chapter 1707 of the Ohio Revised Code is available to the Superintendent of Consumer Finance. The penalty for violation of O.R.C. section 1321.91 is similar to that for violation of the Ohio Securities Act with a fine of not more than five thousand dollars or imprisonment of not less than nor more than five years, or both.

CHEAP STOCK GUIDELINES

On behalf of the North American Securities Administrators Association (NASAA), the Division is printing the following proposed "Cheap Stock Guidelines" and invites comments from Bulletin readers. Please address your written comments to the Office of the Commissioner, Division of Securities, Two Nationwide Plaza (3rd Floor), Columbus, Ohio 43215, for consideration and forwarding to the appropriate NASAA committee.

PURPOSE OF POLICY

The Old Midwest "cheap share" policy and the rules adopted based on that policy were directed to the conscionability of the consideration and risk taken by the "inside" group vis a vis the interest in the venture apportioned to the public investors whose cash funded the development of the company.

There are four principal types of venture capital companies to which this policy will apply. These are:

(1) Concept (intangible) or intellectual property companies, e.g., film makers;
(2) Companies in the early stages of development;
(3) Oil and gas exploration companies; and
(4) Mineral exploration and development companies.

The policy suggested contemplates a formula for determining the maximum number of "cheap shares" which are acceptable, that is deemed conscionable, and an escrow concept which gives the promotional group incentive to finance the venture to success or failure (i.e., earned interest concept).

The policy set out below attempts to capture these concepts in a workable fashion and bears the input of numbers of member states. With the approval of the membership, we wish to give this redraft wider exposure.

I. DEFINITIONS

As used in this Statement of Policy:

A. "Cheap stock" means those shares of common or preferred stock of a corporation, proposing a public offering of its shares or securities convertible into shares (1) issued or to be issued while it is still in a promotional or developmental stage, or (2) issued within the past three years or to be issued to promoters of the corporation for a consideration less than the proposed public offering price or conversion price, provided that employees who are not officers, directors or who do not own five percent or more of the outstanding shares of the corporation will not be included within the definition of promoter for the purpose of subsection (I.A. (2)) only, or (3) issued or to be issued to promoters of the corporation in consideration for any property, including patents, copyrights or goodwill, to the extent that the value has not been established to the satisfaction of the administrator. Excluded from the shares of cheap stock is that number of shares calculated by dividing the public offering price per share into the total amount paid or to be paid for in cash or property for which a satisfactory value has been established.

The following example should assist in determining the quantity of cheap stock shares.

Example:

	Shares	Price Per Share	Total Price to be Paid
Shares to Promoter	100	$ 1.00	$ 100.00
Public Offering	100	10.00	1,000.00
Total			$1,100.00

Number of Cheap Shares

Total Promoters Shares	100	Total Paid by Promoters $100.00
Fully Paid Shares	-10	÷ Public Price Per Share $ 10.00 =
Number of Cheap Shares	90	10 fully paid shares

$10.00 / 10 / 100.00

B. "Promoters of the corporation" means those parties assisting in the formation or initial financing of the corporation and includes but is not limited to the officers, directors, employees, persons rendering services for stock, parties owning five percent (5%) or more of the outstanding shares of the corporation before the public offering or any affiliate of any of them.

C. "A corporation in the promotional or developmental stage" means:

A corporation which has no public market for its shares and has no significant earnings.

NOTE:
Significant earnings shall be deemed to exist if the company's earnings record over the last five (5) years of its operations (or the shorter period of its existence) demonstrates that it would have met either of the earnings tests set forth in Section IV.A.1. or IV.A.2. of these guidelines based upon its capital stock to be outstanding after this offering capitalized at the proposed public offering price.

D. "Net tangible book value" means all tangible assets of a corporation minus total liabilities divided by the total number of shares outstanding.

E. "Earnings per share" means revenues less operating cost, after taxes but before extraordinary items, divided by all issued and outstanding shares adjusted for stock splits and stock dividends in accordance with generally accepted accounting principles.

If the administrator so determines, research and development expenses may be excluded as operating costs for the purposes of computing net earnings per share under this rule.

II. RESTRICTION ON ISSUANCE OR SALE OF CHEAP STOCK

A. Cheap stock issued for promotion of the company shall be equity securities without preference as to dividends, assets or voting rights and shall have no greater rights per share than the securities issued for cash or its equivalent.

B. The promoters of the corporation may not offer or sell their cheap stock until one year after the completion of the public offering.

III. AMOUNT OF CHEAP STOCK

The maximum amount of cheap stock shall not exceed sixty percent (60%) of the outstanding securities of the issuer after the completion of the issue and all cheap stock in excess of ten percent (10%) shall be escrowed pursuant to paragraph IV.

IV. ESCROW OF CHEAP STOCK

A. Cheap stock will be escrowed for a period of five (5) years from the date of the public offering or under extraordinary circumstances for a longer period up to ten (10) years. Such cheap stock shall be disposed of in accordance with the following:

1. If the five (5) year accumulated net earnings per share of the corporation is 30 percent (30%) of the public offering price, then all escrowed shares shall be released.

For each percentage point under 30 percent (30%) a similar ratio of escrowed shares will be cancelled back to the issuer with the balance of the shares to be released.

NOTE:

$$\frac{\text{5 Yr. Accum'd Net Erngs}}{\text{30\% Public Offering Price}} \times \text{Escrowed Shares} = \text{Number Released}$$

Balances to be Cancelled

Example using 10% accumulated earnings, 100 shares escrowed

$$\frac{10\%}{30\%} \times 100 = 33\ 1/3 \text{ shares released (66 2/3 cancelled back issuer)}$$

2. If at the end of any two consecutive years within the five year escrow period or such longer escrow period, the corporation has net earnings of ten percent (10%) per share of the public offering price for each of said two consecutive years, then all the shares will be released.

3. In the case of oil and gas exploration companies, at the end of the term of the escrow agreement, a determination will be made (and presented to the administrator) as to the amount of new Proved Developed Reserves which have been found by the issuer (based upon a reserve report by an independent petroleum engineer) and such amount shall be divided by the SEC case reserve report which is a part of the prospectus for the offering contemplated by the agreement. The percentage of the stock of the issuer to be outstanding immediately following the offering which is escrowed, divided by the percentage of the escrowed shares to be released and the remainder shall be cancelled back to the issuer.

Example:

$$\frac{\text{New Proved Developed Reserves}}{\text{SEC Case Reserves Per Prospectus}} \quad \frac{900{,}000 \text{ bbls}}{10{,}000{,}000 \text{ bbls}} = 990$$

$$\frac{\text{Shares Escrowed}}{\text{Shares to be Outstanding}} \quad \frac{1{,}000}{10{,}000} = 10\%$$

$$\frac{9\%}{10\%} = 90\%$$

90% X 1000 shares = 900 shares released

B. The securities in escrow may be transferred by will or pursuant to the laws of descent and distribution, or through appropriate legal proceedings in court, but in all cases the securities shall remain in escrow and subject to the terms of the escrow.

C. The shares held under an escrow agreement required as a condition to registration of a public offering shall not have any right, title, interest, or participation in the assets of the corporation in the event of dissolution, liquidation, merger, consolidation, reorganization, sale of assets, exchanges or any transaction or proceeding which contemplates or results in the distribution of the assets of the corporation, until the holders of all shares sold in the public offering have been paid, or had irrevocably set aside for them an amount equal to 130 percent of the purchase price per share in the public offering, adjusted for stock splits and stock dividends. Subsequently, the remaining shares shall be entitled to receive an amount equal to the tangible consideration furnished for the shares, and thereafter, all shareholders shall participate equally.

D. Shares held under an escrow agreement shall continue to have all voting rights to which those shares are entitled. Any dividends paid on such shares shall be paid to the escrow agent and held pursuant to the terms of the agreement. The escrow agent shall treat such dividends as assets of the corporation available for distribution under the provisions of subsection "C" above.

Likewise, all certificates representing stock dividends and shares resulting from stock splits shall be delivered to the escrow agent and held pursuant to the escrow agreement.

E. While the escrow agreement remains in effect, the corporation shall not increase compensation and benefits to its officers and directors without prior concurrence of a majority of the independent directors.

F. A summary of the terms of the escrow shall be included in the offering circular.

G. The escrow agent must be satisfactory to the administrator and the escrow agent must not be affiliated with any promoter.

STATEMENT OF POLICY ON PROMOTERS' INVESTMENT

I. DEFINITIONS

As used in this Statement of Policy:

A. An issuer which is in the "promotional or developmental" stage means: an issuer which has no public market for its shares and has no significant earnings.

B. "Promoters" means those parties assisting in the formation or initial financing of the corporation and includes, but is not limited to, the officers, directors, employees, persons rendering services for stock, parties owning five percent (5%) or more of the outstanding shares of the

corporation before the public offering or any affiliate of any of them.

C. "Equity investment of promoters" means the total of all cash, together with the reasonable value of all assets contributed to the issuer as determined by independent appraisals, acceptable to the administrator, and may be adjusted by the earned surplus or deficit of the issuer subsequent to the dates of contribution.

II. PROMOTERS' INVESTMENT

The offering of an issuer which is in the promotional or developmental stage shall be considered unfair and inequitable to public investors unless the equity investment of the promoters equals at least ten percent (10%) of the proposed offering.

NASAA RULES OF CONDUCT FOR FOR DEALERS AND AGENTS

The following is a first draft of proposed Rules of Conduct for dealers and agents as presented at the Spring NASAA meeting and approved for comment.

These rules are meant to address unethical business practices and to serve as guidelines for various administrators in conjunction with their respective statutes. The rules are not intended as an additional layer of regulations for broker-dealers inasmuch as most are already subject to similar rules by virtue of membership in various regulatory organizations.

NASAA is currently soliciting comments on content as well as opinions regarding title and whether NASAA should consider adopting such guidelines. Please address your written comments to the Office of the Commissioner, Division of Securities, Two Nationwide Plaza (3rd floor), Columbus, Ohio 43215.

RULES OF CONDUCT

Each broker-dealer and agent shall observe high standards of commercial honor and just and equitable principles of trade in the conduct of its business.

A. The following acts and practices may be considered contrary to such standards and may constitute grounds for denial, suspension or revocation of registration or such other action authorized by statute.

1. BROKER-DEALERS

a. Engaging in a pattern of unreasonable and unjustifiable delays in the delivery of securities purchased by any of its customers and/or in the payment upon request of free credit balances reflecting completed transactions of any of its customers;

b. Inducing trading in a customer's account which is excessive in size or frequency in view of the financial resources and character of the account;

c. Effecting a transaction in or recommending to a customer the purchase, sale or exchange of any security without reasonable grounds to believe that such transaction or recommendation is suitable for the customer based upon reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other relevant information known by the broker-dealer;

d. Executing a transaction on behalf of a customer without authority to do so;

e. Exercising any discretionary power in effecting a transaction for a customer's account without first obtaining written discretionary authority from the customer, unless the discretionary power relates solely to the time and/or price for the execution of orders;

f. Extending, arranging for, or participating in arranging for credit to a customer in violation of the regulations of the Securities and Exchange Commission or the regulations of the Federal Reserve Board;

g. Executing any transaction in a margin account without securing from the customer a properly executed written margin agreement promptly after the initial transaction in the account;

h. Failing to segregate customers' free securities or securities held in safekeeping;

i. Hypothecating a customer's securities without having a lien thereon unless the broker-dealer secures from the customer a properly executed written consent promptly after the initial transaction, except as permitted by Rules of the Securities and Exchange Commission;

j. Entering into a transaction with or for a customer at a price not reasonably related to the current market price of the security or receiving an unreasonable commission or profit;

k. Failing to furnish to a customer purchasing securities in an offering, no later than the date of confirmation of the transaction, either a final prospectus or a preliminary prospectus and an additional document, which together include all information set forth in the final prospectus;

l. Charging unreasonable and inequitable fees for services performed, including miscellaneous services such as collection of monies due for principal, dividends or interest, exchange or transfer of securities, appraisals, safekeeping, or custody of securities and other services related to its securities business, except where such fees are negotiated or have been previously consented to by the customer;

m. Offering to buy from or sell to any person any security at a stated price unless such broker-dealer is prepared to purchase or sell, as the case may be, at such price and under such conditions as are stated at the time of such offer to buy or sell;

n. Representing that a security is being offered to a customer "at the market" or a price relevant to the market price unless such broker-dealer knows or has reasonable grounds to believe that a market for such security exists other than that made, created or controlled by such broker-dealer, or by any person for whom he is acting or with

whom he is associated in such distribution, or any person controlled by, controlling or under common control with such broker-dealer;

o. Effecting any transaction in, or inducing the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device, practice, plan, program, design or contrivance, including but not limited to:

1. Effecting any transaction in a security which involves no change in the beneficial ownership thereof;

2. Entering an order or orders for the purchase or sale of any security with the knowledge that an order or orders of substantially the same size, at substantially the same time and substantially the same price, for the sale of any such security, has been or will be entered by or for the same or different parties for the purpose of creating a false or misleading appearance of active trading in the security or a false or misleading appearance with respect to the market for the security; provided, however, nothing in this subsection shall prohibit a broker-dealer from entering bona fide agency cross transactions for its customers;

3. Effecting, alone or with one or more other persons, a series of transactions in any security creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others;

p. Guaranteeing a customer against loss in any securities account of such customer carried by the broker-dealer or in any securities transaction effected by the broker-dealer with or for such customer;

q. Publishing or circulating, or causing to be published or circulated, any notice, circular, advertisement, newspaper article, investment service, or communication of any kind which purports to report any transaction as a purchase or sale of any security unless such broker-dealer believes that such transaction was a bona fide purchase or sale of such security; or which purports to quote the bid price or asked price for any security, unless such broker-dealer believes that such quotation represents a bona fide bid for, or offer of, such security;

r. Using any advertising or sales material in such a fashion as to be deceptive or misleading. An example of such practice would be a distribution of any nonfactual data, material or presentation based on conjecture, unfounded or unrealistic claims or assertions in any brochure, flyer, or display by words, pictures, graphs or otherwise designed to supplement, detract from, supercede or defeat the purpose or effect of any prospectus or disclosure;

s. Failing to disclose that the broker-dealer is controlled by, controlling, affiliated with or under common control with the issuer of any security before entering into any contract with or for a customer for the purchase or sale of such security, the existence of such control to such customer, and if such disclosure is not made in writing, it shall be supplemented by the giving or sending of written disclosure at or before the completion of the transaction;

t. Failing to make a bona fide public offering of all of the securities allotted to a broker-dealer for distribution, whether acquired as an underwriter, a selling group member, or from a member participating in the distribution as an underwriter or selling group member;

u. Violating any rule of a national securities exchange or national securities association of which it is a member, or any rule of the United States Securities and Exchange Commission, with respect to any customer, transaction or business in this state; or

v. Failure or refusal to furnish a customer, upon reasonable request, information to which he is entitled, or to respond to a formal written demand or complaint.

2. AGENTS

a. Borrowing money or securities from a customer, or acting as a custodian for money, securities or an executed stock power of a customer;

b. Effecting securities transactions not recorded on the regular books or records of the broker-dealer which the agent represents, unless the transactions are authorized in writing by the broker-dealer prior to execution of the transaction;

c. Establishing fictitious accounts in order to execute transactions which would otherwise be prohibited;

d. Sharing directly or indirectly in profits or losses in the account of any customer without the written authorization of the customer and the broker-dealer which the agent represents;

e. Dividing or otherwise splitting the agent's commissions, profits or other compensation from the purchase or sale of securities with any person not also registered as an agent for the same broker-dealer, or for a broker-dealer under direct or indirect common control; or

f. Engaging in conduct specified in Subsection 1.b, c, d, e, f, g, j, k, o, p, q or r of these rules.

3. The conduct set forth above is not inclusive. Engaging in other conduct such as forgery, embezzlement, nondisclosure, incomplete disclosure or misstatement of material facts, or manipulative or deceptive practices shall also be grounds for denial, suspension or revocation of registration.

ANNOUNCEMENTS

SECURITIES CONFERENCE

The Ohio Division of Securities will sponsor its third annual securities conference at the Hyatt Regency in Columbus on October 14, 1982. The Division's advisory committees will meet in closed session in the morning, and a number of speakers on securities-related topics will follow the lunch-

eon speaker. A flyer announcing the conference and containing a registration form will be mailed to Bulletin recipients in advance of the conference date.

TAKEOVER BID OF ANDERSON EQUITY INVESTMENTS, INC. FOR G. F. BUSINESS EQUIPMENT, INC.

On January 26, 1982, Anderson Equity Investments, Inc. ("Anderson"), pursuant to Ohio Revised Code (O.R.C.) Section 1707.041, filed a Form 041, together with attached exhibits, with the Division of Securities and made an offer to purchase up to 832,000 of the outstanding shares of common stock of G. F. Business Equipment, Inc. ("G.F."), an Ohio corporation, at a price of $5.00 per share net to seller in cash. D. F. King & Co., an Ohio licensed securities dealer, acted as "information agent" for the transaction.

The target company, G. F., made no request for a hearing pursuant to O.R.C. Section 1707.041(B). However, on February 5, 1982, the Commissioner of Securities ordered a hearing sua sponte, pursuant to O.R.C. Section 1707.041 (B)(1)(a). On February 9, 1982, G. F. mailed a letter to shareholders recommending that they reject the offer on the basis of inadequate price.

Pursuant to discussions between the division staff and counsel for Anderson on February 17, 1982, counsel for G. F. proposed amendments to the offering circular to the Division. Discussions between the division staff and counsel to both parties resulted in several amendments to that letter. A hearing was convened on February 19, 1982, and concluded that same morning. The hearing officer accepted submissions from counsel to both target and offeror regarding amendments to the offering circular. The hearing officer issued his findings, conclusions and recommendations on February 23, 1982.

On or before February 23, 1982, Anderson mailed supplemental disclosures to the offerees as suggested in the hearing officer's report, pursuant to Anderson's proposals as modified by commentary from G. F. and the Division. On March 5, 1982, the Commissioner adjudged that the offer did not violate O.R.C. Section 1707.041 and that G. F. could proceed to accept tendered shares for payment.

"DATE OF SALE" FOR SECTION 1707.03(O) AND (Q)

Ohio Revised Code (O.R.C.) Section 1707.03(O) and (Q) require that the issuer (or dealer) file with the Division of Securities a report of sales not later than 60 days after the date of sale. In this context the question often arises as to what constitutes the date of sale for filing purposes.

Looking to the statute, the term "date of sale" is nowhere defined. However, "sale" is defined in O.R.C. Section 1707.01(C)(1) for purposes of O.R.C. Section 1707.01 to 1707.45 as having:

> the full meaning of "sale" as applied by or accepted in courts of law or equity, and includes every disposition, or attempt to dispose, of a security or an interest in a security. "Sale" also includes a contract to sell, an exchange, an attempt to sell, an option of sale, a solicitation of a sale, a solicitation of an offer to buy, a subscription, or an offer to sell, directly or indirectly, by agent, circular, pamphlet, advertisement, or otherwise.

It is apparent from the statutory language that several "sales" may occur within any one securities transaction. For example, a sale occurs when the offer to sell or solicitation of the sale is made and again when the subscription agreement is signed or the contract to sell is concluded.

Ohio Administrative Code Rule 1301:6-3-03(J) however requires only that a report of sales on Form 3-Q be filed within 60 days after each "purchase." The Division interprets such "purchase" to occur whenever the buyer is irrevocably bound to purchase the security. Thus, even though the contract to sell is executory or oral or the subscription is conditioned upon acceptance by the issuer, the Division would consider a purchase to have taken place for reporting purposes so long as the investor does not have the opportunity to rescind.

The Division encourages the issuer or dealer claiming the exemption to file all reports of sale within a time period prescribed by a strict interpretation of the statute. The issuer (or dealer) thus avoids potential rescission actions by investors alleging sale of an unregistered security on the grounds that the claim of exemption was not timely filed.

NEW FOREIGN REAL ESTATE FORMS

Copies of proposed foreign real estate registration forms have recently been mailed to members of the Foreign Real Estate advisory committee and other persons who had expressed an interest in new developments in Ohio's regulation of foreign real estate.

The new forms have been developed in conjunction with the recent passage of amended administrative rules under O.R.C. section 1707.33. The standard foreign real estate registration form, Form 33, has been drastically changed, and addenda for timesharing and condominium registrations have also been distributed.

If you are interested in receiving these forms, copies of the amended foreign real estate rules, or any other information regarding the Division's activities under O.R.C. section 1707.33, please direct a letter to the Division's registration section or call William Leber, Staff Attorney at (614) 462-7427.

CENTRAL REGISTRATION DEPOSITORY SYSTEM

On August 16, 1982, the Ohio Division of Securities expects to go "on line" as a member state with the Central Registration Depository System (C.R.D.).

Once accomplished, applicants for licensure and "transfers", under Ohio Revised Code section 1707.16 whose employing firms are members of the National Association of Securities Dealers (N.A.S.D.) will be able to obtain licensure in Ohio by submitting a form U-4 and the requisite fees to the C.R.D. headquarters in Washington D.C.

The Ohio Securities Division will be able to access and review the application via a cathode ray tube now installed in our offices.

Similarly, renewal applications will be processed through the C.R.D. during December 1982.

N.A.S.D. member firms are urged to discontinue mailing applications to the Ohio Division of Securities as of August 1, 1982.

The Division welcomes this opportunity to streamline the application process through participation in this national system. Questions concerning the C.R.D. should be addressed to Dale Jewell, Supervisor, Broker-Dealer section.

BROKER-DEALER FEE REDUCTION

A Division-sponsored fee reduction bill became effective on November 15, 1981, reducing the dealer renewal fee from $50.00 per salesman to $30.00 per salesman, subject, however, to $150.00 minimum payment.

On June 16, 1982, refund checks were mailed out to the broker-dealers entitled to refunds.

If there are any questions concerning this refund, please contact the Division in writing and a review of your refund will be conducted, and a written response will be mailed to you.

OHIO REVISED CODE SECTION 1707.041(B)(2) RULED UNCONSTITUTIONAL

On June 11, 1982, in the matter of Hanna Mining Co. v. Norcen Energy Resources, Ltd., Judge John M. Manos of the U.S. District Court for the Northern District of Ohio, Eastern Division, declared Ohio Revised Code (O.R.C.) Section 1707.041(B)(2) unconstitutional as being violative of the Commerce Clause.

O.R.C. Section 1707.041(B)(2), often referred to as the "creeping tender provision," reads as follows:

> No offeror shall make a take-over bid if he owns five percent or more of the issued and outstanding equity securities of any class of the target company, any of which were purchased within one year before the proposed take-over bid, and the offeror, before making any such purchase, or before the thirtieth day following the effective date of this section, whichever is later, failed to publicly announce his intention to gain control of the target company, or otherwise failed to make fair, full, and effective disclosure of such intention to the persons from whom he acquired such securities.

In the words of Judge Manos:

> Since the local public interests served by the Ohio tender offer legislation are at most tenuous, the court holds that the third question presented, whether Ohio Revised Code Annotated Section 1707.041(B)(2) . . . imposes a burden on interstate commerce which is only incidental and not excessive in relation to the putative local benefits, must be resolved in the negative.
>
> . . . the one year prohibition imposed by the statute is clearly excessive. The one year prohibition effectively discourages a curative filing that would otherwise permit a tender offeror, which committed a disclosure violation, from proceeding with the offer.
>
> Accordingly, the court holds that Ohio Revised Code Annoted Section 1707.041(B)(2) . . . is unconstitutional because it imposes substantial burdens on interstate commerce without counterveiling local benefits. There can be no doubt that the statute's remedial purpose could be accomplished by some less intrusive means.

ENFORCEMENT

John A. Callandros

On April 8, 1982, John A. Callandros was sentenced to one to five years in the Columbus Correctional Institute. Mr. Callandros pleaded guilty on February 2, 1982, to four felony counts involving the sale of unregistered securities.

Karen Banks, an Investigator with the Division, and Barry Moses, formerly a staff attorney with the Division, began their investigation after seeing a newspaper ad soliciting investors in Tracker Security Systems. Based on information gathered from the investigation, the Division alleged Mr. Callandros used investors' money for his personal use, made misrepresentations in the "prospectus," represented to investors that a market had already been established for his product when it had not, and promised investors exorbitant returns on their investments. Under one investment plan, investors were promised return of their initial investment in eight months and receipt of that amount again fourteen months after investing. Investors would then receive an amount equal to double their original investment every year for the rest of their lives.

Franklin J. Cristiano

On December 7, 1980, Franklin J. Cristiano was indicted on seven counts of selling unregistered securities and selling securities without a license. Mr. Cristiano allegedly sold interests in Realty Resources, Inc., Consolidated Realty, Medical Equipment Products, Inc., and Pisa Pizza, Inc.

Mr. Cristiano was admitted into the Medina County First Offender Diversionary Program where he was ordered to make restitution to investors.

Mr. Cristiano did not meet the requirements imposed on him by the program, and on April 12, 1982, he was indicted on sixteen counts of fraud in the sale of securities and eight counts of grand theft in addition to the counts cited in the earlier indictment.

John Vasi/Joseph Cimino/Commercial Energy, Inc.

On January 28, 1982, the Summit County Grant Jury returned an indictment charging John Vasi and his nephew, Joseph Cimino, on eighteen counts of securities law violations.

Mr. Vasi was owner of the Deerfield Dump and allegedly sold more than $75,000 in unregistered shares of stock to approximately 64 northeast Ohio residents. Investors believed they were investing in an energy recycling venture. Vasi and Cimino allegedly told investors that the drums of toxic industrial chemicals at Deerfield contained oil which could be recycled and sold as fuel.

Vasi and Cimino have been charged with various counts of selling unregistered securities, selling securities without a license, and making false representations in connection with the sale of securities.

Roya, Inc.

On February 11, 1982, Roya, Inc. put its foreign real estate broker-dealer's license in an inactive status.

The Division's investigation had indicated that Roya, Inc. failed to submjt certified financial statements for the year 1981, failed to establish and maintain adequate books and records, and failed to meet the minimum net worth requirement as set forth in Ohio Administrative Code 1301:6-3-15(E).

Basic Management Group, Inc./Al Talib

On March 4, 1982, a Cease and Desist Order was issued against Basic Management Group, Inc. and Al Talib. The Order found that Basic Management Group and Mr. Talib were selling securities without a license and had violated Ohio Revised Code Section 1707.44(G), in that their private placement memorandum contained omissions of facts material to an investment decision. Said omissions were found to have constituted "fraudulent practices" as defined in Ohio Revised Code Section 1707.01(J).

Form 3-Qs Declared Null and Void

Pursuant to various Division Orders, the applications for exemption of certain limited partnership units in the following companies have been declared null and void by the Division on the grounds that a commission was paid to a dealer who was not licensed in the state of Ohio (see 1982 Bulletin, Issue I: Betty Sue Associates):

1) The Beaumont Collection
2) The Wentworth Collection
3) The Carlson Collection
4) The Coleridge Collection

Columbus Partners, Ltd.

On April 27, 1982, the Division issued an Order declaring Columbus Partners, Ltd.'s claim of exemption under Ohio Revised Code Section 1707.03(Q) null and void. An examination by the Division had indicated Columbus Partners did not file its Form 3-Q within sixty days of the sale of certain securities.

STATE OF OHIO
DEPARTMENT OF COMMERCE
DIVISION OF SECURITIES
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(Corner Chestnut & High Sts.)
Columbus, Ohio 43215
Equal Opportunity Employer