OHIO SECURITIES BULLETIN

A QUARTERLY PUBLICATION OF THE OHIO DIVISION OF SECURITIES

Bob Taft
Governor of Ohio

Doug White
Director of Commerce

Dale A. Jewell
Commissioner of Securities

New Director of Commerce, Securities Commissioner Appointed

Two recent appointments brought new leadership to the Ohio Department of Commerce and the Ohio Division of Securities during the final quarter of 2004.

Governor Bob Taft appointed former Ohio Senate President Doug White as Director of the Department in December. A veteran businessman and state legislator, whose leadership in the Ohio General Assembly contributed to the improvement of state laws regulating financial institutions, securities, liquor control, and other industries, White's top priorities as Director of Commerce are the protection of consumers and clear, fair and efficient regulation of business and industry.

Dale A. Jewell was appointed Securities Commissioner by then Commerce Director and Ohio Lt. Governor Jennette Bradley, who currently serves as Treasurer of State. Jewell began his

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The Debt Instrument In Ohio: Is It a "Security"?

By John P. Donahue

Ohio's definition of "security" has two sentences.[1] The first sentence broadly defines the term as "any certificate or instrument that represents title to or interest in, or is secured by any lien or charge upon, the capital, assets, profits, property, or credit of any person or of any public or governmental body, subdivision or agency."[2] The second sentence provides a list of the types of securities that are included within the terms of the first sentence. The debt instruments that are included in the list are: "promissory notes" ... "all forms of commercial paper" ... "evidences of indebtedness" ... "bonds" ... "debentures" ... and ... "any instrument evidencing a promise or an agreement to pay money..."[3]

What attributes or criteria qualify a fixed rate debt instrument[4] as a "security" subject to state regulation under the Ohio Securities Act? Because the existence of a "security" triggers the special fraud proce-

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New Director of Commerce/ Securities Commissioner

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career in the Division of Securities 29 years ago, and he had managed the Division's Licensing and Examination sections since 1978. As the new Securities Commissioner, he replaces Deborah Dye Joyce, who was appointed Assistant Director of the Ohio Department of Commerce earlier in 2004.

White served as President of the Senate during the 125th Session of the Ohio General Assembly. He represented the 14th Senate District which includes Adams, Brown, Clermont and Scioto counties, as well as portions of Lawrence County.

Debt Instrument In Ohio

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dures,[5] protections,[6] and remedies[7] provided by Ohio Blue Sky Law, the answer to the threshold question is of enormous public significance. In recognition of the dearth of analysis in Ohio fixed rate securities case law,[8] the need to give meaning to Ohio's definition of "security" on the heels of its opinion in *Gutmann v. Feldman*, 97 Ohio St.3d 473, 2002-Ohio-6721, 780 N.E.2d 562, infra, and cognizant of the unanswered questions of *Gutmann*, the Supreme Court of Ohio has spoken.

The case is *Perrysburg Township v. City of Rossford, et al.*, 103 Ohio St.3d 79, 2004-Ohio-4362, and it involves the unsuccessful investment of $5 million of the public funds of Perrysburg Township ("Perrysburg") in a proposed arena/amphitheater that was to be financed and constructed by a non-profit agency of the City of Rossford ("Rossford"). When the Rossford Arena Amphitheater Authority ("RAAA") was unable to secure $48 million in additional financing, the project collapsed and Perrysburg lost all of its initial investment and the eight-percent (8%) in annual interest guaranteed by the written instrument memorializing the transaction.

Perrysburg filed two lawsuits, claiming that the instrument was an unregistered, non-exempt security and that representations and omissions of Rossford, Rossford Mayor Mark Zuchowski, and the RAAA, violated the anti-fraud and anti-manipulation provisions of the Ohio Securities Act. The Wood County Court of Common Pleas dismissed all securities claims in both actions finding that, because the instrument provided only a return of principal with a fixed rate of interest, it could not qualify as a security. The Sixth District Court of Appeals reversed, reasoning that because the instrument could reasonably qualify as a "promissory note" under the federal standard adopted by the United States Supreme Court in *Reves v. Ernst & Young*, (1990), 494 U.S. 56, 110 S.Ct. 945, 108 L. Ed.2d 47,[9] it qualified as a "promissory note" under the second sentence of R.C.§ 1707.01(B).[10]

Both parties appealed the appellate court's decision. Prior to its decision in *Perrysburg Township*, the Supreme Court, in *Gutmann*, gave some meaning to the ghost of Ohio securities law - the first sentence of R.C.§ 1707.01(B). No Ohio court had

OHIO SECURITIES BULLETIN

Desiree T. Shannon, Esq., Editor

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

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

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Debt Instrument in Ohio

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addressed the meaning of the first sentence of the statute before *Gutmann*, even though it was adopted in 1929, and has remained substantively unaltered since.[11] Instead, all pre-existing Ohio securities case law had interpreted the term "security" by reference to the meaning of one of the types of securities recited in the second sentence of the statute - the catch-all terms ... "any investment contract..." [12]

Gutmann and the Ghost

The question presented in *Gutmann* was whether the term "any investment contract" in the second sentence meant that an oral investment contract could be a security despite the "certificate or instrument" language of the first sentence. The respondents in *Gutmann* argued that the use of the term any to modify the term "investment contract" evidenced a legislative intent to include oral investment contracts. In answering the question in the negative, the Court identified the first sentence of Ohio's statute as the "core definition" of security, and the second sentence as providing specific examples of the forms that such securities may take. *Gutmann* at ¶ 15. Giving the terms "certificate or instrument" of the first sentence their plain meaning, the Court held that the list of examples of security in the second sentence could not be read to expand upon those terms. Id. Accordingly, an oral investment contract could not be a security under Ohio law because of the limiting "certificate or instrument" language of the first sentence. *Gutmann* did not, however, address the meaning of the remaining terms of the ghost - "title to or interest in, or is secured by any lien or charge upon, the capital, assets, profits, property, or credit of any person or of any public or governmental body, subdivision or agency" - or how the examples of the second sentence fit within the broad "core" language of the first sentence.

Economic Reality and the Ghost

On September 8, 2004, a unanimous Ohio Supreme Court adopted the most flexible definition of "security" in American jurisprudence, and a predictable and meaningful standard for determining when a note meets that definition. See *Perrysburg Twp.*, 103 Ohio St.3d 79, 2004-Ohio-4362. Justice Pfeifer delivered the opinion of the Court, holding as follows:

1. The first sentence of R.C. § 1707.01(B) provides the general definition of a security, which can be applied to any certificate or instrument to determine whether it is a security, and the second sentence provides a list of certificates and instruments that are presumptively securities.

2. To determine whether a particular note is a security, we adopt the test set forth in *Reves v. Ernst & Young* (1990), 494 U.S. 56, 66-67, 110 S.Ct. 945, 108 L. Ed.2d 47.

The Court's tightly worded eight-page opinion adopts a sweeping - yet literal - construction of R.C.§ 1707.01(B), that effectuates the expressed intent of the Legislature, provides maximum flexibility for determining the status of newly devised types of securities, promotes the goal of uniformity of securities law, and keeps the focus upon the economic realities of the particular transaction implicated. The Court's pragmatic substantive two-sentence interpretation represents a clarification of *Gutmann* that makes clear four pertinent ideas.

First, the first sentence of R.C.§ 1707.01(B) is the essence of "security." Its broad terms have substantive meaning that can be applied to future financial arrangements or opportunities to determine the applicability of the Ohio Securities Act. Second, the types of securities listed in the second sentence are not merely examples of forms of securities that are defined by the first sentence.[13] Instead, they have substantive literal meaning and are presumptively securities. Third, for the purpose of answering the threshold question - of whether a certain financial arrangement or opportunity is a security - the second sentence is to be consulted first. If a buyer can demonstrate that he or she has purchased one of the types of securities listed in the second sentence, then the transaction or opportunity is presumptively subject to the Ohio Securities Act. Upon such a demon-

stration, the burden of proof, production and persuasion is now on the seller to rebut the statutory presumption. And, if the security implicated is a note, then the seller must rebut the presumption by demonstrating that the note either falls within one of the categories of notes that is clearly not a "security," see, n. 9 at ¶ {a}, or that it bears "a strong family resemblance" to one of the notes on the list. See n. 9 at ¶ {b}.

Finally, if the financial arrangement or opportunity implicated is not one of the types of securities listed in the second sentence of R.C.§ 1707.01(B), then the threshold question must be determined by reference to the general definition of "security" recited in the first sentence. The meaning of the terms of the ghost, however, and its application have been reserved for another day.

The Perrysburg Skyline

While the sky is blue over Perrysburg, it is clear that storm clouds are forming on the horizon. The unresolved questions of *Perrysburg Township* will significantly affect Ohio's debt instruments, its securities marketplace and its courts for years to come.

Since the United States Supreme Court adopted the "family resemblance test" of *Reves*, to apply only to promissory notes, and since the *Perrysburg Township* Court held that all of the types of securities in the second sentence are entitled to presumptive status, the question remains: what standard or standards will the Court adopt to evaluate the status of the broader sets of non-traditional debt securities - "all forms of commercial paper" ... "evidences of indebtedness" ... and "any instrument evidencing a promise or an agreement to pay money...?" What characteristics, qualities, or attributes distinguish these debt securities from the universe of commercial transactions? And, how will the sellers of these types of written documents rebut the legislative presumption? Ohio courts will receive no guidance from federal securities jurisprudence to evaluate the terms "all forms of commercial paper" ... and "any instrument evidencing a promise or an agreement to pay money ...", because these types of securities are not covered by the federal definition. And, although covered by the federal and Ohio acts, there is no securities case law interpreting the terms "evidences of indebtedness..."

In light of the adoption of *Reves* and its rationale, how will Ohio courts evaluate short-term debt obligations with maturity dates of nine months or less?[14] Are all debt instruments presumptively securities in Ohio – irrespective of their dates of maturity? And, how will Ohio courts apply the four-factored "family resemblance test" of *Reves*? Is the "family resemblance test" merely a balancing test with equal weight to be given to each of the factors?[15] Or, will the legislative goal of the Ohio Securities Act - to provide the investing public with special fraud protection - be effectuated by requiring greater weight to be given to the third and fourth factors of *Reves* - "the reasonable expectations of the investing public" and the "existence of another regulatory scheme that significantly reduces the risk to the instrument?"

Does the adoption of *Reves*, "to fill a gap in Ohio law and promote uniformity in securities law,"[16] signal a trend toward the federalization of the Ohio Securities Act?[17] If so, will Ohio abandon the "risk-capital" "investment contract" standard of *State v. George*, supra, in favor of the widely criticized[18] federal test of *Securities & Exchange Comm. v. W.J. Howey Co.* (1946), 328 U.S. 293, 66 S.Ct. 1100, 90 L. Ed. 1244? And, where a buyer claims to have purchased an "investment contract," how will Ohio courts determine whether the transaction is, in fact, an "investment contract," entitled to presumptive status? See n. 12.

Finally, how will Ohio courts evaluate future non-presumptive financial arrangements or opportunities that either are not listed in the second sentence of the statute or that do not neatly fit within one of the types enumerated? Simply put, what is the substantive meaning of the ghost, and how shall it be applied?

These questions are of public and great general interest. And, it is clear that their determination will be made on a case by

case basis, with an emphasis upon the economic realities of the individual financial arrangement or opportunity implicated, and with a careful and reflective eye towards the nuances of the Court's most recent decision in *Perrysburg Township*.

(Endnotes)

[1] R.C.§ 1707.01(B). The version of R.C.§ 1707.01(B), that was interpreted in *Perrysburg Twp.*, infra, provided as follows: "Security" means any certificate or instrument that represents title to or interest in, or is secured by any lien or charge upon, the capital, assets, profits, property, or credit of any person or of any public or governmental body, subdivision, or agency. It includes shares of stock, certificates for shares of stock, membership interests in limited liability companies, voting-trust certificates, warrants and options to purchase securities, subscription rights, interim receipts, interim certificates, promissory notes, all forms of commercial paper, evidences of indebtedness, bonds, debentures, land trust certificates, fee certificates, leasehold certificates, syndicate certificates, endowment certificates, certificates or written instruments in or under profit-sharing or participation agreements or in or under oil, gas, or mining leases, or certificates or written instruments of any interest in or under the same, receipts evidencing preorganization or reorganization subscriptions, preorganization certificates, reorganization certificates, certificates evidencing an interest in any trust or pretended trust, any investment contract, any instrument evidencing a promise or an agreement to pay money, warehouse receipts for intoxicating liquor, and the currency of any government other than those of the United States and Canada, but sections 1707.01 to 1707.45 of the Revised Code do not apply to the sale of real estate. See also, n. 3, infra. Contrast, 15 U.S.C. § 77b(a)(1); 15 U.S.C. § 78c(a)(10).

[2] As a result of *Gutmann*, infra, the first sentence of R.C.§ 1707.01(B) was amended in September of 2003 to add the following language after certificate or instrument: "<u>or any oral, written or electronic agreement, understanding or opportunity</u>," that represents ...

[3] Id.

[4] Debt instruments are non-proprietary by nature and must be distinguished from the traditional type of "security" - the proprietary interest instrument. The latter provides the investor with an intangible proprietary interest in an enterprise with repayment upon termination plus a share of the profits and losses of the enterprise, while the former provides the investor with an intangible claim against the enterprise with repayment and profit in the form of interest. See, Ronald J. Coffey, The Economic Realities of a "Security": Is There a More Meaningful Formula? 18 W. Res. L. Rev. 367 (1967), 384-86. Non-proprietary fixed rate instruments should also be distinguished from proprietary fixed rate instruments - like preferred stock certificates - that provide the investor with an intangible interest in an enterprise and profit in the form of a fixed rate of interest.

[5] See generally, R.C.§ 1707.44(C) and R.C.§ 1707.07.

[6] See generally, R.C. § 1707.41, R.C. § 1707.44(B), (C), (D), (E), (F), (G), (J), (K).

[7] See generally, R.C.§ 1707.43 and R.C.§ 1707.44.

[8] See, *Mathias v. Rosser*, Franklin App. No. 01-AP-768, 2002-Ohio-2772, (promissory notes are securities); *Boland v. Hammond*, 144 Ohio App.3d 89, 2001-Ohio-2680, (notes issued through a portal investor are securities); *State v. Mong* (Dec. 1, 1998), Licking App. No. 98CA0043, (notes requiring the obligor to repay the principal plus 12% interest within two years of the date of issuance are securities); *Williams v. Waves, Cuts, Colour & Tanning, Inc.* (1994), 92 Ohio App.3d 224, (agreement providing for the repayment of 6.5% interest only with a future promise of a stock conversion in exchange for the cancellation of the obligation, is a security); *State v. Jackson* (May 4, 1994), Wayne App. No. C.A. No. 2754, (television airtime, fixed rate of return, repurchase agreements are securities); *Sloulin v. Intermark Int'l, Inc.* (Apr. 4, 1992), Summit App. No. 15242, (note in the principal amount of $20,404.00 with interest at the rate of 15% per annum, payable monthly, is a security); accord, *Seuffert v. Mobile Health Scan, Inc.* (Sept. 14, 1989), Cuyahoga App. No. 51596.

[9] ¶{a} In Reves, the Court adopted the so-called "family resemblance test" to determine when a promissory note constitutes a "security" under the federal act. The "family resemblance test" begins with a rebuttable presumption that any note with a maturity date in excess of nine (9) months is a security. Reves, 494 U.S. at 65. To rebut the presumption and thus obtain a ruling that the note at issue is not a "security," the seller must demonstrate that the note either falls within one of the categories of notes that is clearly not a security, or that it "bears a family resemblance" to one of the notes on the list. The types of notes that would not constitute a security under Reves are: (1) a note delivered in consumer financing, (2) a note secured by a mortgage on a home, (3) a note secured by a lien on a small business or some of its assets, (4) a note relating to a "character" loan to a bank customer, (5) a note which formalizes an open account indebtedness incurred in the ordinary course of business, (6) short term notes secured by an assignment of accounts receivable, and (7) notes given in connection with loans by a commercial bank to a business for current operations. Id. at 65. The Supreme Court identified four factors for courts to consider in analyzing whether a particular note bears a "strong family resemblance" to any of the categories identified above, and thus, should not be considered a security.

¶{b} Under *Reves*, the reviewing court must examine the transaction to assess the motivations of the seller and buyer to engage in the transaction. If the seller is motivated to earn money for the general use of a business enterprise and the buyer is interested primarily in profit, which includes interest, then the instrument is likely to be

a security. Id. at 66. Second, the court examines the "plan of distribution" of the instrument, to determine whether it is "an instrument in which there is 'common trading for speculation or investment.'" Id., quoting, *SEC v. C.M. Joiner Leasing Corp.* (1943), 320 U.S. 344, 351, 164 S.Ct. 120, 88 L.Ed. 88. Third, the court must consider the reasonable expectations of the investing public. Id. at 66-67. Instruments will be securities on the basis of public expectations "even where an economic analysis of the circumstances of the particular transaction might suggest that the instruments are not 'securities' as used in that transaction." Id. Finally, the court examines whether some other factor such as the existence of another regulatory scheme "significantly reduces the risk to the instrument," thereby rendering the application of the federal act unnecessary. Id.

[10] *Perrysburg Twp. v. Rossford*, 149 Ohio App.3d 645, 2002-Ohio-5498.

[11] In 1929 the first sentence read as follows: The term "security" shall mean any certificate or instrument which represents title to or interest in, or is secured by any lien or charge upon, the capital, assets, profits, property, or credit of any person or of any public or governmental body, subdivision, or agency. 113 Laws of Ohio 216.

[12] ¶ {a} For those cases finding the existence of an "investment contract" and, therefore, the existence of a "security," see, *Peltier v. Koscot Interplanetary, Inc.* (Nov. 11, 1972), Franklin App. No. 72AP-220, (pyramid sales scheme is an investment contract, where the offeree does not have the right to exercise practical or actual control over the managerial decisions of the offeror); *State v. George* (1975), 50 Ohio App.2d 297, (distributorship agreements are investment contracts, where the offeree does not have the right to exercise practical or actual control over the managerial decisions of the offeror); *Leeth v. Decorator's Mfg., Inc.* (1979), 67 Ohio App.2d 29, (contract to produce styrofoam wall plaques for re-sale to offeror, where offeree had no control over the distribution of the same, was an investment contract); accord, *Mazza v. Kozel* (N.D. Ohio, 1984), 591 F. Supp. 432; *State v. Taubman* (1992), 78 Ohio App.3d 834, *State v. Jackson* (May 4, 1994), Wayne App. No. 2754, and *Rumbaugh v. Ohio Dept. Commerce* (2003), 155 Ohio App.3d 299, 2003-Ohio-6107, (viaticals that provide an investor with a fixed rate of return are investment contracts). See also, *Peltier et al. v. Condo-Mobile, Inc.* (Dec. 12, 1980), Franklin App. No. 79AP-747, (sales of memberships in a recreational vehicle park, where investors receive benefits as a result of their <u>own efforts</u> constitute investment contracts)

¶ {b} For those cases to the contrary, see, *State v. Silberberg* (1956), 166 Ohio St. 101; *Emery v. So-Soft of Ohio, Inc.* (1964), 94 Ohio L. Abs. 357; *Brannon v. Rinzler* (1991), 77 Ohio App.3d 749, (general partnership agreement creating partnership for the purpose of purchasing securities is not an investment contract, where partners retain actual control over the managerial decisions); accord, *Cox v. Lemonds* (1995), 107 Ohio App.3d 442; *Cartwright v. Falls Heating & Cooling, Inc.* (Jun. 6, 1994), Summit App. No. 16079, (employment agreement providing for the investment of a sum of money by an employee, in consideration of the payment of profits, is not an investment contract, where the employee retains the right to control of the managerial decisions of the enterprise); *Pride of the Andes, Inc. v. Soberay* (Jan. 1, 2001), Medina App. No. C.A. 3062-M, (purchase agreement for Peruvian alpacas is not an investment contract, where the purchaser retains right to make managerial decisions); and *Glick v. Sokol*, 149 Ohio App.3d 344, 2002-Ohio-4731, (viaticals are not investment contracts).

[13] The *Gutmann* court stated that "we interpret the list of examples in the second sentence as providing specific examples of what *forms* such securities as defined by the first sentence may take." (Emphasis in original), *Gutmann* at ¶ 15. Recognizing that such an interpretation would render the terms of the second sentence surplusage, therefore, precluding the adoption of *Reves*, the *Perryburg Twp.* Court retreated, and held that the terms of the second sentence were, indeed, substantive. *Perrysburg Twp.* at ¶ 7.

[14] Consistent with the exclusion of short term obligations from the purview of the federal act, the specific holding of *Reves* is that <u>only</u> notes with maturity dates of nine (9) months or more are entitled to presumptive "security" status. *Reves*, 494 U.S. at 65, n. 3. In determining that the demand notes of *Reves* matured in more than nine (9) months, the majority of the high court implicitly declined to consider the federal nine (9) month maturity exclusion of 15 U.S.C. § 78c(a)(10).

[15] In *Reves*, the high court gave no indication whether the factors should be balanced or whether each factor must be satisfied in order to rebut the presumption. The Sixth District Court of Appeals and the Ohio Supreme Court in *Perrysburg Twp.*, supra, used a balancing test approach, giving equal weight to each of the factors, in the context of their respective Civ.R. 12(B)(6) determinations.

[16] *Perrysburg Twp.*at ¶ 11.

[17] See, Thomas E. Geyer, Viewing the Columbus Skyline: Incorporating Federal Law Into the Anti-Fraud Standard of the Ohio Securities Act, 28 U. Tol. Rev. 2135 (1997).

[18] See, Maura K. Monaghan, An Uncommon State of Confusion: The Common Enterprise Element of Investment Contract Analysis, 63 Ford. L. Rev. 2135 (1995) (noting the state of confusion existing in the federal courts of appeal over the common enterprise element of *Howey*).

Editor's Note: John P. Donahue is a solo practitioner from Perrysburg, Ohio. He represented Perrysburg Township in the <u>Perrysburg Township</u> case. The views expressed in this article are those of the author and do not necessarily reflect the views or policies of the Ohio Division of Securities.

Enforcement Civil Actions

On December 1, 2004, the Division filed a civil complaint in Cuyahoga County Common Pleas Court against **Joanne C. Schneider** and **Alan C. Schneider**, husband and wife. Previously, the Division had issued a cease and desist order against Ms. Schneider for selling unregistered, non-exempt securities consisting of promissory notes. The Division discovered that the Schneiders continued to issue promissory notes after the issuance of said cease and desist order. The Division alleged that these note sales were also in violation of Revised Code 1707.44(C)(1). The Division further alleged that the Schneiders failed to disclose material facts to investors, including the prior administrative action of the Division. The lawsuit has been assigned to Cuyahoga County Common Pleas Court Judge Villanueva, who on December 1, 2004, issued a preliminary injunction and appointed a Special Master, Matthew Fornshell. On February 4, 2005, Judge Villanueva found that the Schneiders had violated the preliminary injunction because they had sold securities without the Court's permission. Pursuant to this finding, the Judge appointed Fornshell as receiver to manage investor funds and froze all assets and property that Joanne Schneider controlled individually and jointly with her husband.

Criminal Updates

On December 15, 2004, **David Scott Gale** entered a guilty plea in Franklin County Common Pleas Court to three counts of a Bill of Information that included charges of selling securities while unlicensed, making false representations while selling securities and theft. All three of these violations are third degree felonies. On July 30, 2004, the Bill of Information was filed in the Franklin County Common Pleas Court along with a Waiver of Indictment.

Gale posed as a securities salesperson for Merrill Lynch and sold approximately $154,000 in Krispy Kreme Doughnuts stock to an Ohio investor. While not affiliated with Merrill Lynch and not licensed to sell securities, Gale did not disclose to the investor that he has a criminal history. In addition, Gale allegedly guaranteed the investor at least a 50 percent profit on the purchase price in the event of a sudden loss of the stock's value. Between July 2001 and February 2002, Gale sold the investor stock in nine separate transactions. Gale failed to disclose to the investor that he hadn't purchased shares to fulfill the purchase orders, and he converted the investment funds for his own use. Sentencing is scheduled for March 7, 2005.

Minutes of the 2004 Enforcement Advisory Committee Meeting

The Enforcement Advisory Committee met at the Ohio Securities Conference on October 15, 2004. Several topics were discussed, including whether securities brokers have a fiduciary duty to their clients. The consensus was that they do have a duty, but it is not as well-defined as that of other professionals. Attorney Inspector Robert Lang answered inquiries regarding the effect of the longer statute of limitations on the Division's workload. Lang commented that though the Division's new statute of limitations (five years from the date of the sale of a security) is now in effect, it is too early to ascertain the impact on the Enforcement Section's case load. Lang also commented that the Division has not yet invoked the new restitution provision found in R.C. 1707.261, and said that restitution would only be sought in tandem with an injunctive action.

Some attendees were curious about challenges the Enforcement Section faces in carrying out its mission. Some Enforcement personnel in attendance stated that they felt they were in a struggle with scam artists to win the hearts of investors. They said they would like to see investors be more vigilant and notify the Division of problems sooner. They noted that education, particularly among seniors, may address this problem. Division personnel also stated that large enforcement cases tended to sop up most of the section's resources.

Lang discussed the Enforcement Section's relationship with outside agencies, namely prosecutors' offices and the National Association of Securities Dealers (NASD), which recently closed its Cleveland office and consolidated its operations with its Chicago office. Lang said the prosecutors' offices generally were cooperative with the Division, and that the NASD's Chicago office has worked well with the section.

Lang reviewed some high-profile enforcement cases and noted that the section had obtained 12 indictments in seven counties involving 77 counts during the previous twelve-month period. He noted the top scams currently were internet offerings targeting seniors, investment contracts (payphone, web booth kiosks etc.) and promissory notes. Lang noted that the section's priorities were to prevent scam artists from entrenching themselves in the state, and to educate the public, especially seniors and people living in rural areas.

Public Notice

At 10:00 a.m. on Thursday, February 17, 2005, the Ohio Division of Securities will hold a public hearing regarding the Division's intent to amend Ohio Administrative Rule 1301:6-3-09. The hearing will be held in the offices of the Division located at 77 South High Street, 22nd Floor, Columbus, Ohio 43215-6131.

Copies of the proposed rule amendments may be obtained by contacting the Ohio Division of Securities at the above address or by calling the Division at (614) 644-7381. Copies of the proposed rule amendments may also be obtained from the Division's Internet homepage located at www.securities.state.oh.us or the Register of Ohio located at www.registerofohio.state.oh.us. The proposed rule amendments are summarized in the following:

OAC 1301:6-3-09. The proposed amendment includes certain technical amendments throughout the rule in conjunction with cross-referenced material, including Rule 504 of Regulation D and section 3(a)(11) of the Securities Act of 1933.

Minutes of the 2004 Licensing Advisory Committee Meeting

The Division raised issues relating to the renewal of investment advisers and investment adviser representatives through IARD, specifically with regard to the need for investment advisers to complete migration prior to attempting renewal. The Division has sent, and intends to send additional notices, to all Ohio licensed investment advisers regarding the need to complete migration and to timely renew through the IARD system.

Discussion among Division staff and committee members was had on the following issues:

a. the new custody rule, particularly the delivery of quarterly statements;

b. life settlement interests;

c. the new compliance procedures rules for investment advisers;

d. the Division's policies on model advertising by investment advisers; and

e. requiring investment advisers to utilize arbitration in customer disputes.

Following discussion of the aforementioned topics, the meeting was adjourned.

Minutes of the 2004 Takeover Advisory Committee Meeting

The Division's Takeover Advisory Committee held its annual meeting at the 2004 Ohio Securities Conference. David Zagore, Co-Chair of the Takeover Advisory Committee, and Michael Miglets of the Division prepared the agenda and served as moderators for the meeting.

David Zagore reported on the progress of the proposed amendment to R.C. 1707.041 that would give the Division a three-day review period for material amendments of control bids. The Takeover Advisory Committee and the Tender Offer Subcommittee of the Corporation Law Committee of the Ohio State Bar Association drafted an amendment that would require an offeror to file material amendments to a tender offer with the Division. The Division would then have three days to review the amendment. If the disclosure was inadequate, the Division could then suspend the tender offer. A hearing would then be held within three days. A final ruling on the suspension would then be issued within three days. If the offeror amended the disclosure, the suspension could be lifted at any time. The nine day period for Division action is designed not to conflict with the ten day period specified in Rule 14d-4(d)(2)(ii).

The proposed amendment was approved by the Council of Delegates of the Ohio State Bar Association in June 2004. The proposed amendment may be introduced in 126Th Ohio General Assembly.

The Takeover Advisory Committee and the Tender Offer Subcommittee agreed to meet again at the Corporation Law Committee meeting on January 29, 2005.

Capital Formation Statistics*

Because the Division's mission includes enhancing capital formation, the Division tabulates the aggregate dollar amount of securities to be sold in Ohio pursuant to filings made with the Division. As indicated in the notes to the table, the aggregate dollar amount includes a value of $1,000,000 for each "indefinite" investment company filing. However, the table does not reflect the value of securities sold pursuant to "self-executing exemptions" like the "exchange listed" exemption in R.C. 1707.02(E) and the "limited offering" exemption in R.C. 1707.03(O). Nonetheless, the Division believes that the statistics set out in the table are representative of the amount of capital formation taking place in Ohio.

**Categories reflect amount of securities registered, offered, or eligible to be sold in Ohio by issuers.*
***Investment companies may seek to sell an indefinite amount of securities by submitting maximum fees. Based on the maximum filing fee of $1100, an indefinite filing represents the sale of a minimum of $1,000,000 worth of securities, with no maximum. Consequently, for purposes of calculating an aggregate capital formation amount, each indefinite filing has been assigned a value of $1,000,000.*

Filing Type	4rd Qtr 2004	YTD 2004
Exemptions		
Form 3(Q)	$10,064,202	$1,226,256,132
Form 3(W)	5,984,615	21,734,615
Form 3(X)	161,423,278,738	405,812,995,852
Form 3(Y)	103,000,000	111,790,000
Registrations		
Form .06	41,599,200	2,875,895,061
Form .09/.091	45,952,784,409	106,289,191,768
Investment Companies		
Definite	102,550,500	418,262,200
Indefinite**	508,000,000	2,080,000,000
TOTAL	**$208,147,261,664**	**$518,836,125,628**

Registration Statistics

The following table sets forth the number of registration, exemption, and notice filings received by the Division during the fourth quarter of 2004, compared to the number of filings received during the fourth quarter of 2003. Likewise, the table compares the year-to-date filings for 2004 and 2003.

Filing Type	4th Qtr '04	YTD '04	4th Qtr '03	YTD '03
1707.03(Q)	18	98	35	141
1707.03(W)	5	15	4	17
1707.03(X)	340	1453	306	1115
1707.03(Y)	4	9	2	6
1707.04/.041	0	1	2	6
1707.06	17	78	11	74
1707.09/.091	47	182	28	158
Form NF	1117	5420	1008	4301
Total	1548	7256	1396	5818

Licensing Statistics

License Type	YTD 2004
Dealers	2,322
Salespersons	119,750
Investment Adviser/Notice Filers	1,733
Investment Adviser Representatives	10,053

Minutes of the 2004 Registration and Exemption Advisory Committee Meeting

The registration and exemption advisory committee held its annual meeting during the 2004 Ohio Securities Conference. The Division discussed a few developments with direct participation placement offerings. The Division applies the suitability standards contained in the North American Securities Administrators Association guidelines. Those standards generally require that residents who purchase the securities in the direct participation placement offering have either: (1) a net income of $45,000 and a net worth of $45,000; or (2) a net worth of $150,000. Net worth is computed by excluding home, home furnishings and automobiles. These standards have not increased in over 11 years. The Division, through its participation in NASAA, has reviewed census data, rates of inflation and Federal Reserve information. The Division believes that the suitability standards need to be increased to be adjusted for inflation. Net worth would continue to exclude home, home furnishings and automobiles. Many states increase the suitability standards regarding net income and net worth on their own initiative. The Division believes that this adjustment is necessary and may proceed forward with this requirement in the near future.

The Division also mentioned that we do not participate in coordinated review programs. Certain statutory requirements prohibit the Division from participating with the coordinated equity review program or coordinated direct participation placement review. The Division strives to send out comments within two weeks of filing. The comments of the Division have not slowed the coordinated review process. The Division intends to fully cooperate with states in the coordinated review process. Other state examiners may have access to the comment letters of the Division. At this time, the Division seeks to retain the authority to decide if an applicant has resolved the comments.

The Division is also looking to publish standards on the filing, review and approval of advertising and sales literature. The Division has suggested that issuers follow NASD conduct rule 2210 in the preparation of the material. The Division welcomes suggestions on other standards of review and what form of approval or notice is desired by filers of these materials. A bulletin article may be forthcoming on this issue to provide published guidance for filers.

A question was asked concerning the uniform securities act and its proposal in Ohio. The Division noted that substantial changes have taken place by legislation within the last 5 years. The Division is uncertain that a proposal for this provision will benefit issuers or investors.

Finally, co-chair Professor Howard Friedman discussed the proposal for incorporation by reference. Currently, changes to certain federal provisions may have difficulty in adoption through Ohio Securities Act provisions that incorporate by reference. The proposal would mean that federal updates whether by statute, rule or form will be incorporated to the Ohio provision. Certain tax cases may be forthcoming on this issue. This will have benefits throughout the Ohio Securities Act and companion administrative rules.

No further items were discussed and the meeting was adjourned.