Ohio Securities Bulletin

JAMES A. RHODES
Governor

J. GORDON PELTIER
Director of Commerce

KENNETH E. KROUSE
Commissioner of Securities

Issue 3 – 1981

PROPOSED SEC RULE CHANGES AND THEIR EFFECTS ON OHIO SECURITY REGULATION

By Donald E. Meyer*

In August, the Securities and Exchange Commission released a draft of proposed amendments to the rules and regulations promulgated under the Securities Act of 1933. The amendments are intended to fulfill three objectives. First, the revisions coordinate the exemptions promulgated under Sections 3(b) and 4(2) of the 1933 Securities Act and streamline the existing requirements for qualifying for a private offering exemption. Second, the amendments remove certain small offerings from federal regulation and defers them to state regulation. Third, by coordinating the federal regulations with state regulations, the amendments have attempted to reduce the cost burden of a private offering by small businesses. The last objective was mandated by the Small Business Incentive Act of 1980, which requires the SEC to work with an organization representing state security regulators in order to develop a co-ordinated federal-state security regulatory scheme.

The SEC intends to replace Rule 240, Rule 242, and Rule 146 with what has been coined as Regulation D. The Rules within Regulation D are numbered from 501 to 506. Rule 501 sets forth common definitions of terms used in Regulation D and Rule 502 sets forth the common conditions to be met in order to qualify for an exemption under Rule 504, Rule 505 or Rule 506. The conditions which must be met include the providing of certain information about the issuer to investors (the amount of information to be provided varies with the dollar amount of the offering), a prohibition of general advertising and solicitation, a requirement that steps be taken to insure that the security is not being purchased for resale and the limitation that any commission to be paid to a broker-dealer who is registered under either a federal or state broker-dealer statute. Rule 503 provides for a uniform notice of sale form to be filed whenever an exemption is claimed under Rule 504, Rule 505 or Rule 506.

Rule 504 will replace the current Rule 240 exemption. Under the new rule the dollar amount of securities which may be sold within a twelve month period has been increased from $100,000 to $500,000. The increase was prompted by a study which indicated that most issuers could not utilize Rule 240 because the dollar limitation on the offering was too low. The proposed rule further alters Rule 240 by eliminating the "100 beneficial purchaser" limitation and allowing sales to be made to an unlimited number of purchasers. The expansion of this exemption to an unlimited number of purchasers will not have much impact since the real limitation is the $500,000 limitation.

The current Rule 242 is to be replaced by Rule 505 which grants an exemption from registration offerings which will not exceed $5,000,000. Rule 242 limited the size of the offering to no more than $2,000,000 within a six-month period. As in Rule 242, sales may be made to 35 unaccredited purchasers and an unlimited number of accredited purchasers. The term "accredited purchaser" has been expanded in the "fat cat" area to include a purchaser of at least $100,000 worth of securities which cannot exceed 25% of his net worth, a purchaser who has a net worth of at least $1,000,000 or has an adjusted net income of $100,000 for at least three years.

The exemption for the limited offer and sale of securities exceeding $5,000,000 will be governed by Rule 506 which has been designed to replace Rule 146. As in the past, sales may be made to 35 unaccredited purchasers and an unlimited number of accredited purchasers. Rule 506 retains the concept embodied in Rule 146 that each unaccredited purchaser either alone or with his purchaser representative has knowledge and experience in business matters or is capable of evaluating merits and risks of the prospective investment. However, the alternative requirement for the nature of the offeree under Rule 146, that the offeree

*Donald E. Meyer is an attorney examiner in the Registration Section of the Ohio Division of Securities and is also a member of the NASAA Small Business Sub-Committee which developed the uniform state exemption.

OHIO SECURITIES BULLETIN
Publication of the
Ohio Department of Commerce
Division of Securities
Two Nationwide Plaza - 3rd Fl.
Columbus, Ohio 43215

ADMINISTRATION – 466-7602

Kenneth E. Krouse
Commissioner of Securities

Phillip Lehmkuhl
Deputy Commissioner

James F. Hurd
Assistant Commissioner

Nick Caraccilo
Office Manager

David G. LeGrand
Counsel

Patricia Dye
Attorney Assigned to Commissioner

EXAMINATION AND BROKER DEALER SECTIONS – 466-3466

Dale Jewell, Supervisor

REGISTRATION SECTION – 466-3440

Robert Bibler, Supervisor
Examiner of Form 2B

Janet Gibson, Examiner
Oil and Gas
William D. Henry, Attorney Examiner
Private Offerings
James F. Hunt, Attorney Examiner
Investment Companies
Clyde Kahrl, Attorney Examiner
Form 6
William E. Leber, Attorney Examiner
Foreign Real Estate
Tina Manning, Examiner
Forms 9 and .091
Don E. Meyer, Attorney Examiner
Forms 9 and .091
Sid Silvian, Attorney Examiner
Corporate Form 9
Gordon Stott, Examiner
Form 39 and Non-Profit Organizations
Kathy Veach, Examiner
Form 3-O
James Warneka, Examiner
Oil and Gas

ENFORCEMENT SECTION – 466-6140

Paul Tague, Attorney Inspector

STAFF ATTORNEYS

Nancy Ivers Ferguson
Barry Moses
Scott Roberts

INVESTIGATORS

Karen Banks
Dale Barrett
William Sturkey
Doria Wideman

EXAMINER

Robert Almond

be able to bear the economic risk of the investment, has been dropped from the proposed Rule.

The exclusion from the count of the number of purchasers under current Rule 146, of those purchasers who purchase over $150,000 worth of securities has been changed in Rule 506 to comport with the "fat cat" accredited purchaser in Rule 505. In other words, under Rule 506, a purchaser of at least $100,000 worth of securities which does not exceed 25% of his net worth, a purchaser who has a net worth of at least $1,000,000 or who has an adjusted net income of $100,000 for at least three current years, meets the definition of an accredited purchaser and is not included in the 35 purchaser count.

One of the most significant and unique modifications is the information requirements set forth in proposed Rule 502. For offerings in excess of $500,000 if 60% or more of the investors are accredited, then the rule provides no specific requirements for the disclosure of information to the unaccredited purchasers. The issuer is merely required to provide the unaccredited purchaser with the information which was provided to the accredited purchaser, if the unaccredited purchaser so requests in writing. This innovative change reflects a belief that institutional investors can generally be relied upon to evaluate the fairness and merits of an offering.

Members of the small business division of the SEC consulted with the Small Business Finance Subcommittee of NASAA when Regulation D was being drafted so that a coordination with a uniform state exemption would be facilitated. In addition to negotiating changes in Regulation D, the NASAA Small Business Finance Subcommittee drafted a proposed Uniform Limited Offering Exemption which has been coordinated with Regulation D. This uniform state exemption is expected to be submitted to a vote for adoption by NASAA membership at their meeting in Atlanta this month. The NASAA Uniform Limited Offering Exemption is drafted to allow the states to choose between two regulatory options. Both options provide an exemption from state security regulation for an offering which is sold in compliance with Rule 501 to Rule 503, Rule 505 and Rule 506. (Rule 504 is excluded from the state uniform exemption). The second option, Option B, goes further than the federal exemption requirements by adding the requirement that the issuer determine that the investment is suitable for the purchaser and that the purchaser be sophisticated. The investment is presumed to be suitable for a purchaser if it does not exceed 20% of his net worth, exclusive of home furnishings and personal automobile. The initial draft of the second option also requires a ten-day pre-sale notice to the state administrator (as opposed to the 30 day post sale notice which must be given to the SEC or the states adopting Option A). It is anticipated that many of the merit states would prefer Option B of the uniform state exemption over Option A.

The Ohio legislators have been reluctant to adopt statutes which adopt federal rules and regulations en banc due to the delegation of state power constitution issue and due to the vulnerability to unfavorable change in federal regulation. Although, the Ohio Division of Securities has formally endorsed the state's adoption of the NASAA Uniform Limited Offering Exemption, no formal decision

on whether or not Ohio will adopt the exemption has been made. Ohio is considering a change to the registration by description provision which, if passed by the legislature, would reduce the registration burden in Ohio for small businesses. The proposed Ohio statutory revision is anticipated to incorporate many of the features of the existing federal Rule 242.

Since the Ohio Securities Act presently has two tie-ins with the Federal Securities Act and regulations, the proposed Regulation D will have an effect on Ohio filings. The Ohio Act tie-ins with the Federal Act and regulations are in Section 1707.03(Q), the private offering exemption, and 1707.091, registration by coordination. If the proposed 60% piggy back rule concerning the furnishing of information to unaccredited investors were to be adopted by the SEC, it would be automatically incorporated into the Ohio exemption. Furthermore, the change in the "fat cat" definition of an accredited investor as well as the elimination of the economic risk test (described above) would be automatically incorporated in a 3(Q) claim for an exemption. This is not to say, however, that if the Division determines that these changes have proven to be unwise that it will not promulgate rules to return the 3(Q) exemption to its original state.

The only significant change to Section 1707.091 will occur if the SEC decides to eliminate Regulation A and permit issuers to register up to $3,000,000 on a form S-18 without audited financial statements. The Division has always held the view that audited financial statements plays an important part in the regulation of securities. However, it is uncertain whether or not the SEC will propose the elimination of Regulation A and the Division will await its decision.

Regulation D has culminated a three year evaluation by the SEC and various organizations of the effect of security regulation upon the capital formation processes of small businesses. The proposed changes should reduce the burden of claiming registration exemptions by liberalizing and expanding their availability. At the same time the SEC has shifted the burden of regulating the issuance of securities by smaller businesses to the states which must assume a more positive role in the regulation of such issuances.

[1]Release No. 33-5339; File Number S7-891

Parameters Of A Form .06

by Clyde C. Kahrl

This article is written for the purpose of clarifying present policies of the Division regarding the application of fairness standards to the registration of securities pursuant to Revised Code Section 1707.06. It discusses the most commonly encountered problems arising from the filing of one of the various forms under Section 1707.06.

Fairness standards applicable to the registration of securities in Ohio originate in Revised Code 1707.13. These standards apply to all sales of securities in the state of Ohio regardless of the provisions by which they are registered. The basic standard for testing a registration is that of whether "such security is being disposed of or purchased on grossly unfair terms, in such manner as to deceive or defraud or as to tend to deceive or defraud purchasers or sellers, or in disregard of the lawful rules and regulations of the division applicable to such security or transactions therein."

At the request of various securities practitioners the Division has available exerpts from the Ohio Securities Bulletin of 1973. Previously published as "general standards of determining whether a proposed offering of securities is being made on grossly unfair terms," these guidelines provide a broad and flexible set of standards for reference in constructing a financing plan for a corporation wishing to issue securities in Ohio.

The availability of Section 1707.06 to a potential registrant is conditioned upon specified sets of circumstances, which then allow the issuer to sell securities with an abbreviated registration and an exemption from dealer licensing. Section 1707.06 does not exempt an issuer from the fairness standards because it exempts him from full registration; instead it anticipates that under certain circumstances less information is necessary to prevent deceit.

However, deviations from a simple offering will usually trigger a Division request for explanatory amendments. Thus, a complex transaction may eventually require as much disclosure on a Form 6 as it would elsewhere, and little is gained by registering a complex transaction on a Form 6 other than allowing the issuer to sell securities for his own account without being deemed a dealer.

Practitioners should note that the Division does not exempt "ma and pa" corporations from application of the fairness standards even if: 1) all associated with the corporation are closely related by blood, 2) all of those associated with the corporation are bound by gentlemen's contracts, 3) potential shareholders have waived the right to receive statutorally required material, 4) the Division once allowed a deal "just like this one" to pass uncontested.

The balance of this article deals with some of the commonly experienced problem areas in section 6 registrations.

Integration

For the purpose of applying all of the requirements and fairness standards to a Form 6 registration, the Division will integrate into the potential future offering other sales of stock that it deems to be artifically fragmented from a unified financing scheme. The Division will apply the federal common law integration standards to Ohio offerings. In Securities Act Release No. 4552, the SEC listed the factors it deemed relevant to integration: "1) are the offerings part of a single plan of financing; 2) do the offerings involve issuance of the same class of security; 3) are the offerings made at or about the same time; 4) is the same type of consideration to be received; 5) are the offerings made for the same general purpose?"

Most often, issuers encounter integration problems when they sell securities under sections 1707.03(O) or 1707.03(Q) and then immediately attempt to register further sales of the same security at a higher price to the general public.

Securities sold under other exemptions are also subject to integration with securities sold subject to a registration.

Varying Terms

Any sale or exchange of the same class of securities with various purchasers at or about the same time on varying terms is per se unfair.

Cheap Stock

Cheap stock, issued to promoters, officers, or other employees of a corporation for services is not registerable under section 1707.06(A)(1) because services are "intangible property". It is important to note that the sale of cheap stock pursuant to 1707.03(O) immediately prior to or following a sale under 1707.06(A)(1) is deemed to be in violation of the statutory requirements of 1707.06(A)(1). Note that 1707.06(A)(2) imposes no restriction with regard to "intangible property".

Corporate Code

Ohio Business Association Law is subsumed in the Ohio Securities Law. The Division will declare grossly unfair any offering of securities which appears in form or substance to violate the various Ohio laws governing business associations. It has been found that a number of provisions are often overlooked. The Division would draw the practitioner's attention to certain sections of Ohio general corporation law (Chapter 1701) namely: 1) Sections 1701.30-32 dealing with capital surplus, 2) Sections 1701.56 and 1701.59 dealing with the authority of the board of directors, 3) Section 1701.64 dealing with the authority of the officers, and 4) Section 1701.60 dealing with insider transactions.

Voting rights and preferences

The Division will not allow the sale of non-voting securities without the grant of some variety of dividend or liquidation preference. This prohibition is discussed in the Division Guidelines. The purpose of this limitation should be readily apparent. Non-voting common stock has virtually no worth even when entitled to share dividends with voting common stock in pari materia. Without the ability to vote or without the ability to receive dividend or liquidation preferences the non-voting common holders are not only at the total mercy of the policy-making authority of the voting common shareholders, but in addition they are extremely vulnerable to corporate waste and even looting by the voting common shareholders.

Insider Transactions

Insider transactions must be disclosed in detail. The Division strongly recommends that when engaging in an insider transaction the corporation pursue the procedures set forth in the General Corporation Law Section 1701.60(A)(1)(a) or (b) at the very minimum.

Management Contracts

Management contracts need to be spelled out in detail and fully disclosed in a registration statement with the Division. It is essential when drafting a management contract that deference be given to the provisions of Ohio general corporation law, Revised Code Section 1701.59 which provides that "all of the authority of a corporation shall be exercised by its directors." Promoters and managers may not usurp the authority of the board of directors. It is essential that the management contract have a fair and detailed severence clause.

Tangenial Agreements

Filings on a Form 6 must include all buy/sell agreements, subscription agreements, or any other shareholder or corporate agreements relating to the sale of the stock. It is important to note that any interest in a corporation, any interest in an income stream derived from the corporation, or any interest of employment or directorship flowing from the purchase of securities is very likely to be a security in and of itself. Such opportunities must be afforded to all potential purchasers. These interests must be disclosed in the registration statement and possibly in the articles of incorporation.

Discrete Project

An offering of securities on a Form 6 requires a stated purpose for which the stock is offered. Form 6 is not intended to be an outstanding and continuous registration. The Division expects each offering of securities to go toward a discrete and complete project.

Dealer Licensing

The practitioner should also be aware that although Section 1707.06(B) exempts the issuer from dealer licensing for the purposes of a transaction within that section, the issuer must be licensed as a dealer to actively trade in his own stock. Thus, the provisions of Section 1707.06(B) do not sanction circulating stock through the treasury and back on the open market.

Pre 13 month rules

Effective August 3, 1978, Rule 1301:6-3-08 limits the period of effectiveness of a registration by description to 13 months. Prior to this rule many registrations by description had no specified expiration date. All such registrations expired on September 13, 1979.

Prospectus

The Division has no formal statement upon the form of prospectus necessary for a registration under Section 1707.06. As a general rule, practitioners will find that Regulation A promulgated under the Securities Act of 1933 should serve as a good outline for the necessary inclusions in a Form 6 prospectus.

Additional Exhibits

The forms used for registration under 1707.06 require the submission of "literature used in connection with the sale of securities". This includes written documents to be seen

(Continued on Pg. 6)

The Division is pleased to add this new column as a regular feature to the Ohio Securities Bulletin. In each issue, we hope to include an article by a practitioner in the securities field or an attorney specializing in securities law.

We are proud that Robert A. Richardson, partner in the Cleveland law firm of Calfee, Halter and Griswold has "volunteered" to contribute the first article.

OVERVIEW OF INDUSTRIAL DEVELOPMENT REVENUE BONDS

by Robert A. Richardson, Esq.

An industrial development revenue bond ("IDRB") is a debt obligation issued by a state or political subdivision in order to provide funds for acquiring, constructing, enlarging, improving or equipping buildings, equipment and certain other real or personal property for industry, commerce, research or distribution (a "Project") (Chapter 165 Ohio Revised Code). Typically, a loan is made by a political subdivision (city, county or state) to the owner or user of the Project. The political subdivision borrows the money which it loans to the owner or user of the property from the buyer of its IDRB. The revenues received by the political subdivision as repayments of the loan are used to repay the IDRB's. The IDRB's are not general obligations of the political subdivision and are not to be repaid through use of moneys raised by taxation. Repayment of the IDRB's depends upon the credit of the owner or user of the Project.

IDRB's which may be in the form of bonds, notes or other evidences of indebtedness, are sold typically to an institutional investor, usually a financial institution or insurance company or to an underwriter for resale in a public offering or to institutional or other investors. The proceeds of the sale received by the issuing political subdivision are the funds loaned to the owner or user of a Project.

The indebtedness is usually secured by a mortgage on the Project from the owner to the issuer. If the owner then leases the Project, the rents are assigned to the issuer as additional security for the loan. The issuer then assigns the mortgage and its interest in the lease to a Trustee (in the case of bonds) or to a Mortgage Assignee (in the case of Notes) as security for repayment of the IDRB's. In addition, the issuer pledges to the Trustee or Mortgage Assignee for repayment of the loan all the revenues the issuer receives as loan payments, which revenues may be used solely for the repayment of the issuers IDRB's. As noted above, the IDRB's are repayable solely out of these revenues.

Benefits

IDRB financing is one of the most attractive methods available for funding a new (or expanding or acquiring an existing) industrial or commercial facility. In essence, a company can finance facilities by having a city, county or the state issue and sell revenue bonds, the proceeds of which are used to acquire or build the required facilities for the company.

IDRB financing is low-cost. The interest income on industrial development revenue bonds is exempt from federal income tax (Section 103 Internal Revenue Code). Therefore, these bonds carry a lower interest rate than conventional debt financing.

Proceeds can be used for multiple purposes. The proceeds from the IDRB can be used to cover both real and personal property as well as certain intangibles associated with the construction and financing of a Project.

Prompt, timely financing is usually provided. Arranging the financing can be fairly rapid once a need has been determined. Typically, it takes from 60 to 90 days to make the proceeds available to the company once a lending source is located. Additionally, construction can begin once approval is received, so there is no delay in waiting for the proceeds of the bonds.

How Is Industrial Development Revenue Bond Financing Obtained?

Once a need for financing has been established, a determination of eligibility must be made. Eligibility is determined by reference to federal, state and local statutues regarding the requirements for this form of financing.

If eligible, a proposal must be presented to the issuing authority: a) if a county bond – the County Commissioners; b) if a city bond – the City Council; c) if a State of Ohio bond – the Ohio Development Financing Commission. The proposal is normally made through a Community Improvement Corporation ("CIC") (Chapter 1724, Ohio Revised Code) that acts as an agent or reviewing body for the issuing authority in its financial efforts. The issuing authority then meets and agrees to issue the bonds. This agreement must be obtained before work on the Project begins. Therefore bond counsel should be contacted when a Project is first being considered so that a determination can be made concerning the eligibility of the Project for IDRB financing.

State Law Requirements

Financing is available for projects that create or preserve jobs and fall into the broad classifications of manufacturing - industrial, commercial, research, distribution, pollution control and solid waste (special statewide issuing authorities).

Federal Law Requirement - Internal Revenue Code (IRC 103)

The aggregate face amount of an IDRB issue of $1,000,000 to $10,000,000, together with all capital expenditures by the company within the political subdivision in which a Project is located, may not exceed $10,000,000 during the six-year period, beginning three years prior to the issuance of the bonds and ending three years after that date. If the aggregate capital expenditures exceed $10,000,000 limitation, interest on the bonds becomes taxable as of the date the limitation is exceeded. If an Urban Development Action Grant (UDAG Grant) is received for the Project, the capital expenditures limitation will be increased to $20,000,000, although the maximum size of the bond issue (and other issues outstanding in the political subdivision for the benefit of the users of the Project) cannot exceed $10,000,000. On the other hand, if the face amount of a bond issue (and other issues outstanding in the political subdivision for the benefit of users of the Project) do not exceed $1,000,000, the six-year aggregate capital expenditure restriction is not applicable. There are no dollar limitations for expenditures on pollution control equipment and certain other facilities (if such other facilities are for the benefit of the general public).

Loan Terms

The pricing of the issue involves determination of an interest rate acceptable to the lender and to the company. Factors affecting the coupon rate include the credit standing of the company, the supply of tax free bonds currently on the market, the need of the particular lending institution for tax-free income, prevailing money market conditions, and the complexity of the issue. Other loan terms such as maturity and repayment penalties are negotiable with the lender.

PARAMETERS OF A FORM .06 (Continued from Pg. 4)

by an offeree including, but not limited to, agreements, contracts, business plans, and pictures.

It is hoped that the above discussion of registration by description will be helpful to the practitioner. Section 1707.06 still represents a most effective and comparatively simple means of raising capital in compliance with Chapter 1707. Moreover, the guidelines are not intended to be rigid prescriptions for structuring a deal; deviations from the guidelines should however, be discussed with the Division before filing.

ANNOUNCEMENTS

Staff Changes

In April, Janet Gibson joined the Division where she has recently been assigned to review oil and gas registrations. She received both her undergraduate and juris doctorate degree from Ohio State University. Before attending law school, Ms. Gibson was employed as a claims representative for the Social Security Administration.

In May, Mark Holderman left the Division after serving as a staff attorney for the enforcement section and as attorney examiner in the registration section. Mr. Holderman joined the Huntington Leasing Company where he will combine his legal experience with his financial background.

Richard Slavin resigned from the Division in June to become Commissioner of Securities for the State of Connecticut. Mr. Slavin had joined the Division in 1972 as a field examiner. Upon graduation from law school, Mr. Slavin joined the enforcement section as staff attorney, where he served until his promotion to Attorney Inspector in 1979.

In July, Nodine Miller left the Division of Securities to enter private practice. During her five year tenure with the Division, Ms. Miller served as Attorney Assigned to the Commissioner, Staff Attorney and Attorney Inspector in the Enforcement section. In 1978 Ms. Miller was appointed Deputy Commissioner of Securities where she supervised both the enforcement and registration sections and acted as Hearing Officer on state tender offer proceedings. Ms. Miller is currently associated with the law firm of Zacks, Luper and Wolinetz in Columbus.

Paul Tague joined the Division staff in July. Mr. Tague will serve as Attorney Inspector for the Division, where he will supervise the enforcement section. Prior to joining the Division of Securities, Mr. Tague served as counsel to the Director of the Department of Commerce.

Tina Manning has recently joined the Division's Registration Section as an Examiner. Ms. Manning received her juris doctorate degree in May from Capital University Law School, and is currently awaiting the results of the July Bar Exam. Prior to joining the Division, she was a law clerk for the thirteen judges of Franklin County Municipal Courts.

Annual Securities Conference

On December 11, 1981 the Division of Securities will hold its second annual Securities Conference at the Hyatt Regency Hotel in Columbus.

The Division's advisory committees will meet in the morning at 9:00 a.m. The regular conference program, which begins with the noon luncheon and concludes at 4:30 p.m., will feature speakers of national importance in the securities area.

The fee for the conference will be $20. Further details will be published in the next edition of the Ohio Securities Bulletin. Reservations may be made by contacting Patricia Dye, Esq. at 466-3466.

Division Moves To New Offices

On October 24 and 25, 1981, the Division of Securities will move into new offices at Two Nationwide Plaza in downtown Columbus. The Division will occupy the third floor of the new building, which is located across Sensenbrenner Park from the new Hyatt Regency Hotel and Ohio Center complex.

Most of the move will be completed over the weekend in order to minimize interruption of Division business.

The Division's new mailing address is:

Division of Securities
Two Nationwide Plaza
(Corner Chestnut & High Sts.)
Columbus, Ohio 43215

The Division's phone number will not be changed.

New Subscribers

We have recently expanded the mailing list of the Ohio Securities Bulletin. It is our hope that, in doing so, we are making more people familiar with securities laws and division practices in the State of Ohio.

Any additions, corrections or comments pertaining to the Bulletin mailing list, should be addressed to:

Dale Barrett
Bulletin Staffperson
Ohio Division of Securities
Two Nationwide Plaza
(Corner Chestnut & High Sts.)
Columbus, Ohio 43215

License Renewal

On November 2, 1981, the annual license renewal package will be mailed to all licensed dealers, and those on inactive status.

Licenses for securities dealers and salesmen, as well as foreign real estate dealers and salesmen, must be renewed not less than 15 nor more than 60 days prior to the expiration of their current licenses. The 1981 licenses expire on December 31, 1981.

As reported in the last issue of the Ohio Securities Bulletin, the Division is currently supporting an amendment to Ohio Revised Code Section 1707.17 which would reduce dealer license renewal fees for salesmen, by 40%. Licensees should be prepared to pay the same license fees as last year, however, unless notified by the Division that such an amendment has been adopted by the legislature.

TAKE-OVERS: When Is A Hearing Appropriate?

In considering a target company's request for a hearing pursuant to Revised Code Section 1707.14(B)(1)(b) the Division looks primarily to the several opinions of Cedar Point, Inc. v. Krouse, Franklin Co. C.P. 79CV-12-6117 (Dec. 21, 1979), and Cedar Point v. Krouse, Franklin Co. App. 79AP-938 (Jan. 10, 1980), for standards relative to the need to call a hearing.

As stated in the majority appellate opinion, the application of the target company "must contain sufficient information for the Division to determine whether or not cause for hearing exists. In other words, the target company in its application or supportive documents must make allegations in sufficient detail to enable the Division to determine whether cause for hearing exists, either that the filing is defective in that it fails to comply with law or that 'effective provision is not made for fair and full disclosure to offerees of all information material to a decision to accept or reject the offer.' " Id. at 3. Where an application for a hearing demonstrates the existence of a factual question concerning the adequacy of the offeror's provisions for full, fair, and effective disclosure of all information material to a decision to accept or reject the offer, a hearing should be conducted to receive such evidence in order to resolve and determine such factual issue. Id. at 4. "Denial of such application is similar to dismissal of a complaint for failure to state a claim." Id. at 6, n. 2.

Upon consideration of a request for hearing, the Commissioner, in the exercise of his administrative expertise, has the discretion to judge whether no cause for a hearing exists by reviewing all filings and comparing them to the many elements of disclosure required by statute. No single element need be dispositive. Because of the complex nature of such consideration, the Division considers prior orders as providing neither philosophical, nor legal precedent for the future. Each decision upon whether or not to hold a hearing is made on an ad hoc basis.

In a recent .041 filing, the offeror, National City Lines Inc. (NCL), sought to acquire 25% of the outstanding shares of Gray Drug Stores, Inc. (Gray). In its memoranda relative to the question of whether "cause" existed to hold a hearing under 1707.041, NCL asserted, inter alia, that "Cedar Point reflects the clear policy of the Ohio Act to exempt non-for-control tender offers. It is the controlling precedent here."

The Ohio Division of Securities rejects such an argument for the following reasons: 1) as a matter of law, administrative orders do not form binding precedent; 2) an offer for less than 51% of the stock of a target corporation may well constitute effective control; 3) Section 1707.041(F)(2) grants the Division authority to prescribe rules "exempting from this section takeover bids not made for the purpose of, and not having the effect of, changing or influencing the control of a target company." The Division has made no rules pursuant to this section.

TAKE-OVER BID: National City Lines/Gray Drug Stores

On August 8, 1981 National City Lines, Inc. ("NCL") a Delaware corporation with its principal place of business in Texas, filed a Form .041 with the Division pursuant to Revised Code Section 1707.041(B)(1) of the Ohio Take-over Act. Concurrent with this filing, NCL offered to purchase from 10% to 25% of the common stock of Gray Drug Stores, Inc. ("Gray"), an Ohio corporation based in Cleveland. NCL offered $15.00 per share tendered — approximately $2½ above the prevailing market price.

On the same day, NCL filed a complaint in the U.S. District Court for the Southern District of Ohio, seeking a declaratory judgment and preliminary and permanent injunctive relief against the Ohio Take-over Act, alleging the Act violates the Supremacy and Commerce Clauses of the United States Constitution. Gray successfully moved to intervene as defendant.

On August 8, 1981 Gray filed an application for a hearing (Form .041(B)(4)) pursuant to Revised Code Section 1707.04(B)(1)(b). Both parties filed memoranda on the issue of the need for a hearing on August 11, and reply memoranda on August 13. Upon reviewing the documents submitted, the Division found that no cause for a hearing existed. In re Take-over Bid of National City Lines, Inc. for Gray Drug Stores, Inc., File No. 041-20 (Division Order, August 14, 1981).

Upon NCL's bid for Gray, the price of Gray on the New York Stock Exchange rose above $15, and hovered between $15½ and $16½ for the remainder of the Gray offer.

On August 19, arguing that Gray's offer was a sale within the meaning of Section 1707.01(C)(1), Gray requested the Division to issue a cease and desist order against NCL for failing to use a licensed dealer in accordance with Section 1707.14. Responding in a letter, the Commissioner noted that D. F. King & Co., Inc., an Ohio licensed dealer, was listed as the "information agent" to the transaction. This satisfied the requirement that the transaction be conducted "through or with a licensed dealer" even though King was not actively involved with the physical distribution of these materials.

On August 27, 1981 the Division filed a motion to dismiss the complaint of NCL in Federal Court. Simultaneously

Gray appealed the August 14 Division Order in the Common Pleas Court of Franklin County pursuant to Revised Code Section 119.12. Upon Gray's motion and following a hearing, the state court suspended the Division Order.

On August 28, upon motion of NCL, the Southern District Court issued a temporary restraining order, restraining all actions to invoke the Take-over Act with regard to the NCL tender offer. A hearing was scheduled for September 1. On August 31 the state common pleas court rejected a request by NCL to lift its suspension of the Division Order in consideration of the Federal T.R.O.

NCL began taking down shares at midnight August 31. On September 1, with the consent of Gray's board of directors, Sherwin-Williams, Inc., an Ohio corporation, made a competing bid of $21.00 per share with the approval of the Gray board of directors. Gray withdrew its state court appeal of the Division Order. The federal hearing on the merits of the constitutional challenge was posponed indefinitely and the T.R.O. remained in effect through the conclusion of NCL's offer on September 8.

ENFORCEMENT

Enforcement Cases Involving 1707.03(Q)

The Division of Securities' enforcement section has a number of cases involving the payment of commissions to unlicensed salesmen while relying on the exemption provided in section 1707.03(Q).

The sale of securities by an unlicensed individual is a violation of 1707.44 O.R.C., and, accordingly, can be referred to the County Prosecutor for criminal prosecution as a felony.

Furthermore, since section 1707.03(Q) provides that commissions can only be paid to dealers or salesmen registered in Ohio, issuers utilizing unlicensed salesmen lose their claim for exemption under section 1707.03(Q).

Convictions Obtained In Cincinnati

On August 24, 1981, Judge Paul George of the Hamilton County Court of Common Pleas found Mayurkant Trivedi of Cincinnati guilty of eight counts of selling unregistered securities. Trivedi faces a possible 40 years imprisonment and $40,000 fine from his conviction for violation of the Ohio Securities Act. Sentencing was scheduled for September 28, 1981.

Trivedi's conviction arose from an investigation by William Leber, Staff Attorney with the Division of Securities. The case was referred to the Hamilton County Prosecutor, Simon Leis, Jr., by the Attorney Inspector in 1980. In November of that year, the Hamilton County Grand Jury handed down a 22 count indictment which charged four defendants, including Trivedi, with selling unregistered interests in a series of limited partnerships under the name of United Investments, Ltd.

Testimony at Trivedi's trial indicated that he had been involved in selling over $800,000 worth of limited partnership interests in United Investment, Ltd. during 1977 and 1978. Counsel for Trivedi stated the conviction would probably be appealed.

Prior to the trial of Mr. Trivedi, Trilok Aggarwal and Walter Boeckley of Cincinnati pleaded guilty to first degree misdemeanors of attempted sale of unregistered securities. Charles Scharf, of Elyria pleaded guilty to two felonies, unregistered sale and unlicensed sale of securities. Mr. Scharf was sentenced on August 31, 1981 to a one year prison term but that term was suspended, contingent on the defendant's making restitution.

Ross Pleads No Contest

On Monday, September 21, 1981 Frederick L. Ross pleaded no contest in Franklin County Common Pleas Court to six counts of securities violations, under section 1707.44(B)(4) O.R.C. Six counts of theft against Ross were dropped in exchange for the no contest plea.

Mr. Ross' indictment resulted after an investigation by the Ohio Division of Securities, the Division of Oil and Gas, and the Franklin County Prosecutor's office. The indictment charged he had caused false representations to be made for the purpose of selling securities in Eagle Energy Development, Ltd. No. 3. Although Ross raised approximately $1.2 million dollars to drill oil and gas wells, no wells were ever drilled.

Although Ross pleaded no contest to the charges, he is maintaining his challenge to the validity of the Grand Jury process and the indictments. Judge G. W. Fais will rule on Ross' guilt after such time as the state has had an opportunity to submit a responsive brief.

Mahoning County Indictment

On September 25, 1981, the Mahoning County Grand Jury returned an indictment against Joseph Hornstein, of the Youngstown, Ohio area. Mr. Hornstein, dba Metalworking Lubricants, was charged with the following four securities law violations: 1) selling securities without being licensed in Ohio; 2) selling securities which were not registered in Ohio and not exempt from registration; 3) misrepresentation in the sale of securities; and 4) committing a fraudulent act in connection with the sale of securities.

A complaint against Mr. Hornstein was filed with the Division of Securities, Enforcement Section in April. After an investigation and hearing on the matter, the case was referred to the Mahoning County Prosecutor on May 22nd.

Furman Tinon

On August 25, 1981, the Division ordered Furman Tinon to show cause why his dealer's license should not be revoked. An investigation by the Division had indicated Mr. Tinon did not maintain adequate books and records, did not maintain sufficient adjusted net worth, and did not submit a certified statement of his financial condition as required by law.

Under an agreement reached with the Division, Mr. Tinon will transfer his license to a limited partnership and meet several other requirements imposed by the Division of Securities.

Mega Project Development Corporation

On August 28, 1981, the Division issued an Order denying the application for qualification of certain securities of the Mega Project Development Corporation ("Mega").

In January of 1980, Mega filed a Form 39 in an attempt to qualify eighteen units of "one percent gross profit interests" which had been sold without compliance with the Ohio Securities Act.

The Order stated that Mega failed to submit certain exhibits to the Form 39 and failed to exercise reasonable diligence in its attempt to qualify. Furthermore, the Order stated that Mega sold the units at varied prices without disclosing the same to individual purchasers.

Accordingly, the Division found that it was unable to conclude that no person was defrauded, damaged or prejudiced by Mega's sale of securities in violation of Chapter 1707 of the Ohio Revised Code. Although Mega was notified of its opportunity to request a hearing on the denial, it chose not to request the same.

Baca Grande Corporation

On August 26, 1981, the Division ordered Baca Grande Corporation ("Baca Grande") to show cause why its license as a dealer in foreign real estate should not be revoked or suspended. The Order stated that Baca Grande Corporation failed to maintain a net worth of $25,000 for 1979, and failed to submit certified audited financial statements for the year 1980. The Order also stated that the company refused to comply with the Division's request to furnish certain information concerning its parent company, AZL Resources, Inc. Failure to comply with this request is a violation of O.R.C. section 1707.19(D) and (J).

Upon receiving the Order, Baca Grande requested their license be cancelled.

Manhattan Investment Company

On October 5, 1981, the Division of Securities ordered the revocation of Manhattan Investment Company's broker-dealer license. The Order stated that Manhattan Investment Company filed to maintain a net worth of at least $25,000 as required by Ohio Administrative Rule No. 1301:6-3-15(E). The Order also stated that the company failed to submit certified audited financial statements to the Division for the years 1978, 1979, and 1980.

Innerspace Power Corporation

On August 31, 1981, the application of Innerspace Power Corporation ("Innerspace") to qualify 100,000 shares of no-par non-voting common stock at $10.00 per share, was denied by the Division. The company had filed a Form 9 with the Division.

The Division Order stated that the Division was not able to find that the business of the issuer is not fraudulently conducted, that the proposed offer or disposal of securities is not on grossly unfair terms, that the plan of issuance and sale of securities referred to in the proposed offer or disposal would not defraud or deceive, or tend to defraud or deceive purchasers, as required by section 1707.09 O.R.C.

The Division Order further stated that:

"1. Applicant has failed to exercise reasonable diligence in its attempt to qualify.

2. Applicant has failed to adequately describe the use of the proceeds from the proposed offering.

3. The promoters have failed to contribute any significant cash or property to the corporate applicant."

Barron's Petroleum, Ltd., 1980-2

On August 13, 1981, the Division issued an order finding that Barron's Petroleum, Ltd., 1980-2 had paid a commission to an individual who was not licensed by the state of Ohio. Accordingly, it was found that Barron's Petroleum did not meet the requirements for exemption from registration under O.R.C. section 1707.03(Q)(3) and the company's form 3-Q was marked null and void.

Pinewood Village Associates, Ltd.

On September 11, 1981, the Division issued an Order finding the exemption claimed by Pinewood Village Associates, Ltd. ("Pinewood Village") to be null and void. Pinewood Village had claimed exemption under Ohio Revised Code Section 1707.03(Q).

The Order stated that Pinewood Village had paid a commission in excess of 10% to its securities dealer.

Creager Enterprises, Inc.

On April 16, 1981, the Division of Securities issued a Cease and Desist Order against Patric Creager, Creager Enterprises, Inc. of the New Philadelphia, Ohio area.

On July 21, 1981 a hearing was held, at which time Mr. Creager was given the opportunity to explain certain business practices which resulted in an approximately $3,000,000 loss for Creager Enterprises, Inc.

Although Creager Enterprises had several subsidiaries, the primary business involved the purchase and sale of gold, silver and other numismatic materials. Investors alleged that Creager borrowed large sums of money from them to purchase numismatic materials, and that he promised them as much as 20% interest per month. The promissory notes were not registered with the Division of Securities. Creager Enterprises declared bankruptcy in January, 1981.

On August 27, 1981, the case was referred to the Tuscarawas County Prosecutor for possible criminal action.

On September 28, 1981, the Tuscarawas Grand Jury indicted Mr. Creager on 106 counts of engaging in fraudulent acts in the sale of securities, 106 counts of selling securities without disclosing insolvency, 106 counts of selling unregistered securities, 106 counts of making false representations in selling securities and 106 counts of selling securities without a license.

CHANGE OF ADDRESS FORM

Address as now listed: (attach label, if available)

Name(s) _____

Firm Address _____

_____

_____

New Address:

Name(s) _____

Firm Address _____

_____

_____

Please Return to:

Ohio Division of Securities
Attn: Debbie Chafin
Two Nationwide Plaza – 3rd Fl.
(Corner Chestnut & High Sts.)
Columbus, Ohio 43215

Securities Act of 1933		Description	Form	Ohio Securities Act	Description	Form
§3(a)(11)	Rule 147	Intrastate Offering Exemption	N/A	§1707.03(O) §1707.06(A)(1) §1707.06(A)(2) §1707.09	Sale of Equity Securities by Corp. Sale of Securiries By Ohio Corp. Sale of Shares By a Corp. Full Registration	3-O 6(A)(1) 6(A)(2) 9
§3(b)	Rule 240	Offer and Sale By Closely-Held Issuers of Up to $100,000 Per Year	Form 240	§1707.03(O) §1707.06(A)(1) §1707.06(A)(2) §1707.09	Sale of Equity Securities By Corp. Sale of Securities By Ohio Corp. Sale of Shares By a Corp. Full Registration	3-O 6(A)(1) 6(A)(2) 9
§3(b)	Rule 242	Offer and Sale By Corporation of Up to $2,000,000 In A Six Month Period	Form 242	§1707.03(O) §1707.06(A)(1) §1707.06(A)(2) §1707.09	Sale of Equity Securities By Corp. Sale of Securities By Ohio Corp. Sale of Shares By a Corp. Full Registration	3-O 6(A)(1) 6(A)(2) 9
§3(b)	Reg. A	Offer and Sale By Issuer of Up to $1,500,000 Per Year	Form 1-A	§1707.09 §1707.091	Full Registration Registration By Coordination	9 U-1
§4(2)	Rule 146	Private Offering	Form 146	§1707.03(Q) §1707.09	Private Offering Exemption Full Registration	3-Q 9
§4(6)		Sale of Securities to Accredited Investors Up to Limit Set Forth in §3(b)	Form 4(6)	§1707.06(A)(1) §1707.06(A)(2) §1707.09	Sale of Securities By Ohio Corp. Sale of Shares By a Corp. Full Registration	6(A)(1) 6(A)(2) 9
Registration On Form S-18		Offer and Sale of Up to $5,000,000 By Non-Publicly Held Corporate Issuers	Form S-18	§1707.09 §1707.091	Full Registration Registration By Coordination	9 U-1

*The above federal law/state law tie-in sheet was distributed at the Federal Bar Association – S.E.C. Conference, "Capital Raising for the Small issuer", in June. By request, we have republished the sheet for Bulletin subscribers unable to attend the conference.

STATE OF OHIO
DEPARTMENT OF COMMERCE
DIVISION OF SECURITIES
Two Nationwide Plaza – 3rd Fl.
(Corner Chestnut & High Sts.)
Columbus, Ohio 43215
Equal Opportunity Employer