

OHIO SECURITIES BULLETIN

A QUARTERLY PUBLICATION OF THE OHIO DIVISION OF SECURITIES

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DIVISION USES ANTI-FRAUD PROVISION AGAINST ISSUER FOR MATERIAL OMISSION CONCERNING REGISTRATIONS

For decades, the lynchpin of the Division's enforcement function has been the anti-fraud provisions found in sections 1707.44 (B)(4) and (G) of the Ohio Revised Code. The Division has used these two sections to protect Ohio investors from those who would offer an untruthful or materially inaccurate assessment as to the character or value of the securities they are issuing or selling, either by outright misrepresentation of important facts, or by omission of the same. The Division itself also must rely on honest and accurate information from those who seek to register their securities under the Ohio Securities Act's provisions. Accurate disclosure to the Division regarding proposed investments is necessary for the Division to police the industry and maintain its integrity for the benefit of the investing public.

A recent case brought by the Division's enforcement section against The Thaxton Group, Inc. illustrates how the Division can utilize the anti-fraud provisions against issuers and sellers who change material features of an offering without notifying the Division after obtaining approval of their registration filings. The Division issued a final order against this company after it won a contested Chapter 119 hearing regarding an initial Notice and Opportunity for Hearing. In its notice order, the Division alleged facts to support violations of Revised Code sections 1707.44(A)(1), 1707.44(C)(1) and 1707.44(G) and Administrative Code sections 1301:6-3-09(B)(2)(f) and 1301:6-3-091(E). The Revised Code sections address, respectively, unlicensed salespersons, unregistered securities and knowingly engaging in illegal, fraudulent or prohibited acts while selling securities (the rules are discussed below).

Thaxton's dealings with the Division began in 2001, when it filed a registration by coordination of \$75 million aggregate principal amount of subordinated daily, one month and term promissory notes. It filed the following year to renew this registration. Later in 2002, it filed its application for registration by coordination of \$125

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million aggregate principal amount of subordinated daily and term promissory notes. The Division issued orders granting registration by coordination in all three instances, and, its orders specified that the securities be sold in accordance with the terms and conditions set forth in the applications, exhibits and other documentation on file. One condition of sale was that Ohio sales would be made through a licensed dealer.

Contrary to the terms and conditions of sale represented to the Division in the course of its filings, Thaxton allowed unlicensed employees of a subsidiary company, Modern Finance Company (doing business in Ohio as Tico Credit Company) to sell notes covered by the registrations noted above. The employees were offered awards in the form of vacations and cash. The sales were done under the purported supervision of a licensed dealer, Carolinas First Investments, Inc. The Division stated in its order that the broker's approval of note sales was given without "reasonable inquiry about the suitability of the investment for the investors by (Thaxton's) employees." The Division maintained that Thaxton "knew that it was material to the Division that all sales would be made to suitable investors only..." Additionally, the

Division noted that Ohio Administrative Rule section 1301:6-3-09 (B)(2)(f) provides that "issuers must amend their registration by qualification when the occurrence of any event causes a statement in a prospectus or circular to be false or misleading in any material respect." Ohio Administrative Code section 1301:6-3-091(E) extends this requirement to registrations by coordination as well. The Division cited Thaxton with these two rule violations as well as the statutory violations outlined above, maintaining that the company failed to amend its registrations when its plan of distribution changed.

R.C. 1707.44(G) is the anti-fraud provision the Division usually invokes in cases where an issuer or seller has omitted a material fact in the offering or

sale of a security, as distinguished from an affirmative misrepresentation made in violation of R.C. 1707.44(B)(4). The omission is the "fraudulent act" covered by R.C. 1707.44(G). This interpretation of R.C. 1707.44(G) was set forth in the case of *State v. Warner*, 55 Ohio State 3d 31 (1990). R.C. 1707.44 also contains other lesser-used anti-fraud provisions such as R.C. 1707.44(J) and (K). R.C. 1707.44(J) prohibits persons from purposely deceiving through the publication of advertisements or statements the value of securities, or the financial condition of the issuer, where the deception concerns a material fact. R.C. 1707.44(K) prohibits persons from purposely recording or publishing reports that are "false in any material respect." R.C. 1707.44(B)(1) prohibits persons

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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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Ohio Division of Securities

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Division Uses Anti-Fraud Provision

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from knowingly making false representations concerning a material and relevant fact in “any oral statement or in any prospectus, circular, description, application, or written statement” for various purposes, including registering securities with the Division. But it is R.C. 1707.44(B)(4) and (G) that comprise the backbone of the Division’s anti-fraud enforcement efforts, and violations related to these two sections appear in many Division Orders, as well as civil and criminal actions pursued by the Division.

However, these two provisions have almost exclusively concerned dealings between sellers/issuers and investors. The Division’s action against Thaxton is a significant one in that the Division claimed that it was the recipient of a fraudulent act by an issuer/seller. The Division claimed that, when Thaxton chose to sell its notes using its own employees, with adherence to the Division’s suitability standards in question, the

company violated a major condition the Division relied upon in approving Thaxton’s registration filings. This is a novel use of the anti-fraud provisions found in R.C. 1707.44.

Thaxton requested a Chapter 119 adjudicatory hearing challenging the Division’s Notice of Opportunity for Hearing. A hearing was held, with Division personnel testifying that the details relating to the manner of sale regarding the company’s offerings was material in approval of Thaxton’s registration filings. The Hearing Officer upheld the Division’s allegations in his Report and Recommendation, and the Commissioner of Securities, in turn, accepted the Hearing Officers’s Report and Recommendation and issued a final Cease and Desist Order on July 14, 2006 against Thaxton. The final order upheld the alleged violations listed in the Notice of Opportunity for Hearing. (It should also be noted that the Division had earlier issued a Cease and Desist Order against Carolinas First Investments, Inc., citing it with violating Division rules regard-

ing investor suitability and failure to disclose a relationship between a dealer or salesperson and the issuer of the security).

This case seems to be consistent with the spirit of past applications of R.C. 1707.44(G) that generally concerned omissions to investors. If the Division is to represent the interests of the investing public, it must be able to rely on the accuracy of information issuers and sellers of securities provide when dealing with the Division regarding matters relating to issues of oversight. In the wake of the Thaxton case, issuers and sellers should be on notice that the Division is capable of addressing less than forthcoming conduct by companies approaching the Division for approval of their offerings.

Licensing Statistics

License Type	YTD 2006
Dealers	2,444
Salespersons	136,381
Investment Adviser/Notice Filers	2,033
Investment Adviser Representatives	12,636

Criminal Updates

On August 17, 2006, **Edmund Burke Pearson**, a former salesperson of A.C.H. Securities and former president of Alexander Chase pled no contest to 32 felony counts in Montgomery County Common Pleas Court, including violations of the Ohio Securities Act. He was subsequently found guilty on all 32 counts by the Court. The 32 counts consist of 18 counts of securing writings by deception and 14 counts of fraud with respect to the sale of securities. The 14 counts of securities fraud included 10 first-degree felonies, two second-degree felonies, and two third-degree felonies. The conviction relates to the sale by Pearson of preferred stock in Financial Solutions International. On October 24, 2006, Pearson was sentenced to a prison term of four years and ordered to pay restitution. At

the time of sentencing, Pearson had deposited \$700,000 with the Montgomery County Clerk of Courts for distribution to investors.

On May 3, 2006, **Perry R. Hall, Sr.**, of Sheffield Lake, Ohio, was indicted by a Lorain County grand jury on four felony counts. The violations alleged include one count each of securities fraud, false representations in selling securities, unregistered sale of securities and theft. Hall allegedly sold an ownership interest in a minor league basketball team, when in fact the investor never purportedly received an ownership interest. Hall allegedly converted the funds received from the investor to his own personal use. Hall posted a personal and surety bond in Elyria on August 3, 2006, and was arraigned on August 10,

2006, at which time he entered a plea of not guilty.

On July 3, 2006, **Lee A. Skierkiewicz** was indicted in Hamilton County Common Pleas Court on two counts of aggravated theft and 10 counts of theft. Skierkiewicz, who was mayor of Loveland from December 1995 to December 1999, was a licensed salesperson with R.W. Baird until October 2000. In December 2000, he created a hedge fund called Prima Partners and solicited his friends and former clients with Baird to invest. The indictment alleged that Skierkiewicz failed to disclose that he no longer had a license to sell securities, gave investors fraudulent account statements, and used investor funds to pay his child support, trips to Disneyland, and golf outings. A warrant is outstanding for his arrest.

Enforcement Section Reports

Paul Dean Yocum and Diversified Financial Consultants, Inc.

On April 19, 2006, the Division issued Order No. 06-103, a Cease and Desist Order, against Paul Dean Yocum and Diversified Financial Consultants, Inc. Yocum failed to maintain licenses for himself and his company. However, throughout 2004 and 2005 and

while unlicensed, he authorized trades on individuals' mutual fund accounts and charged a fee for his conduct. Therefore, on November 14, 2005, the Division issued Order No. 05-196, a Notice of Opportunity for Hearing, against Paul Dean Yocum and Diversified Financial Consultants, Inc. for allegedly violating Revised Code Section 1707.44(A)(1) and/or 1707.44(A)(2), selling securi-

ties to an Ohio resident without being licensed. The Respondents initially requested a hearing pursuant to Chapter 119 of the Ohio Revised Code. However, they subsequently withdrew their request, thereby allowing the Division to issue its Cease and Desist Order No. 06-103, which incorporated the allegations set forth in the Notice of Opportunity for Hearing.

Enforcement Section Reports

David Massey and Island Song Productions, LLC

On August 22, 2006, the Division issued Order No. 06-186, a Cease and Desist Order, against David Massey and Island Song Productions, LLC of North Hills, California. In October of 2005, David Massey, through his company, Island Song Productions, LLC, offered to Ohio residents an investment opportunity in a feature film. This investment op-

portunity was an investment contract and, thereby, a "security" under the Ohio Securities Act, though it was not registered with the Division. Therefore, on July 17, 2006, the Division issued Order No. 06-169, a Notice of Opportunity for Hearing, against David Massey and Island Song Productions, LLC for allegedly violating Revised Code Section 1707.44(C)(1), the unregistered sale of securities. David Massey and Island Song Pro-

ductions, LLC did not request a hearing pursuant to Chapter 119 of the Ohio Revised Code, thereby allowing the Division to issue its Cease and Desist Order No. 06-186 which incorporated the allegations set forth in the Notice of Opportunity for Hearing.

Court Clears Way for Liquidation of Westhaven Group

The Lucas County Common Pleas Court approved a procedure for handling proof of claim forms and liquidating Westhaven Group, LLC and its related companies on November 9, 2006. The Receiver will submit a general accounting report of the business and an accounting of claims filed and recommendations as to claims that should be accepted or rejected by December 8th. The report will include recommendations on handling claims from investors, an itemized profit-and-loss statement of the business since the receivership began last December, and a list of receivership bills. The receivers have estimated the assets at \$15 to \$17 million and the liabilities at almost \$30 million, resulting in at least a \$13 million loss. Investors, estimated to be about 280 individuals, hold about \$28 million in promissory notes.

A plan for distributing the remaining assets was pending before Judge Osowik, but the Receivers and attorneys representing investors last month reached a compromise agreement for distributing the assets and asked the court for 60 days to develop a comprehensive settlement proposal. Investors have been sent claim forms asking them to provide information on amounts of their promissory notes, as well as the interest, dividend, and principal payments of the accounts. A proposal concerning distribution of investor funds will be submitted within seven days after the accounting and recommendations are filed. A hearing is scheduled for December 15th to address objections or recommendations on the proposed distribution. (*Editor's Note: for more information on the Division's actions against the Westhaven Group, see Ohio Securities Bulletin No. 05:4*).

PUBLIC NOTICE

At 10:00 a.m. on Wednesday, December 20, 2006, the Ohio Division of Securities (“Division”) will hold a public hearing regarding the Division’s intent to amend Ohio Administrative Rules 1301:6-3-03 and 1301:6-3-03(E)(5). 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 1301:6-3-03. The proposed amendment eliminates the “as in effect as of September 1, 2003” language from each incorporation of a federal statute or rule. Each incorporation by reference of a federal statute, rule or form will now include “as amended” to include any future amendments to the federal statute, rule or form pursuant to R.C. 1707.20(A)(2).

OAC 1301:6-3-03(E)(5). The proposed amendment to this rule will exempt voluntary employee benefit trust associations (“VEBA Trusts”) qualified under Section 501(c)(9) of the Internal Revenue Code of 1986 from registration under R.C. 1707.06 to 1707.11. The VEBA Trusts may only be offered by not-for-profit entities that are exempt under Section 501(c)(3) of the Internal Revenue Code of 1986. The rule currently only exempts employee plans qualified under Sections 401 to 425 of the Internal Revenue Code of 1986 from registration under the Ohio Securities Act.

The proposed amendment to 1301:6-3-03(E)(5) will expand the exemption from registration for tax-qualified employee benefit plans to cover VEBA Trusts qualified under Section 501(c)(9) of the Internal Revenue Code of 1986 as registration is not necessary or appropriate in the public interest or for the protection of investors. (See R.C. 1707.03(V)).

MILITARY PERSONNEL FINANCIAL SERVICES PROTECTION ACT BECOMES LAW

Congress recently enacted legislation to protect military personnel from unscrupulous sales of insurance and investment products. “The Military Personnel Financial Services Protection Act” was signed into law on September 29, 2006 by President Bush.

Securities regulators support provisions in the newly enacted law that will allow online public disclosure of information regarding financial firms and their employees. This will enhance investor protection by ensuring that the investing public benefits from being able to access this information online before deciding which firm and representative will handle their brokerage and investment advisory business. Additionally, the Department of Defense will now maintain a list of individuals who have been banned from selling financial services products on military bases, and will share that list with Federal and State securities and insurance regulators.

The legislation also bans the sale of high-priced, contractual mutual funds. The product has become scarce in the civilian market but was still being offered to soldiers by sales staffs allowed on military bases. Congressional hearings revealed that life insurance sales were made without informing soldiers that life insurance was available to them through the federal government. Under the act, disclosures are required before private life insurance could be sold to military personnel.

Licensing Section Reports

Neil O'Donnell

On September 5, 2006, the Division issued Order No. 06-190, a Final Order to Deny Neil O'Donnell's securities salesperson, investment adviser representative, and investment adviser license applications (see CRD Nos. 107013 and 353316). The Division found that Neil O'Donnell filed applications with the Division that contained false statements of material fact and/or omissions of material fact. O'Donnell revealed in six DRP attachments to his form U-4 that he had been sued by certain former customers and that each of the cases had been withdrawn. The DRPs all stated that "market collapse triggered a complaint from customer as to suitability and misrepresentation. Case was withdrawn by customer's attorney for lack of substance." These statements were false. In fact, O'Donnell had been named in at least 24 separate lawsuits and arbitrations, each of which were stayed as a result of O'Donnell's Chapter 7 Bankruptcy filing, and each of which were ultimately settled by O'Donnell's former firm, American Skandia. At least 129 plaintiffs who sued O'Donnell settled with American Skandia for more than \$8,761,723. He made similar misrepresentations and omissions concerning arbitration actions filed against him on his form ADV. O'Donnell falsely stated in questions 14k(2) and (3) of the form U-4 that no companies

over which he exercised control had filed for bankruptcy. O'Donnell failed to disclose that his three companies, a broker dealer and two investment advisers, had filed for bankruptcy in 2003. The Division further found that O'Donnell made omissions and misleading statements to his advisory clients that constituted violations of O.R.C. 1707.44(M)(1)(b), which prohibits investment advisers from engaging in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person. The Division made additional findings that O'Donnell failed to maintain required financial information or investment advisory contracts in his investment adviser business.

Burse Investment Advisory Group, LLC

On September 30, 2005, the Division issued a Notice Of Intent To Deny The Investment Adviser License Application of Burse Investment Advisory Group, LLC based on the following: on April 28, 2004, the NASD issued a hearing panel decision barring Perrin Burse, the sole owner of Burse Investment Advisory Group, from associating with any NASD member in any capacity. The basis of the NASD action was that Perrin Burse recommended unsuitable transactions in variable annuities, forged his customer's signature, and failed to respond to requests for

information. Specifically, Perrin Burse sold a variable annuity to his customer that would not mature until the customer reached age 95, and would cost \$34,000 annually in premiums when the customer only made \$40,000 in income. The policy only provided \$100,000 in death benefits if the customer died before age 95. Burse also admitted to forging the signature of his customer 25 times on distribution request forms. Based on the foregoing, the Division alleged that Perrin Burse lacked good business repute, and that pursuant to R.C. 1707.19(F), this was a sufficient basis for denying the investment adviser application of his firm, Burse Investment Advisory Group.

On January 11, 2006, an administrative hearing was held to determine whether the license of Burse Investment Advisory Group should be denied. Perrin Burse was present and submitted evidence and testimony along with the testimony of his witnesses. After considering all the evidence presented at the hearing, the hearing officer recommended that the license of Burse Investment Advisory Group be denied based on the lack of good business repute of Perrin Burse. On August 2, 2006, the Director of Commerce issued Order No. 06-175, accepting the recommendation of the hearing officer and issuing a Final Order of Denial against Burse Investment Advisory Group.

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	3rd Qtr 2006	YTD 2006
Exemptions		
Form 3(Q)	\$58,302,932.00	\$138,651,640.00
Form 3(W)	-0-	12,060,000
Form 3(X)	149,948,074,205	395,165,953,033
Form 3(Y)	-0-	19,125,000
Registrations		
Form .06	698,612,230	2,021,545,900
Form .09/.091	9,404,038,594	18,593,942,730
Investment Companies		
Definite	121,659,500	362,405,891
Indefinite**	536,000,000	1,649,000,000
TOTAL	\$160,766,687,461	\$417,962,684,194

Registration Statistics

The following table sets forth the number of registration, exemption, and notice filings received by the Division during the third quarter of 2006, compared to the number of filings received during the third quarter of 2005. Likewise, the table compares the year-to-date filings for 2005 and 2006.

Filing Type	3rd Qtr '06	YTD '06	3rd Qtr '05	YTD '05
1707.03(Q)	23	76	18	98
1707.03(W)	0	3	5	15
1707.03(X)	454	1398	340	1453
1707.03(Y)	0	6	4	9
1707.04/.041	0	1	0	1
1707.06	18	62	17	78
1707.09/.091	45	109	47	182
Form NF	1276	3817	1117	5420
Total	1816	5469	1548	7256