

# OHIO SECURITIES BULLETIN

A QUARTERLY PUBLICATION OF THE OHIO DIVISION OF SECURITIES

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Governor of Ohio

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## House Bill 488 and its Impact on the Ohio Securities Act

by Erwin J. Dugasz, Jr.

On October 11, 1994, House Bill 488 became law in Ohio. Although the investing public may not realize the importance of this legislation, House Bill 488 will transform the way intrastate broker-dealers and their salesmen conduct themselves if they wish to continue to do business in the State of Ohio, thus providing new safeguards for investors.

In addition, there are significant changes occurring in the area of securities registration due to this legislation. House Bill 488 relieves some of the burden on issuers attempting to raise capital by eliminating the most common filing made with the Division and easing the

requirements of other registration filings.

The new law requires certain dealers with more than 100 retail customers and more than \$150,000 in annual gross revenue to become registered with the Securities and Exchange Commission ("SEC") within ninety days of meeting these requirements.<sup>1</sup> With exceptions, an SEC registered broker or dealer is subject to a requirement for membership in the National Association of Securities Dealers, Inc. ("NASD"), a self-regulatory organization under the auspices of the SEC. A broker or dealer is required to become an NASD mem-

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## Limited Liability Company Legislation in the 120th Ohio General Assembly

By William E. Leber, Esq.

"Not the last to set the old aside, nor the first by whom the new is tried."

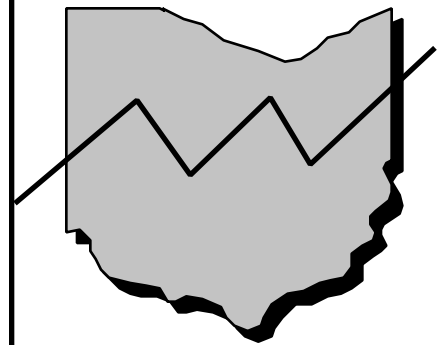
That old couplet describing Ohio's willingness to embrace emerging legal theories and to adopt new statutory concepts is still apt. While Ohio law is rarely on the "cutting edge," it is equally unlikely to harbor discarded legal precepts and procedures. The Ohio General Assembly's treatment of Limited Liability Company ("LLC") legislation presents another example of the cliché's verity.

The Limited Liability Company is a new form of business organization that is more flexible than an S Corporation, but with characteristics which had only been available together in an S Corporation: The limited liability for investors of a corporation, and pass-through treatment for federal income tax purposes of a partnership.

In 1977, Wyoming was the first state to adopt LLC legislation, and for the next eight years, despite the

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## OHIO DEPARTMENT OF COMMERCE DIVISION OF SECURITIES



Ohio Securities Bulletin

Issue 94:3

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## House Bill 488

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ber if it effects transactions other than on a national securities exchange<sup>2</sup> of which it is a member or is a member of a securities association under Section 15A of the Securities Exchange Act of 1934 ("Exchange Act") of which the NASD is the only association registered at this time.<sup>3</sup> House Bill 488 also permits the Division to enforce certain federal standards which will result in additional protection for Ohio investors.

Prior to the enactment of House Bill 488, intrastate broker-dealers were not required to be registered with the SEC. Section 15(a)(1) of the Exchange Act exempts from registration any broker or dealer

"...whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange..."<sup>4</sup> (Emphasis added)

Although the federal courts have strictly construed the intrastate exemption<sup>5</sup>, the SEC has been reluctant to use jurisdictional authority to review and investigate the activities of intrastate broker-dealers, absent evidence of fraud.<sup>6</sup> The new legislation requires intrastate broker-dealers to maintain SEC registration as long as they meet the criteria set forth in the Ohio Revised Code. Consequently, most (if not all) intrastate broker-dealers will fall under the jurisdiction of the SEC and the NASD as well as the Division.

While acknowledging that intrastate broker-dealers may play an important role in capital formation, the Division foresaw a need for legislation which would provide additional investor protection.<sup>7</sup> The Division's interpretation of its statutes and rules has been that the intrastate broker-dealers are subject to all anti-fraud provisions including those of the SEC and NASD.<sup>8</sup>

Similar legislation had been proposed before. Several years ago, the Division supported legislation that would have addressed the regulatory concerns of the Division regarding intrastate broker-dealers. In 1991, the Finance Committee of the Ohio House of Representatives considered two proposed bills: House Bill 346, which would have required SEC membership for intrastate broker-dealers, and rival House Bill 495, which would have not provided for such membership. House Bill 346 had the support of the Division, the NASD, the North American Securities Administrators Association, Inc. (an organization comprised of securities regulators from 65 jurisdictions located in the United States, Puerto Rico, Canada and Mexico), the Securities Industry Association (a trade group that represents broker-dealers) and the Corporate Law Committee of the Ohio State Bar Association. A concerted lobbying effort by the intrastate broker-dealers defeated the House Bill 346 pending in committee while House Bill 495 was voted out of committee. Neither bill

was passed by the Ohio General Assembly.<sup>9</sup>

As an overview, NASD member broker-dealers are required to adhere to record-keeping,<sup>10</sup> financial reporting<sup>11</sup> and net capital requirements<sup>12</sup> set forth by that organization and by the SEC. The new members of the NASD will still need to comply with the requirements set by Division regulations.<sup>13</sup>

Broker-dealers, their supervisors and their salesmen are required to conduct themselves in accordance with the NASD's Rules of Fair Practice. The Rules of Fair Practice deal with diverse issues such as disclosure of pertinent information to customers,<sup>14</sup> fair dealing,<sup>15</sup> advertising and sales literature,<sup>16</sup> supervision of salesmen and branch offices.<sup>17</sup> The Division will continue to enforce the restrictions and prohibitions found in the Ohio Securities Act and its related administrative code provisions.<sup>18</sup>

The Rules of Fair Practice also set forth NASD disciplinary procedures for any violations of these rules, NASD By-Laws, federal securities laws and the Municipal Securities Rulemaking Board. Depend-

## OHIO SECURITIES BULLETIN

Thomas E. Geyer, 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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### Ohio Division of Securities

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ing on the violation, an NASD member or its salesmen may be censured, fined, suspended, excluded, revoked, barred, or a combination thereof.<sup>19</sup>

NASD members are also subject to investigative inquiries of the SEC which can be broad in nature and scope. The SEC has discretionary authority to investigate violations of the Securities Act of 1933; the Exchange Act and rules promulgated thereunder pertaining to such matters as manipulation, short selling, mark-ups and mark-downs, trading on insider information, misstatements and omissions and other anti-fraud matters;<sup>20</sup> violations of any self regulatory organizations such as the national exchanges, the Municipal Securities Rulemaking Board and the NASD.<sup>21</sup> In addition, the SEC can refer cases to the United States Attorney's Office for criminal prosecution.<sup>22</sup>

Most NASD members are also required to become a member in The Securities Investor Protection Corporation ("SIPC").<sup>23</sup> SIPC is funded by its member securities broker-dealers.<sup>24</sup> If a member fails financially, SIPC will help arrange to have some or all customer accounts transferred to another SIPC member broker-dealer. If this is not feasible, customers receive all the securities registered in their names and, on a pro rata basis, all remaining customer cash and securities held by the defunct broker-dealer. SIPC funds are then made available to satisfy the remaining claims of customers up to a maximum of \$500,000, including up to \$100,000 on claims for cash.<sup>25</sup>

House Bill 488 codifies violations of Section 15(c) and 15(g) of the Exchange Act and the rules promulgated thereunder as violations under the Ohio Securities Act. Thus, the federal standards regarding cold-calling investors, investor suitability and risk disclosure in low priced securities transactions are incorporated as part of the prohibition section under Section 1707.44.<sup>26</sup>

An important aspect of Section 15(c) of the Exchange Act and the rules thereto provide the framework for "cold calling" investors by dealers and their salesmen.<sup>27</sup> The dealers are also required to determine investor suitability when selling penny stocks. Prior to the transaction, the broker-dealer is required to obtain from the investor his or her financial information, investment experience and knowledge and their investment objectives.<sup>28</sup> The broker-dealer must then reasonably determine that based on the information furnished by the customer, that the customer is indeed suitable for the transaction and that the person has enough knowledge and experience in evaluating these risks.<sup>29</sup> The customer is then required to receive a written statement from the broker-dealer which sets forth the basis of its determination that penny stocks purchased were suitable for the customer.<sup>30</sup> The written statement must include language in a highlighted format preceding the customer signature line that the broker-dealer is required to provide the statement and the person should not sign the agreement and return it to the broker or dealer if it does not accurately reflect the person's financial situation, investment experience and investment objectives.<sup>31</sup> When these rules were first enacted by the SEC, it appeared to the Division interpreted that the cold call and suitability rules applied to both intrastate and interstate dealers.<sup>32</sup>

Section 15(g) of the Exchange Act pertains to extensive public disclosure and record keeping requirements on brokers or dealers purchasing from or selling to the public certain low-priced, non NASDAQ, non-exchange listed securities.<sup>33</sup> In certain circumstances,<sup>34</sup> broker-dealers are required to furnish a customer with a Risk Disclosure Document prior to the initial transaction in a penny stock.<sup>35</sup> The Risk Disclosure Document should describe the penny stock market, how it operates and the risks involved.<sup>36</sup>

If the customer wishes to buy a penny stock, the broker-dealer is required to disclose to the customer, prior to the transaction, quotation and information relating to the penny stock market,<sup>37</sup> as well as the broker-dealer's<sup>38</sup> and salesmen's compensation<sup>39</sup> in connection with the transaction. In addition, a customer is required to receive a monthly account statement concerning the penny stock he or she had purchased.<sup>40</sup>

These additional requirements set forth by the SEC and the NASD, coupled with the Ohio Revised Code and administrative regulations, will provide another layer of protection for the investing public.

As stated earlier, this article has focused on the particular issue of the impact House Bill 488 will have on the intrastate broker dealer industry. However, these are by no means the only statutory changes that have occurred due to this legislation. Significant changes have also taken place in the area of securities registration.

In November 1993, House Bill 569 was introduced which dealt with changes in the areas of registration, exemption and bond investment companies. House Bill 569 was then merged with House Bill 488 in February 1994. Some common securities filings made with the Division are now eliminated due to House Bill 488.

Ohio Revised Code section 1707.02(B) exempts certain federal, foreign, state and local government securities from registration. However, in order to perfect the exemption, the governmental issuer of securities was required to file a Form 2(B) along with a filing fee of \$50.00.

Likewise, in order to perfect the exemption under Ohio Revised Code section 1707.3(O), an issuer was required to file a Form 3(O) along with a filing fee of \$25.00 with the Division if the issuer offered for sale equity securities within 60 days after the sale, to not more than ten persons in any one year period. The

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## House Bill 488

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new legislation eliminates the need to file either a Form 2(B) or Form 3(O) in order to perfect the respective exemptions. Please note that House Bill 488 only eliminates the need for the filings but does not otherwise change the terms of the exemptions.

The elimination of Form 2(B) and Form 3(O) filings is significant. According to Division statistics, approximately seventy percent (70%) of the filings received by the Division in 1993 were related to 2(B), 3(O) and .391/.03(O) filings.<sup>41</sup>

Previous filings made under Ohio Revised Code section 1707.06(A)(1) required that the issuer's total commission, remuneration, expense or discount not exceed three percent (3%) of the initial offering price. House Bill 488 revised Ohio Revised Code section 1707.06(A)(1) to permit the issuer to exclude legal, accounting, and printing fees when determining the three percent (3%) limitation.

Filings made under the provisions of Ohio Revised Code section 1707.091 required that the Division receive three copies of the latest form of prospectus or offering circular. Now only one copy need be supplied to the Division.

Finally, the provisions of the Bond Investment Company Act, under Ohio Revised Code section 3949, were repealed by House Bill 488. Under the Exchange Act, bond investment companies are required to become licensed with the SEC through the NASD. The State of Ohio required bond investment companies to obtain both a securities license under Ohio Revised Code section 1707 and a separate bond investment company license under Ohio Revised Code section 3949. Bond investment companies were thus required to hold two separate licenses despite engaging in only one activity. House Bill 488 repealed Ohio Revised Code section 3949, and as a result bond investment companies need only maintain a securities license under Ohio Revised Code section 1707.

Clearly, House Bill 488 will have an effect on the registration of securities

and the compliance side of broker-dealers for years to come benefiting both issuers of securities and the investing public.

### Endnotes

<sup>1</sup> The legislation grants exceptions from federal broker-dealer registration for dealers who may meet the 100 customers/\$150,000 gross revenue criteria, *see* Ohio Rev. Code Ann. § 1707.14(B)(1),(2)(a) and (2)(b).

<sup>2</sup> The following exchanges are currently registered as national securities exchanges under the Securities Exchange Act of 1934 §6(a): the American Stock Exchange, the Boston Stock Exchange, the Chicago Board Options Exchange, the Cincinnati Stock Exchange, the Intermountain Exchange, the Midwest Stock Exchange (Chicago), the New York Stock Exchange, the Pacific Stock Exchange, Inc., the Philadelphia Stock Exchange, Inc. and the Spokane Stock Exchange.

<sup>3</sup> Securities Exchange Act of 1934 § 15(A)(1). Please note however, there is an exemption from NASD registration for broker-dealers who conduct de minimis over-the-counter business - *see* 17 C.F.R. § 240.15b9-1.

<sup>4</sup> Securities Exchange Act of 1934 § 15(a)(1).

<sup>5</sup> *See Associated Investors Securities, Inc.*, Exchange Act Release No. 6859, July 24, 1962; *In re The Whitehall Corporation*, 38 S.E.C. 259 (1958); *In re People's Securities Co.*, 39 S.E.C. 641 (1960), *aff'd*, 289 F.2d 268 (5th Cir. 1961); *Allied Real Estate Securities, Inc.*, SEC No Action Letter [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶181,041 (Dec. 15, 1976).

<sup>6</sup> The SEC has attempted and been successful in several instances in having federal courts grant them jurisdiction of intrastate broker dealers, their officers and salesmen in Ohio. *See Securities and Exchange Commission vs. First Ohio Equities Inc.*, No. C2-91-332 (S.D. Ohio May 3, 1991) (order granting preliminary injunction); *Securities and Exchange Commission vs.*

*AEI Group, Inc.*, John W. Vogel, James W. Barber and Robert W. Masters, No. C2-91-770 (S.D. Ohio September 18, 1991) (complaint for permanent injunction and other equitable relief); *Securities and Exchange Commission vs. Midwest Investments, Inc.*, Robert D. Hodge, Michael J. Eberle, Thomas J. Van Echo, Thomas L. Costello, Donald H. Gilliland and Thomas Williamson, No. C2-93-0389 (S.D. Ohio March 31, 1994) (permanent injunction order).

<sup>7</sup> Prior to House Bill 488, the Division had some success in enforcement cases involving intrastate broker dealers. *See Linda Page, Director, Ohio Department of Commerce and Mark V. Holderman, Commissioner, Ohio Division of Securities vs. AEI Group, Inc.*, Case No. 89CV96495 (Franklin Cty. Ct. C.P. May 29, 1990) (permanent injunction order); *In The Matter of AEI Group Inc.*, Div. No. 90-058 (1990); *In The Matter of Ohio State Planning, Inc.*, Div. No. 91-080 (1991); *In The Matter of Liberty First Securities Inc.*, Div. No. 91-101 (1991); *In The Matter of First Ohio Equities, Inc.*, Div. No. 91-101 (1991); *In The Matter of Worthington Investments, Inc.*, Div. No. 92-052 (1991); *Nancy Chiles, Ohio Department of Commerce and Mark Holderman, Commissioner, Ohio Division of Securities vs. Liberty First Securities, Inc.*, No. 91CVH06-4984 (Franklin Cty. Ct. C.P. October 27, 1992) (Consent and Stipulation of Final Judgment of Permanent Injunction); *In The Matter of The Cranston Group, Inc.*, Div. No. 94-097 (1994). In one case, the Division has filed Notices of Appeal and Memorandum in Support of Jurisdiction with the Ohio Supreme Court, *see The Division of Securities et al. vs. Columbus Skyline Securities, Inc.*, Michael L. Eberle, Allen Herman, Harry Freeman, Sharon Fizer, Sandra Freeman, James Rapp and Bruce Langhirt, No. 93AP-790 (10th Dist. Ct. of App. 1994), appeal docketed, No. 94-1445 (Ohio S. Ct., July 7, 1994). In another case, the Division is opposing an appeal to the Ohio Supreme Court, *see Nancy Chiles, Director Ohio Dept. of Commerce and Mark Holderman, Commissioner Ohio Division of Securi-*

ties vs. M.C. Capital Corp. and Wayne Meadows, No. 93API09-1317 (10th Dist. Ct. of App. 1994) appeal docketed, No. 94-1479 (Ohio S. Ct., July 12, 1994).

<sup>8</sup> Ohio Rev. Code Ann. § 1707.01(J) defines “fraud,” “fraudulent practices,” or “fraudulent transactions” as anything recognized after July 22, 1929, as such in courts of law or equity....*see also* Ohio Admin. Code § 1301:6-3-19(D)(1).

<sup>9</sup> Several newspaper articles were written on these bills. *See Opposition Voiced To 2 Securities Bills*, The Columbus Dispatch, Sept. 26, 1991, at 2B; *Investor Tells Sad Story In Debate of Bills*, The Columbus Dispatch, Sept. 27, 1991 at 2G; *Amendments To Penny Stock Bill Turned Down In House*, The Columbus Dispatch, Nov. 8, 1991, at 2G; *Industry Prevails on Bill*, Dayton Daily News, March 18, 1993 at 1A.

<sup>10</sup> for books and records examples, *see* 17 C.F.R. § 240.17a-3, NASD Manual ¶ 4041; 17 C.F.R. § 240.17a-4, NASD Manual ¶ 4051; 17 C.F.R. § 240.17a-8, NASD Manual ¶ 4080, NASD Rules of Fair Practice Art. III, § 21 ¶ 2171.

<sup>11</sup> for financial reporting and record keeping examples, *see* 17 C.F.R. § 240.17a-4, NASD Manual ¶ 4080.

<sup>12</sup> *See* 17 C.F.R. § 240.15c3-1, NASD Manual ¶ 4111; NASD Rules of Fair Practice Art. III, § 38 ¶ 2198.

<sup>13</sup> Ohio Admin. Code § 1301:6-3-15.

<sup>14</sup> *See* NASD Rules of Fair Practice, Art. III, § 1 ¶ 2151; NASD Rules of Fair Practice, Art. III, § 5 ¶ 2155; NASD Rules of Fair Practice, Art. III, § 12 ¶ 2162.

<sup>15</sup> *See* NASD Rules of Fair Practice, Art. III, § 2 ¶ 2152.

<sup>16</sup> NASD Rules of Fair Practice, Art III, § 35 ¶ 2195; NASD Rules of Fair Practice, Art III, Sec. 35A ¶ 2195A.

<sup>17</sup> NASD Rules of Fair Practice, Art. III, § 27 ¶ 2177; Securities Exchange Act of 1934 § 15 (b)(4) & (6).

<sup>18</sup> *See* Ohio Revised Code Ann. § 1707.19, § 1707.44 and Ohio Admin. Code § 1301:6-3-19.

<sup>19</sup> *See* NASD Rules of Fair Practice, Art V, § 1 ¶ 2301.

<sup>20</sup> This is by no means a laundry list of every violation under the Securities Exchange Act of 1934. For more complete information on the above violations, prohibitions and other anti-fraud violations examples, *see* Securities Exchange Act of 1934 § 9, § 10, § 11 and all rules and regulations prescribed thereunder.

<sup>21</sup> *See* Securities Exchange Act of 1934 § 21(a).

<sup>22</sup> *See* Securities Exchange Act of 1934 § 21(d)(1).

<sup>23</sup> SIPC has excepted the following from the term “members of SIPC”. They are: persons determined by SIPC to be conducting their principal business outside the United States, its territories and possessions; broker-dealers whose business as a broker-dealer is exclusively the distribution of shares in mutual funds, the sale of variable annuities, the business of insurance or the furnishing of investment advice to investment companies or insurance company separate accounts; or broker-dealers whose securities business is limited to United States government securities and who are registered with the Securities and Exchange Commission under a provision of law which does not confer SIPC membership. *See* Securities Investor Protection Act of 1970 § 3(a)(2)(A) and § 16(12).

<sup>24</sup> *See* Securities Investor Protection Act of 1970 § 4, for a full explanation of the fund and how broker-dealers are assessed.

<sup>25</sup> *See* Securities Investor Protection Act of 1970, § 8 and § 9.

<sup>26</sup> Ohio Rev. Code Ann. § 1707.44(L)

<sup>27</sup> *see* Securities Exchange Act of 1934 § 15(c); *see also* 17 C.F.R. § 240.15c2-6 redesignated as 17 C.F.R. § 240.15g-9 and amended in Exchange Act Release No. 34-32576 [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,201 (July 2, 1993).

<sup>28</sup> For a more detailed discussion on what information a broker-dealer needs from its customer in order to determine customer suitability, *see* Exchange Act Release No. 27160 [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,440 (August 22, 1989).

<sup>29</sup> 17 C.F.R. § 240.15g-9(b)(1) and (b)(2).

<sup>30</sup> 17 C.F.R. § 240.15g-9(b)(3)(i).

<sup>31</sup> 17 C.F.R. § 240.15g-9(b)(3)(iii)(A) and (B).

<sup>32</sup> Penniman, New Federal Regulation 15c2-6 Governs Sales of Penny Stocks, Ohio Sec Bull 90:1 (Winter Quarter 1990). The SEC later determined that the Division’s interpretation was indeed correct, *see* Edward A. Schrag, Jr., SEC No Action Letter [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,041 (Sept. 3, 1991).

<sup>33</sup> Securities Exchange Act of 1934 § 15(g) and 17 C.F.R. § 240.15g-1 through § 240.15g-9.

<sup>34</sup> For exemptions for certain transactions regarding these disclosures, *see* 17 C.F.R. § 240.15g-1.

<sup>35</sup> For the definition of “penny stock”, *see* 17 C.F.R. § 240.3a51-1.

<sup>36</sup> *See* 17 C.F.R. § 240.15g-2 and § 240.15g-100. *See also* Exchange Act Release No. 34-32576 [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,201 (July 2, 1993).

<sup>37</sup> *See* 17 C.F.R. § 240.15g-3.

<sup>38</sup> *See* 17 C.F.R. § 240.15g-4.

<sup>39</sup> *See* 17 C.F.R. § 240.15g-5.

<sup>40</sup> *See* 17 C.F.R. § 240.15g-6.

<sup>41</sup> These calculations are based on the most recent yearly statistics provided by the Division regarding registration filings. *See* Registration Statistics, Ohio Sec Bull 94:1 (Winter Quarter 1994).

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## Former Officers and Salesmen of Worthington Investments, Inc., Indicted

On August 12, 1994, the Cuyahoga County Clerk of Courts unsealed a 107 count secret indictment returned by a Cuyahoga County Grand Jury against nine former officers and salesmen of Worthington Investments, Inc. The indictment resulted after the Division conducted an extensive investigation of the activities of Worthington Investments, Inc., and subsequently referred the case to the office of the Cuyahoga County Prosecutor for criminal prosecution.

Worthington Investments, Inc., was an intrastate broker-dealer, dealing primarily in penny stocks, that was headquartered in Worthington and had offices throughout the state. The Division began investigating Worthington Investments, Inc., in May 1991. On August 9, 1991, the Division issued Order No. 91-141, which suspended Worthington Investments Inc.'s Ohio Dealer of Securities License. Worthington Investments, Inc., immediately obtained a stay order

against the suspension and also requested an administrative hearing on the matter.

Subsequent to the administrative hearing, on September 11, 1992, the Division issued Order No. 94-052 which revoked Worthington Investments, Inc.'s Ohio Dealer of Securities License for violations of R.C. sections 1707.19(D), (F) and (J) and Administrative Code rule 1301:6-3-15. Worthington Investments, Inc., also obtained a stay order against

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### Limited Liability

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interest in making the LLC format available to small start-up companies, only a few additional jurisdictions followed Wyoming's lead. By 1992, only sixteen states had followed the Equality state's example. The June 1994 issue of The Ohio CPA Journal reported that forty three states and the District of Columbia had enacted LLC legislation in one form or another.

The primary reason for the slowed growth of the LLC concept was the question of how the Internal Revenue Service would treat LLCs. The Internal Revenue Service answered that question with a 1992 ruling. Rev. Rul. 88-76, 1988-2 C.B. 360, confirmed that a Wyoming LLC should be treated as a partnership for pass-through taxation, and opened the door for a number of states to pass LLC legislation.

Early in the 120th Ohio General Assembly, two bills were introduced in the Ohio Senate that proposed the adoption of LLC legislation for Ohio, Senate Bills 67 and 74. Senate Bill 67 was introduced by Senator Barry Levey (R-Middletown) and supported by the Ohio State Bar Association. Senate Bill 74 was introduced by Senators Roy L. Ray (R-Akron) and Eugene J. Watts (R-Columbus), and was promoted by the Ohio Society of Certified Public Accountants. Both bills used language which had been developed by a subcommittee of

the Corporations Law Section of the Ohio State Bar Association. Because there had been no Uniform State LLC Law, the language is an Ohio hybrid of elements of enactments in other states, and sections based on Ohio corporations law. The sole distinction between the two bills was the inclusion of "limited liability companies to render professional services" in Senate Bill 74, which specifically refers to Accounting and five other professions (Health Care Services, Public Accounting Firms, Architects, Dentists, Pharmacists, and Engineering & Surveying) in providing specific authority for organization as limited liability companies.

The Financial Institutions and Insurance Committee of the Ohio Senate considered the bills concurrently, and, on June 23, 1993, Senate Bill 74 was voted out of committee. On June 29, 1993, the bill unanimously passed a Senate vote, and was referred to the Ohio House of Representatives where it was assigned to the Financial Institutions Committee. In the House Committee it was merged with Senate Bill 97 which modified the Ohio limited partnership law and related statutory provisions. Substitute Senate Bill 74 also established a statutory basis for "Limited Liability Partnerships" under Ohio law. Substitute Senate Bill 74 was passed by the Ohio House, was signed by Governor George V. Voinovich on April 1, 1994, and was effective on July 1, 1994.

The Ohio legislation does differ from the majority of LLC statutes in one significant respect, however. Substitute Senate Bill 74 amends the Ohio Securities Act to specifically include membership interests in Limited Liability companies in the definition of "security" in section 1707.01(B) of the Ohio Securities Act, and to grant limited liability interests the same flexibility under the Ohio Securities Act as other securities.

The Ohio Division of Securities, its counterparts in other states, and the legal community generally have long held that interests in limited liability companies are securities, but LLC interests were included in the definition of "security" in the Ohio statute to save LLC investors from having to separately establish their status in the event that problems arise. Inclusion in the definition of "security" also grants LLCs access to the exemption and registration procedures available to other equity securities under the Ohio Securities Act.

The Limited Liability Company may be the appropriate form of organization for a wide range of Ohio businesses. The Ohio Division of Securities sought the inclusion of LLCs in the Ohio Securities Act to expedite the registration and exemption process for start-up LLCs.

*William E. Leber, Esq., is Counsel to the Commissioner of Securities.*

## **Worthington Indictments**

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the revocation from the Franklin County Court of Common Pleas. After opposing motions regarding reconsideration of the stay order, on January 6, 1993, the court modified the stay order by requiring Worthington Investments, Inc., to post a \$100,000 surety bond. On January 13, 1993, Worthington Investments, Inc., filed for bankruptcy under Chapter 7 of the federal bankruptcy code.

The Division's investigation continued after the bankruptcy filing and concluded with a formal referral to the office of the Cuyahoga County Prosecutor. The indictment returned by the Grand Jury included charges for securities fraud, misrepresentations in selling securities, selling securities without a license, grand theft, theft and corrupt activities in violation of the Ohio Corrupt Activities Act.

Robert W. Masters, of Worthington, Ohio, President, Director and salesman for Worthington Investments, Inc., was indicted on one count of selling securities without a license, twenty

three counts of misrepresentations in selling securities, twenty three counts of securities fraud, nine counts of grand theft and one count of corrupt activities.

Ken A. Guss, of Columbus, Ohio, Vice President and salesman for Worthington Investments, Inc., was indicted on three counts of misrepresentations in selling securities, three counts of securities fraud, two counts of grand theft and one count of corrupt activities.

LaRae G. Wiese, of Dublin, Ohio, a branch manager and salesman for Worthington Investments, Inc., was indicted on one count of misrepresentations in selling securities, four counts of securities fraud, two counts of grand theft, one count of theft and one count of corrupt activities.

Philip M. Archambault, of Columbus, Ohio, a salesman for Worthington Investments, Inc., was indicted on four counts of misrepresentations in selling securities, four counts of securities fraud, two counts of grand theft and one count of corrupt activities.

Frank Ayyash, of North Royalton, Ohio, a branch manager

and salesman for Worthington Investments, Inc., was indicted on eight counts of misrepresentations in selling securities, nine counts of securities fraud, two counts of grand theft and one count of corrupt activities.

Seth Brown, formerly of Columbus, Ohio, a salesman for Worthington Investments, Inc., was indicted on three counts of misrepresentations in selling securities, three counts of securities fraud, two counts of grand theft and one count of corrupt activities.

C. Patrick Harkins, of Columbus, Ohio, who served as President of Worthington Investments, Inc., after Mr. Masters, was indicted on eight counts of grand theft, one count of theft and one count of corrupt activities.

Vern E. Davis, formerly of Delaware, Ohio, Sara S. Bernsdorff of Columbus, Ohio, and Worthington Investments, Inc., were each indicted on one count of corrupt activities.

A hearing on all pre-trial motions has been scheduled for January 18, 1995, in the Cuyahoga Court of Common Pleas.

## **Division Enforcement Section Reports**

### ***Administrative Orders***

#### **Jack N. Coenen and C&O Equipment Company**

On May 4, 1994, the Division issued separate final Cease and Desist Orders against C&O Equipment Company of Cincinnati, Ohio, and its former Vice President and Treasurer, Jack N. Coenen of Loveland, Ohio.

Division Order No. 94-093, issued against Coenen, and Division Order No. 94-092, issued against C&O, were based on findings by the Division that Coenen and C&O violated Revised Code sections 1707.44(B)(4) and (G) by providing false financial information about C&O. Specifically, the Division

found that Coenen directed the preparation of inaccurate financial statements detailing the purported financial condition of C&O. Among other things, the inaccurate financial statements materially overstated C&O's net worth.

Coenen then provided such inaccurate financial information to an Ohio resident, knowing that such inaccurate financial information would be relied upon in making an investment decision. In fact, such inaccurate financial statements were relied upon in making the decision to purchase \$90,000 worth of C&O securities from Coenen.

The final Cease and Desist orders were issued after neither Coenen nor C&O requested an administrative hearing as permitted by Division Order Nos. 94-006 and 94-007 issued against C&O and

Coenen, respectively, on January 5, 1994.

#### **Carl Christian Roba**

On May 20, 1994, The Division issued a final order, Division Order No. 94-103, which denied Carl Christian Roba of Playa Del Rey, California, an Ohio Securities Salesman License. On March 18, 1994, the Division had issued to Roba Division Order No. 94-059, which was a Notice of Intent to Deny Application for a Securities Salesman License and Notice of Opportunity for Hearing.

The Division found that Roba was not of "good business repute" as that phrase is used in the Ohio Securities Act and Rules. During 1993 alone, Roba was subject to settlements totaling over \$400,000 resulting from customer complaints

alleging conduct ranging from fraud to misrepresentations and unsuitability. During 1993, Roba was also jointly and severally liable for an NASD arbitration in the amount of \$150,000 based on allegations of misrepresentations in connection with the sale of securities. In addition, from 1990 through 1992, Roba was a party to settlements totaling over \$450,000 resulting from customer complaints in the sale of securities.

The Division issued the final order after Roba failed to request an administrative hearing on the matter.

### **Miracles' Restaurant Limited Partnership and Gary A. Grabowski**

On June 3, 1994, the Division issued a final Cease and Desist Order, Division Order No. 94-104, against Miracles' Restaurant Limited Partnership and Gary A. Grabowski, both of Cleveland, Ohio. The final order resulted from Miracles' attempt to file a Form 3(Q) with the Division to perfect an exemption from registration for the sale of its limited partnership interests.

Miracles filed the Form 3(Q) with the Division on June 26, 1991. The Form 3(Q) reported the date of sale of the limited partnership interests as April 27, 1991. However, an examination by the Division revealed that the date of sale of the limited partnership interests was prior to April 17, 1991, which was more than sixty days prior to the filing of the Form 3(Q). The Division further found that the foregoing constituted a knowing misrepresentation made in violation of R. C. section 1707.44(B)(4).

The Division notified Miracles of the allegations through Division Order No. 94-090, a Notice of Opportunity of hearing issued April 29, 1994. Through counsel, Miracles waived the right to an administra-

tive hearing on the matter. Consequently, the Division entered the final order, which ordered Miracles and Grabowski to cease and desist from violating R. C. section 1707.44(B)(4).

### **Reifsnnyder, Torosian and Arnold, Inc.; David Owens and Robert M. Seibert**

On August 16, 1994, the Division issued a final Cease and Desist Order, Division Order No. 94-141, against Reifsnnyder, Torosian and Arnold, Inc., David Owens and Robert M. Seibert, all of Costa Mesa, California.

During the summer of 1991, RTA had sponsored radio advertisements describing its services in connection with the preparation of applications to be filed with the Federal Communications Commission ("FCC") for Multi-Channel Multi-Point Distribution Services ("MMDS") licenses. In connection with the radio advertisements, Owens and Seibert solicited Ohio residents to enter into MMDS Application Services Agreements with RTA. At least two Ohio residents entered into Agreements with RTA by signing a written Agreement and delivering to RTA a fee for filing with the FCC and a fee for "application services."

After an investigation, the Division determined that the Agreements were "investment contracts" and consequently within the statutory definition of "security" set out in R. C. section 1707.01(B). In reaching this conclusion, the Division analyzed the Agreements under the four prong test established by State v. George, 50 Ohio App. 2d 297 (Franklin Cty. Ct. App. 1975). Specifically, the Division concluded that the investors furnished initial value, such initial value was subject to the risks of the enterprise, the investment was induced by the representation of future financial gain and

the investors were not granted any management control.

Since the Agreements were securities, they were sold to Ohio investors in violation of R.C. section 1707.44(C)(1) because they were neither registered with the Division nor exempt from the registration provisions. In addition, at the time of the sales to the Ohio investors, neither Owens nor Seibert were licensed by the Division. Consequently, the Agreements were also sold in violation of R.C. section 1707.44(A).

On April 11, 1994, the Division had issued Division Order No. 94-082, a Notice of Opportunity for Hearing, which gave RTA, Owens and Seibert notice of the Division's allegations and an opportunity to request an administrative hearing on the matter. The notice order was sent via certified mail to each of RTA, Owens and Seibert at their last known business address. All three notice orders were return undelivered. Pursuant to R.C. Chapter 119, the Division then published notice of the notice order in The Orange County (Cal.) Register.

After satisfying the statutory publication time of three consecutive weeks and failing to receive a request for an administrative hearing, the Division entered the final order, which ordered RTA, Owens and Seibert to cease and desist from violation R.C. sections 1707.44(A) and (C)(1).

### **Gilbert Greens Limited Partnership**

On August 25, 1994, the Division issued Division Order No. 94-151, a final Cease and Desist Order against Gilbert Greens Limited Partnership. In connection with the Cease and Desist Order, the Division and Gilbert Greens entered into a Consent Agreement in which Gilbert Greens consented, stipulated and agreed to the findings, conclusions and orders set forth in the Cease and Desist Order.



The Division's action followed an investigation which revealed that in November 1991 Gilbert Greens sold limited partnership interests to four Ohio residents. The limited partnership interests were neither registered nor subject to a perfected exemption from the registration requirements. Consequently, the limited partnership interests were sold in violation of R.C. section 1707.44(C)(1).

The Division issued a Notice of Opportunity for Hearing, Division Order No. 94-041, to Gilbert Greens on March 8, 1994. Instead of requesting an administrative hearing, Gilbert Greens entered into the Consent Agreement, pursuant to which Gilbert Greens agreed to cease and desist from violating R.C. section 1707.44(C)(1), and also agreed to waive its right to appeal under R.C. section 119.12.

### **David Christopher Pulzone**

On August 26, 1994, the Division issued Division Order No. 94-152, a Notice of Suspension and Notice of Intent to Revoke Ohio Securities Salesman License No. 142114 to David Christopher Pulzone of Washington, D.C. The Division issued the order after Pulzone consented to the entry of a Securities and Exchange Commission order, without admitting or denying its allegations, on August 5, 1994.

The SEC order alleged that Pulzone aided and abetted violations of the anti-fraud provisions of the Securities Exchange Act of 1934, as amended and the Investment Advisers Act of 1940, committed by James Donahue, formerly a Denver, Colorado, based investment adviser. Specifically, the SEC order alleged that Pulzone was the registered representative for various accounts managed by Donahue. Donahue, it was alleged, operated a fraudulent scheme in which he managed funds for investors in limited

partnerships and for various separate accounts.

According to the SEC order, Pulzone's violations stem from twenty fraudulent transfers of money made by Donahue from accounts into which partnership funds were invested and separate accounts. The SEC order bars Pulzone from association with any broker-dealer, investment adviser, investment company or municipal securities dealer, with a right to reapply in two years. It also orders Pulzone to cease and desist from various violations of the securities laws and orders him to pay disgorgement, including prejudgment interest, of \$97,713.42.

On September 1, 1994, Pulzone terminated his Ohio Securities Salesman License. As a result, the Division issued Division Order No. 94-168 on September 7, 1994, which withdrew the "intent to revoke" portion on Order No. 94-152.

### **Seminole Pipeline, Ltd.; The Stanton Group, Inc.; and Shikar Corporation**

On August 31, 1994, the Division issued a final Cease and Desist Order, Division Order No. 94-154, against Seminole Pipeline, Ltd., a California limited partnership, The Stanton Group, Inc., a California corporation and a general partner of Seminole and Shikar Corporation, a Texas corporation and a general partner of Seminole.

The enforcement action arose after Seminole filed with the Division on July 16, 1990, a Form 3(Q) to perfect the exemption for the sale of nine limited partnership units to Ohio residents. However, an examination by the Division revealed that an additional thirty-six and one-half limited partnership interests were sold to Ohio residents between July and November 1990. The additional limited partnership units were not registered with the Division and were not subject to a valid claim of exemption. Further, nei-

ther Seminole, Stanton nor Shikar was licensed by the Division to sell securities at the time the limited partnership interest were sold.

On February 12, 1992, the Division had issued Division Order No. 92-012, a Notice of Opportunity for Hearing, which gave Seminole, Stanton and Shikar notice of the Division's allegations and an opportunity to request an administrative hearing on the matter. None of the respondents requested a hearing.

The final Division order ordered Seminole, Stanton and Shikar to cease and desist from selling securities without being licensed to do so in violation of R.C. section 1707.44(A), and from selling unregistered securities in violation of R.C. 1707.44(C)(1). In connection with the final order, Seminole and Stanton entered into a consent agreement with the Division in which Seminole and Stanton consented, stipulated and agreed to the findings, conclusions and orders set forth in the final order.

### **Carlos Alberto Enriquez**

On September 6, 1994, the Division issued a final order, Division Order No. 94-163, which denied Carlos Alberto Enriquez, of Coral Gables, Florida, an Ohio Securities Salesman License. On July 28, 1994, the Division had issued to Enriquez Division Order No. 94-123, which was a Notice of Intent to Deny Application for a Securities Salesman License and Notice of Opportunity for Hearing.

The Division found that Enriquez was not of "good business repute" as that phrase is defined in the Ohio Securities Act and Rules. Specifically, the Division found that in 1993, the NASD censured and fined Enriquez \$14,400 for engaging in "free riding" in connection with an initial public offering in contravention of the NASD Rules of Fair Practice. In addition, the Division found that in 1982, the Chicago Board Options Exchange censured and suspended Enriquez for one

week for effecting unauthorized transactions in a customer's account.

The Division issued the final order after Enriquez failed to request an administrative hearing on the matter.

## ***Criminal Actions***

### **Kenneth A. Jackson**

On May 4, 1994, the Ninth District Court of Appeals affirmed the conviction of Kenneth A. Jackson of Wooster, Ohio, on 117 felony counts of securities violations, theft, perjury and passing bad checks. As previously reported in *Bulletin* Issue 93:2, Jackson had been convicted on all counts by a Wayne County jury in August 1992. An appeal was filed on Jackson's behalf with the Ohio Supreme Court.

### **Stephen Wayne Kochensparger**

On May 27, 1994, a Franklin County Grand Jury returned a thirty-two count indictment against Stephen Wayne Kochensparger of Columbus, Ohio. Included in the indictment were five counts of theft, three counts of unlicensed sale of securities in violation of R.C. 1707.44(A), and six counts each of misrepresentations in violation of R.C. 1707.44(B), sale of unregistered securities in violation of R.C. 1707.44(C) and securities fraud in violation of R.C. 1707.44(G).

The indictment was based on Kochensparger's activities first as a salesman at the now defunct Parsons Securities, Inc., and then as president of One Plus Communications, Inc. The indictment alleges that while at Parsons, Kochensparger took funds from a client's account without authorization and invested the money. The indictment also alleges that while with One Plus, Kochensparger systematically sold unregistered securities using offering materials that contained material misrepresentations and omissions, and used the invest-

ment proceeds other than as represented in the offering materials.

As reported in *Bulletin* Issue 94:1, in April 1993, the Division issued three related orders against Kochensparger and One Plus. Division Order No. 93-013 ordered One Plus to cease and desist from the unlicensed sale of unregistered securities; Division Order No. 93-018 ordered Kochensparger personally to cease and desist from fraudulent acts in connection with the sale of securities; and Division Order No. 93-031 ordered both Kochensparger and One Plus to cease and desist from the unlicensed sale of unregistered securities and making misrepresentations in connection therewith.

In addition, on August 18, 1993, Kochensparger pled guilty to charges of federal mail and wire fraud.

### **Robert L. Hill, Jr.**

On July 25, 1994, Robert L. Hill, Jr., of Worthington, Ohio, was indicted on six counts by a Franklin County Grand Jury. Included in the indictment were one count of selling securities without a license in violation of R.C. 1707.44(A), one count of making false representations for the purpose of selling securities in violation of R.C. 1707.44(B) and one count of securities fraud in violation of R.C. 1707.44(G).

The indictment resulted after an investigation by the Division revealed a scheme in which Hill represented that he would make investments on behalf of Ohio residents in a mutual fund but allegedly never forwarded the investment funds to the mutual fund. The indictment also alleges that Hill used false and misleading statements and documents to induce investment.

As reported in *Bulletin* Issue 94:1, on November 17, 1993, Hill had been indicted on six counts arising out of the same scheme. The July 1994 indictment brings to twelve the number of counts on which Hill has been indicted.

### **Randell Lee Clark**

On August 18, 1994, Randell Lee Clark of Cincinnati, Ohio, was sentenced by Hamilton County Common Pleas Court Judge O'Connor to one hundred twenty days incarceration and five years of probation. Judge O'Connor also ordered Clark to pay restitution as part of his probation.

Clark, a licensed securities salesman, was vice president of Financial General Group, a Delaware Corporation. While affiliated with Financial General Group, Clark sold to Ohio residents over \$250,000 in unregistered securities in the form of promissory notes and various other securities.

On March 2, 1993, Clark was indicted by a Hamilton County Grand Jury on twelve counts of selling unregistered securities in violation of R.C. 1707.44(B). On July 26, 1994, Clark pled guilty to seven counts of attempting to sell unregistered securities, a first degree misdemeanor. At the sentencing, defense counsel stated that it would not file an objection to the five year probation period.

### **Thomas P. Gilmartin, Jr.**

On August 30, 1994, Thomas P. Gilmartin, Jr., formerly of Akron, Ohio, was sentenced by Judge Aldrich in the United States District Court for the Northern District of Ohio to nine years imprisonment to be followed by three years of supervised release. Judge Aldrich also ordered Gilmartin to make restitution of over \$3.9 million. As previously reported in *Bulletin* Issue 94:1, in June 1993 Gilmartin had been indicted on fifty-eight counts by a federal grand jury resulting from his activities as the CEO of First Ohio Securities Company. Gilmartin pled guilty to 35 counts, including 14 counts of securities fraud.

## Registration Statistics

The table to the right sets out the number of registration filings received by the Division during the third quarter of 1994, compared to the number received during the third quarter of 1993, as well as the number of registration filings received by the Division in 1994 year to date, compared to the number received in 1993 year to date.

<i>Form Type</i>	<i>Q3 94</i>	<i>Q3 93</i>	<i>YTD 94</i>	<i>YTD 93</i>
.02(B)	241	764	374	1,087
.02(E)	0	0	0	1
.03(O)	2,699	9,283	2,708	8,994
.03(Q)	331	1,073	321	951
.03(W)	32	98	36	109
.04	0	2	0	0
.041	0	0	0	2
.06(A)(1)	22	102	25	113
.06(A)(2)	11	36	10	38
.06(A)(3)	8	17	2	14
.06(A)(4)	8	37	17	47
.06(A)(30)(G)	0	0	0	0
.09	142	438	130	396
.091	823	2,513	806	2,299
.39	19	79	23	73
.391/.09	1	3	0	2
.391/.091	2	9	5	7
.391/.03(O)	261	743	203	600
.391/.03(Q)	41	138	28	94
.391/.03(W)	2	8	1	4
.391/.06(A)(1)	0	0	0	0
.391/.06(A)(2)	0	0	0	0
.391/.06(A)(3)	0	0	0	0
.391/.06(A)(4)	0	0	0	0
.391/.06(A)(30)(G)	0	0	0	0
<i>Totals</i>	<i>4,643</i>	<i>15,343</i>	<i>4,689</i>	<i>14,831</i>

## Licensing Statistics

The table below sets out the number of Salesmen and Broker/Dealers licensed by the Division at the end of the fourth quarter of 1993, compared to the same quarter of 1992, as well as the number of Salesmen and Broker/Dealers licensed by the Division at the end of the first, second and third quarters of 1994, compared to the same quarters of 1993.

	End of Q4 1993	End of Q4 1992	End of Q1 1994	End of Q1 1993	End of Q2 1994	End of Q2 1993	End of Q3 1994	End of Q3 1993
Number of Salesmen Licensed:	64,589	56,212	65,991	56,200	70,200	59,570	72,045	62,345
Number of Broker/Dealers Licensed:	1,800	1,573	1,778	1,678	1,842	1,750	1,894	1,812

# OHIO SECURITIES BULLETIN

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