

# OHIO SECURITIES BULLETIN

A QUARTERLY PUBLICATION OF THE OHIO DIVISION OF SECURITIES

George V. Voinovich  
Governor of Ohio

Donna Owens  
Director of Commerce

Mark V. Holderman  
Commissioner of Securities

## Summaries of the Advisory Committee Meetings held at the 1994 Ohio Securities Conference

### Registration And Exemption Advisory Committee

by Mark Heurman

The Registration Advisory Committee and Exemption Advisory Committee were merged into one committee for 1994. Howard Friedman, Warren Udisky and Michael Miglets agreed to act as co-chairpersons of the combined committee for 1994-95. Many issues over the past years were discussed simultaneously or needed the comments of the other committee before proceeding forward with policy, rule or statutory changes. Co-Chairs Howard Friedman and Michael Miglets prepared the agenda and presented a few topics for discussion.

The first topic for discussion concerned a proposal by the Investment Company Institute in a letter to the Division of Securities. The letter requests a change to rule 1301:6-3-09(E)(12) of the Ohio Administrative Code. The rule restricts an investment company from investing 15% of its total assets in unseasoned issuers or issuers who have securities that are restricted as to disposition. Unseasoned issuers are considered under the rule as issuers which together with any predecessors have a record of less than three years continuous operation. A major concern of unseasoned issuers is the liquidity of those securities. The federal Investment Company Act requires liquidity in order for the investment company

*continued on page 3*

## Caveats To Senior Citizens About "Legitimate" Investments

*Editor's Note: On March 14, 1995, the Ohio Division of Securities, American Association of Retired Persons, and Consumer Federation of America released an "Investor Bulletin" outlining investment dangers for older Ohioans. Following is a summary of the release, prepared by William Leber, Counsel to the Commissioner. Copies of the release may be obtained from the Division.*

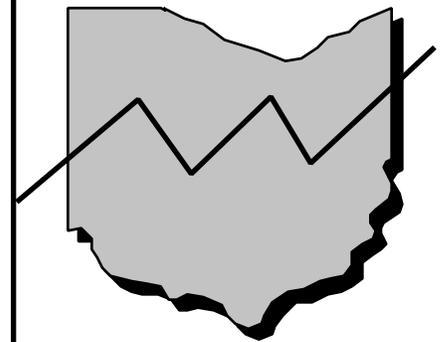
More than 28 million Americans over the age of 65 rely to some extent on investment income to meet their expenses. Three-quarters of all seniors, including an estimated

1.1 million in Ohio, derive 25 percent of their income from investments. Older Americans once relied almost exclusively on federally insured products such as bank savings accounts and certificates of deposit. Now, a number of factors, including a slump in interest rates, have fueled the movement of older America into riskier investments.

The Investor Bulletin focuses on the five most common pitfalls in "legitimate" investing that pose particular problems for older individuals:

*continued on page 2*

## OHIO DEPARTMENT OF COMMERCE DIVISION OF SECURITIES



Ohio Securities Bulletin

Issue 95:1

Table of Contents

Summaries of the Advisory Committee Meetings held at the 1994 Ohio Securities Conference .....	1
Caveats to Senior Citizens about "Legitimate" Investments .....	1
1995 Ohio Securities Conference Notice .....	4
Division Enforcement Section Reports .....	6
Registration Statistics .....	7
Licensing Statistics .....	7

## **"Legitimate" Investments** *continued from page 1*

**1. Commissioned salespeople posing as impartial advisors.** Research shows that older consumers tend to be more trusting, which is why confusion can result from the increasingly common use of titles such as "investment consultant" and "financial advisor" by commissioned investment salespeople.

**2. Uninsured products sold by banks.** Older investors in Ohio are the people who are most likely to place particular trust in their bank as a seller of mutual funds. It is vitally important for seniors to remember that bank-sold mutual funds are uninsured and can result in loss of principal.

**3. Poor quality of oral and printed disclosure about investment products.** Older investors in Ohio need to be on their guard about unwarranted claims that some financial professionals may make in their sales pitches. This "bad information" problem is compounded by prospectuses (and other investment disclosure documents) that are virtually impossible for typical seniors to understand.

**4. Hidden derivatives in funds touted as "safe."** Some of the uninsured investment products that are most likely to be sold to older investors are also more and more likely to feature risky and volatile investments in derivatives. In some cases, the use of derivatives is obscured through legalese, industry jargon and other barriers to clear disclosure.

**5. Account statements that do not clearly indicate performance, fees and commissions.** Most brokerage and mutual fund account statements reveal very little about performance and ongoing burden of fees and commissions.

The Investor Bulletin recommends six techniques to combat the foregoing pitfalls:

**1. Define your financial objectives.** The first step to wise investing is understanding your current financial condition and goals for the future. Most older investors will be interested in investments that generate income and preserve capital. This means that volatile, high-risk investments are likely to be inappropriate.

**2. Check out your financial professional.** The first step in dealing with an investment professional is to check him or her out with the Ohio Division of Securities. You should avoid doing business with financial professionals who have a track record of state, federal, and self-regulatory disciplinary actions, negative arbitration decisions, and civil litigation judgments.

**3. Exercise particular caution when it comes to investing at a bank.** More and more banks are selling mutual funds. However, it is important to recognize that mutual funds sold at banks are NOT covered by the Federal Deposit Insurance Corporation (FDIC).

**4. Understand your investment before you invest.** Never assume that your investment is federally insured, low risk, or guaranteed to deliver a certain return. Always check out, with the assistance of your financial professional, the investment by obtaining and reading the prospectus (or similar offering document) before investing.

**5. Understand how your financial professional is going to make money off of your money.** Never confuse investment salesmanship with objective financial advice. Before investing in a product, understand how much of a commission your broker will earn and how much you will pay in fees.

**6. Monitor your account statements closely.** Your account statement should reflect only the pattern of investing that you have authorized. If you note a discrepancy, raise the problem immediately with your broker and, if necessary, the branch manager who oversees the broker.

## **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.

Portions of the *Ohio Securities Bulletin* may be reproduced without permission if proper acknowledgement is given.

### **Ohio Division of Securities**

77 South High Street, 22nd Floor • Columbus, Ohio 43215

*All listings are area code (614)*

Receptionist .....	644-7381	Enforcement .....	466-6140
Broker-Dealer .....	466-3466	Examination .....	644-7467
Records .....	466-3001	Registration .....	466-3444

## Committee Meetings

*continued from page 1*

to meet redemptions. Additionally, the federal Investment Company Act would prohibit a diversified company from investing more than 5% of its total assets in any one issuer and from owning more than 10% of the voting securities of any one issuer. The states are split on the unseasoned issuer restriction. Investment companies who do not wish to adhere to the rule can place a sticker on the cover page of the prospectus which indicates that the issuer does not comply with the rule.

The second limitation of the rule concerns restricted securities. The Investment Company Institute has requested that the Division specifically exclude Rule 144A securities from the 15% limitation. The exclusion would permit private resales of restricted securities to Qualified Institutional Buyers. Qualified Institutional Buyers are defined in rule 144A which includes registered investment companies. Ohio is the only state that does not exclude rule 144A securities from the restriction. Other states, such as Texas, may exclude 144A securities but place an affirmative obligation on the board of directors to determine that the securities are liquid.

The second issue for consideration was submitted by Howard Friedman and Karl May. They suggested a need for an exempt transaction filing by rule for the Uniform Limited Offering Exemption. Practitioners would prefer an Ohio Securities Act exemption for issuers relying on both rules 505 and 506 of federal Regulation D as marked on the Form D. Currently, practitioners must select either the exemption under section 1707.03(Q) or 1707.03(W) of the Revised Code. An issue was whether the Division may promulgate a rule for this exemption. The exemption may require a statutory change as the Division may not be able to promulgate a rule exemption for transactions currently the subject matter of statu-

tory provisions. *State v. Gill*, 63 Ohio St. 3d 53 (1992), may also require that the entire language of the federal provision be stated in the corresponding state rule or statute.

The last topic discussed the application of merit standards to limited liability companies. Very few public offerings of LLC's have been received by the Division. The Division provided two examples of public LLC offerings for discussion. Organizational documents have resembled both corporate and partnership format. The format may dictate the merit standards applied by the Division. The Division will use its best efforts to be uniform with other states in the application of merit standards. A tax opinion, if not included, may be requested by the Division. Jason Blackford considered the tax opinion an essential exhibit in any LLC offering.

## Enforcement Advisory Committee

*by  
Lynne Greenler*

Caryn A. Francis, Chairman of the Enforcement Advisory Committee called the meeting to order. Also presiding at the meeting was Co-Chairman Gregory J. Zelasko.

During last year's meeting, a sub-committee was formed to address the proposed rule on timely delivery of securities. The sub-committee reported the results of their research and provided copies of the re-drafted proposed rule. The Committee agreed that the Licensing Advisory Committee should have input into the drafting of this proposed rule. A motion was made, and unanimously carried, to establish a new sub-committee that would, on behalf of Enforcement Advisory Committee, discuss the proposed rule with the Licensing Advisory Committee. William Jackson and Thomas Geyer were selected to comprise the new sub-committee. The

Chairman then asked for a vote on the proposed delivery rule, in its re-drafted form. Thirteen committee members voted yes; two members voted no; and one committee member abstained from voting. A copy of the proposed rule was then delivered to the Licensing Advisory Committee.

Another issue remaining from last year was the proposal to statutorily grant fining authority to the Division. This proposal involved the creation of a new Revised Code section 1707.371, Division of Securities Enforcement Fund, amending R.C. section 1707.37, and adding new subsection (I) to R.C. section 1707.23. Philip Lehmkuhl discussed the changes that were made to the proposal from last year's version. Co-Chairman Zelasko asked for comments. Committee members raised a number of concerns on the proposal as a whole, including: use of funds for the purchase or lease of equipment, use of funds for educational purposes, whether fines could be collected through attachment, and making it clear in the statute that the Enforcement Fund would not be available to investors to recover lost moneys.

In light of the number of concerns raised, the Chairman asked the Committee to vote on whether or not to pursue the fining authority legislation. Fourteen committee members voted in the affirmative. One member abstained from voting. The Chairman then moved that the Committee vote on each individual paragraph in the proposed subsection 1707.23(I).

The Committee unanimously approved the first four paragraphs of the proposed subsection which respectively address fine amount, notice and administrative procedure, attorneys fees to the Division upon successful appeal and negotiated Orders.

The Committee voted to re-draft Paragraphs 5 and 6, which address fine collection and lien assessment. A motion was made that

*continued on page 4*

## Committee Meetings

*continued from page 3*

a sub-committee be formed to re-draft Paragraphs 5 and 6. Michael Quinn, volunteered, with Mr. Lehmkuhl's assistance. Mr. Lehmkuhl declined.

Finally, a number of changes were suggested to Paragraph 7, which sets out the factors to be considered in assessing a fine. After a lengthy discussion, the following Committee members volunteered to form a new sub-committee to re-draft Paragraph 7: Mr. Lehmkuhl, Chair, Mr. Zelasko, Allan Blue, Dan Malkoff, Greg Seeley and Jamie Zitsman. The sub-committee agreed to have the re-draft done in 90 days and ready for review by the Division.

The meeting closed with the nomination of the 1995 Enforcement Advisory Committee Co-Chairman. William Jackson, was nominated and unanimously chosen as the 1995 Co-Chairman of the Committee.

## Licensing Advisory Committee

*by  
Dale Jewell*

The Licensing Advisory Committee met in conjunction with the annual Ohio Securities Conference at the Columbus Marriott North Hotel. The meeting was attended by twelve members, including Co-Chairs Dale Jewell and James Francis.

The Committee was given a copy of the proposed rule 1301:6-3-19(A) regarding the "failure to deliver proceeds to a customer or a customer's account from a sell transaction within thirty (30) calendar days of the trade or sale date". The Committee discussed the effect the proposed rule would have on intra-state and inter-state dealers. The Enforcement and Licensing Advisory Committees formed a sub-committee to review the current language and possible language changes.

The Committee discussed the impact of House Bill 488 on Revised Code section 1707.14. Questions were raised regarding the requirement of Securities and Exchange Commission registration for certain dealers with more than 100 retail

customers and more than \$150,000 in annual gross revenues. The Committee concluded that the plain language of section 1707.14, as amended, requires a dealer to either register with the SEC or establish an exemption from SEC registration within 90 days of meeting the statutory criteria.

## Takeover Advisory Committee

*by  
William Leber*

The Takeover Advisory Committee met briefly to review the changes to the Securities Act and Rules of the Division. The Committee expressed the consensus that the current trend of takeover bids taking the form of share exchanges had limited the application of the Control Bid provisions in the Securities Act. Accordingly, attendance at the Takeover Advisory Committee meeting was limited.

The Committee expressed particular interest in the adoption of Division rule 1301:6-1-05, "Computation of Time." That rule was initially proposed by the Takeover Advisory Committee, submitted to the Division for consideration, and promulgated by the Division in 1994.

### 1995 OHIO SECURITIES CONFERENCE MONDAY, NOVEMBER 6, 1995 COLUMBUS MARRIOTT NORTH

#### *NEW ONE DAY FORMAT*

##### Proposed Schedule:

- 8:00 to 8:30 a.m. — Registration
- 8:30 to 10:00 a.m. — Panel I
- 10:15 to 11:45 a.m. — Panel II
- 11:45 a.m. to 1:15 p.m. — Lunch (with speaker)
- 1:15 to 2:45 p.m. — Panel III
- 3:00 to 5:00 p.m. — Advisory Committee Meetings
- 5:00 to 7:00 p.m. — Reception

The Division intends to apply for 5 hours of CLE credit for the Conference. Registration Information and Panel Topics will appear in the next edition of the *Bulletin*.

## Grand Jury Returns More Indictments in Dublin Securities Case

On March 28, 1995, a Franklin County Grand Jury handed down an 84 count indictment against five former salesmen of Dublin Securities, Inc. The charges primarily relate to alleged misrepresentations and omissions made in the sale of securities of three Columbus-based companies, Confluence Apparel, Inc., Reitz Data Communications, Inc. and Lifeline Shelter Systems, Inc. This is the second series of indictments arising out of the activities of Dublin Securities, a now defunct intra-state penny stock dealer.

The five salesmen indicted are: Dennis G. Houston, of Zanesville, and Michelle R. Leuschen, of Co-

lumbus, each indicted on eleven counts of misrepresentations in the sale of securities and eleven counts of material omissions in the sale of securities; Donald H. Gilliland, of Columbus, indicted on eight counts of misrepresentations and eight counts of material omissions; Thomas E. Marr, of Columbus, indicted on seven counts of misrepresentations and seven counts of material omissions; and Thomas L. Costello, of Columbus, five counts of misrepresentations and five counts of material omissions.

As reported in *Bulletin* Issue 94:2, the first series of indictments based on the affairs of Dublin Securities were returned last April. At

that time, an indictment detailing 1,350 criminal charges was returned against Dublin Securities, Dublin Management, Inc., former principal Clarence J. Eyerman, three other former executive officers and the attorney who served as legal counsel to the companies. As reported in *Bulletin* Issue 94:4, Eyerman and one of the former executive officers, David M. Carmichael, each reached plea agreements with the special prosecutor. The trial of the other two former executive officers, Robert D. Hodge and xxxxxxxxxxxxxxxx, and the former legal counsel, Dwight I. Hurd, is scheduled to begin on June 26, 1995, in the Franklin County Court of Common Pleas.

---

## Division Issues Notice Orders in "Derivatives" Cases

In February, the Ohio Division of Securities issued two notice orders based on the sale of high risk "derivative" securities to Ohio public entities.

On February 6, 1995, the Division issued Order No. 95-008, a Notice of Intent to Revoke the Ohio Securities Salesman License of Kenneth Schulte. The notice order informed Schulte of his right to request an administrative hearing on the matter, which he did. The hearing is set for August 1, 1995.

The notice order alleges that during 1990 and 1991, Schulte, while employed in the Houston, Texas offices of Murchison Investment Bankers and Hart Securities, sold "Interest Only" derivative securities ("IOs") to Ohio counties, municipalities and school boards. IOs are securities derived from

mortgage-backed securities that entitle the purchaser to the interest payment portion of the mortgage payments. While the underlying mortgage is guaranteed by the federal government or federal issuing agency, neither the interest payment stream nor the principal invested in an IO is guaranteed. Also, IOs are extremely sensitive to interest rate changes because prepayment of the underlying mortgage eliminates the interest payment stream. The notice order alleges that Schulte made material misrepresentations and omissions in regard to these and other risks associated with IOs.

On February 27, 1995, the Division issued Division Order No. 95-012, a Notice of Intent to Revoke the Ohio Securities Dealer License of Government Securities Corpora-

tion ("GSC") of Houston, Texas. GSC requested an administrative hearing on the matter, which is scheduled for September 12, 1995.

The notice order issued to GSC alleges that during 1992 and 1993 former GSC salesman James Winter sold derivative securities including IOs and "Inverse" IOs to Ohio counties. The Inverse IO, a form of IO, carries risks in addition to those associated with IOs because the return of an Inverse IO is also based on an adjustable interest rate. The notice order alleges that Winter made material misrepresentations and omissions in the sale of derivatives to the counties. In addition, the notice order alleges that GSC failed to properly supervise Winter and also failed to determine whether investment in the derivatives was suitable for the counties.

## Division Enforcement Section Reports

### *Administrative Orders*

#### **Aerospace Technologies Group, Inc.**

On January 3, 1995, the Division issued a final Cease and Desist Order, Division Order No. 95-001, against Aerospace Technologies Group, Inc. of Columbus, Ohio. The order resulted from the company's failure to properly claim an exemption from the registration provisions of the Ohio Securities Act for sale of its own securities.

On August 27, 1991, Aerospace filed a Form 3-Q claiming an exemption from registration for the sale of 250 shares of Aerospace common stock. However, the Division's investigation revealed that sale of some of the stock allegedly covered by the Form 3-Q had been consummated more than 60 days prior to the filing of the Form 3-Q.

In addition, on December 18, 1991, Aerospace filed another Form 3-Q claiming an exemption from registration for the sale of 1,925 shares of Aerospace common stock. However, the Division determined that at least four of the sales that were purportedly covered by this Form 3-Q had occurred more than 60 days prior to the filing of the Form 3-Q.

On December 2, 1994, the Division had issued Division Order No. 94-206, a Notice of Opportunity for Hearing to Aerospace, setting out the alleged violations of R.C. section 1707.44(C)(1). After Aerospace failed to request an administrative hearing, the Division issued the final Cease and Desist Order.

#### **Kelly L. Ainsworth**

On January 5, 1995, the Division issued a final Cease and Desist Order, Division Order No. 95-002, against Kelly L. Ainsworth of Co-

lumbus, Ohio. The Division issued the final order after Ainsworth failed to request an administrative hearing as permitted by Division Order No. 94-177, a Notice of Opportunity for Hearing, issued on September 20, 1994. The notice order set forth the Division's allegations of violations of the Ohio Securities Act by Ainsworth in connection with the activities of Virginia Capital Group, Inc.

The Division found that in January and February of 1993, Ainsworth sold to at least four Ohio residents shares of stock of Virginia Capital and made false representations in connection with those sales. Further, at the time of the sales, Ainsworth was not licensed to sell securities in Ohio and the securities were not registered with the Division, the subject matter of an exempt transaction, or otherwise exempt from the registration provisions of the Ohio Securities Act. Consequently, Ainsworth violated R.C. section 1707.44(A), (C)(1) and (G). The final order ordered Ainsworth to cease and desist from future violations of the Ohio Securities Act.

*Editor's Note: Reports of additional administrative orders issued by the Division during the first quarter of 1995 will appear in the next issue of the Bulletin.*

### *Criminal Actions*

#### **Stephen T. Strabala**

On February 8, 1995, Stephen T. Strabala of Salem, Ohio, was sentenced to nine years in federal prison and ordered to pay \$4,000,000 in restitution to Columbiana County. Stephen Strabala is the son of former Columbiana County Treasurer Ardel Strabala. The elder Strabala invested over \$10,000,000 of county monies through his son. As de-

scribed in *Bulletin* Issue 94:2, Stephen's fraudulent schemes and illegal activities resulted in the loss of over \$6,000,000 of county funds.

As reported in *Bulletin* Issue 94:4, on December 6, 1994, Stephen pleaded guilty to a total of fifty-nine counts including multiple violations of R.C. sections 1707.44(G) (fraud), 1707.44(B)(4) (false representations) and 1707.44(A) (unlicensed sales).

#### **Steven W. Kochensparger**

On February 16, 1995, Steven W. Kochensparger, formerly of Upper Arlington, Ohio, was sentenced in Franklin County Common Pleas Court to eighteen months incarceration, fined \$9,000 and ordered to pay nearly \$60,000 in restitution. On December 27, 1994, Kochensparger pleaded guilty to a multiple count indictment alleging securities fraud (1707.44(G)), false representations (1707.44(B)(4)), unlicensed sales (1707.44(A)), unregistered sales (1707.44(C)(1)) and theft. As reported in *Bulletin* Issue 94:3, 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.

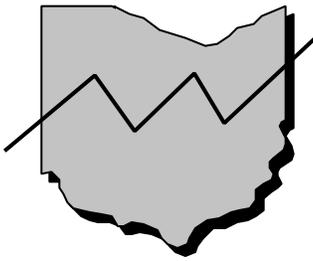
#### **James B. Thomson**

On March 21, 1995, James B. Thomson of Youngstown, Ohio, was sentenced in Trumbull County Common Pleas Court to six years in a state penitentiary and ordered to pay \$20,000 plus interest in restitution. As reported in *Bulletin* Issue 94:4, on November 22, 1994, Thomson pleaded guilty to three counts of securities fraud (1707.44(G)), three counts of theft and one count of unlicensed sales of securities (1707.44(A)). Thomson committed the improprieties while persuading investors to purchase shares in his insurance company, General Agency Center.

## Registration Statistics

The table to the right sets out the number of registration filings received by the Division during the first quarter of 1995, compared to the number received during the first quarter of 1994, as well as the number of registration filings received by the Division in 1995 year to date, compared to the number received in 1994 year to date.

\*Effective October 11, 1994, the Form 2(B) and Form 3-O filing requirements were eliminated.



<i>1707</i>	<i>1Q'95</i>	<i>YTD '95</i>	<i>1Q'94</i>	<i>YTD '94</i>
.02(B)*	0	0	280	280
.03(O)*	0	0	3508	3508
.03(Q)	376	376	445	445
.03(W)	37	37	27	27
.04	0	0	1	1
.041	1	1	0	0
.06(A)(1)	35	35	37	37
.06(A)(2)	12	12	11	11
.06(A)(3)	5	5	4	4
.06(A)(4)	6	6	14	14
.09	136	136	159	159
.091	839	839	844	844
.39	13	13	35	35
.391/.09	0	0	2	2
.391/.091	7	7	4	4
.391/.03(O)	119	119	256	256
.391/.03(Q)	47	47	64	64
.391/.03(W)	0	0	2	2
.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
<i>Totals</i>	<b>1633</b>	<b>1633</b>	<b>5693</b>	<b>5693</b>

## Licensing Statistics

The table below sets out the number of Salesmen and Dealers licensed by the Division at the end of the first quarter of 1995, compared to the same quarter of 1994, as well as the number of Salesmen and Dealers licensed by the Division at the end of the second, third and fourth quarters of 1994, compared to the same quarters of 1993.

	End of Q2 1994	End of Q2 1993	End of Q3 1994	End of Q3 1993	End of Q4 1994	End of Q4 1993	End of Q1 1995	End of Q1 1994
Number of Salesmen Licensed:	70,200	59,570	72,045	62,345	70,642	64,589	69,143	65,991
Number of Dealers Licensed:	1,842	1,750	1,894	1,812	1,759	1,800	1,837	1,778

# OHIO SECURITIES BULLETIN

Ohio Division of Securities  
77 South High Street  
22nd Floor  
Columbus, Ohio 43215

Bulk Rate  
U.S. Postage  
PAID  
Columbus, Ohio  
Permit No. 5455