Ohio Securities Bulletin

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Issue I — 1982

REAL ESTATE JOINT VENTURE INTERESTS AS SECURITIES

by Marc H. Morgenstern, Esq.*

Editor's Note: To acquaint more people with our "Perspective" column, we are printing it on page one, this issue.

The Division invites readers of the Bulletin to submit articles for publication in the "Perspective" column and will print articles on a space-available basis.

This issue's "Perspective" column has been submitted by Marc H. Morgenstern, Esq., a principal in the Cleveland law firm of Kahn, Kleinman, Yanowitz & Arnson. The article provides an informative overview of the application of securities laws to real estate joint venture interests.

Real estate developments are more complex and capital intensive than ever. Until recently, a developer could purchase land, prepare architectural drawings, and obtain all, or most, of the money required for the development through a long-term, fixed-rate, low interest mortgage loan. In the past few years, however, institutional mortgage financing has increased dramatically in cost, and decreased in availability and term. One result of this changing financial environment is the growing use by developers of joint ventures, wherein the developer contributes services and/or land, and investors contribute the equity and/or debt capital.

Many developers, and their counsel, believe that their joint venture activities are exempt from the federal and state securities laws because: (1) the substance of the transaction involves real estate, and (2) the form of the transaction is a joint venture. As to the first contention, Professor Loss noted, that, ". . . some things which look like real estate are securities, [while] some things which look like securities are real estate".[1] As to the second premise, although neither federal nor state securities laws expressly define an interest in a "joint venture" as a security, such an interest can be a security if it is an "investment contract". The term "investment contract" is defined as a security under both federal and state securities laws.

The benchmark analysis of the term investment contract was provided in S.E.C. v. W.J. Howey Co.[2] The Supreme Court held that an investment contract requires four elements: (1) an investment in a (2) common enterprise with the (3) expectation of profits (4) resulting solely from the efforts of another.

Based upon Howey, ordinarily an interest in a joint venture (or a general partnership) is the antithesis of an investment contract. Although a real estate joint venture frequently satisfies the first three elements of Howey, the fourth element is rarely satisfied. Joint ventures (or general partners) are not passive investors; they are co-owners of a business who expect to earn profits because of their active participation in managing the business. The consistent teaching of the Supreme Court, however, has been that substance, and not form determines when an interest is a security. The name that an interest bears is a starting point for analyzing whether the interest is a security, but the name, by itself, is not dispositive. As a result, although there may be an implicit presumption that a joint venture interest is not a security, that determination can only be made on a case-by-case basis.

The Fifth Circuit Court of Appeals in Williamson v. Tucker[3] recently articulated the most detailed federal judicial examination of whether a real estate joint venture interest is a security, although holding that the interest at bar was not a security. The Court formulated a test to determine when the allocation of management responsibility in a joint venture warrants a conclusion that an interest therein constitutes an investment contract. The test focuses on whether a joint venture investor would anticipate making profits based on his own efforts or "on the efforts of another", and provides that a joint venture interest is an investment contract when:

(1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or

*Principal, Kahn, Kleinman, Yanowitz & Arnson Co., L.P.A., Cleveland, Ohio. B.A. Yale University, 1972; J. D. Boston University, 1975. An expanded version of this material is contained in Morgenstern, Real Estate Joint Venture Interests as Securities: The Implications of Williamson v. Tucker, 59 Wash. U. L. Q. 1234 (1982).

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(2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or

(3) the partner or venturer is so dependent on some unique enterpreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.[4]

Williamson exposes certain of the traps for unwary joint venture promoters or their counsel. Joint venture relationships may result in the creation of securities either because of the joint venture agreement, the characteristics of the investor, or the characteristics of the joint venture promoter. An investment contract may exist if any of the following are true: (1) the joint venture agreement retains management rights for the promoter and denies them to the investor; (2) the investor has the financial capability for the investment, but lacks the business knowledge or sophistication required to exercise, in a meaningful way, whatever putative managerial powers he possesses in the joint venture agreement; or (3) the unique or irreplaceable skills of the promoter compel the realistic conclusion that the promoter, not the investors, will manage the joint venture and determine whether the investors receive a profit.

It may surprise some promoters to discover that the creation of a security may result not solely as a product of the joint venture agreement but rather from the skills and characteristics of the parties to the agreement.

The Williamson test, although arguably overbroad and somewhat ambiguous, provides a useful starting point for joint venture promoters and their counsel to design joint venture relationships that will not constitute investment contracts. Care must be taken to preserve to the investors meaningful managerial powers. Participation must be restricted to investors who can effectively exercise their retained management responsibilities. The lessons of Williamson are critical. Failure to heed its warnings may result in the inadvertent creation of a security, with all of the attendant regulatory and compliance problems.

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[1] L. LOSS, SECURITIES REGULATION 493 (2d ed. 1961).

[2] SEC v. W. J. Howey Co., 328 U. S. 293 (1946).

[3] Williamson v. Tucker, 645 F. 2d 404 (5th Cir.), cert. denied, 50 U.S.L.W. 3278 (U. S. Oct. 13, 1981) (No. 81-285).

[4] Id. at 424.

Time Sharing

by William E. Leber, Attorney Examiner

The number of foreign real estate filings received by the Division has increased dramatically in recent months, and is primarily due to the growing popularity of resort time sharing projects.

Ohio Revised Code Section 1707.33 requires the registration of any interest in real estate when the real estate is not situated in the state, and when the interest is to be sold or offered for sale in Ohio. Traditionally, the Division has reviewed registrations involving the sale of condominiums or real estate parcels. The growth of resort time sharing has, however, added a new element to Ohio's regulation of foreign land development.

Under most time sharing arrangements, the purchaser buys the right to use a specific residential unit for a designated period of time each year and for a term of years. For example, an individual may buy two weeks in January in a Florida townhouse for the next twenty years under a "vacation lease". Or, in a condominium variation, the buyer may purchase a fee interest in a condo unit with use of those facilities limited to a designated time period each year.

The marketing of time shares, which began in Europe in the early 1970's, potentially allows the developer a higher profit margin and, because of the lower price per transaction, it also creates a larger class of purchasers. At the same time, the developer incurs more long-term responsibilities than he would with a conventional sale.

The Foreign Real Estate Advisory Committee and Division staff are developing a new format for time sharing registrations. The committee and staff are also working to improve the filing requirements for other foreign real estate offerings.

Because the characteristics of time sharing projects deviate significantly from conventional real estate sales, it is anticipated that new forms and administrative rules pertaining to time sharing will be adopted during the next few months. Those having a particular interest in the area, will be added to the Foreign Real Estate mailing list by sending their name and address to: William E. Leber, Attorney Examiner, Foreign Real Estate Section, Ohio Division of Securities, Two Nationwide Plaza, Columbus, Ohio 43215.

ANNOUNCEMENTS

Staff Changes

In December, Mark Robbins joined the Division's registration section as an examiner and will review governmental securities applying for exemption under section 1707.02(B) Ohio Revised Code. Mr. Robbins received his undergraduate degree in Business Administration from the Ohio State University.

Sandi Rosso became employed in the Division's registration section in December. Ms. Rosso will work as a registration examiner and will coordinate the 1982 Securities Conference. For nine years prior to joining the Division, Ms. Rosso worked for the Department of Commerce where she served as Assistant Fiscal Officer.

In January, Cy Sedlacko joined the Division as an investigator in the enforcement section. After serving in the military for a number of years, Mr. Sedlacko began working for the Department of Commerce in 1980. Among his other responsibilities at the Department, Mr. Sedlacko coordinated the move to our new offices at Two Nationwide Plaza.

Gregg Zelasko joined the Division's registration section as an attorney examiner in January. Mr. Zelasko received his juris doctorate degree in May from Capital University Law School. Prior to joining the Division, he was employed by Franklin County Municipal Court as a bailiff to Judge George C. Smith.

James Lummanick joined the Division in January as a staff attorney in the enforcement section. Prior to joining the division, Mr. Lummanick was an associate in a Cincinnati law firm specializing in complex civil litigation. He received his juris doctorage from Chase College of Law, and holds a B.A. and M.A. from Ohio State University.

Clarification

Recent phone calls to the Division, have indicated some confusion concerning the Policy Statement printed in the last issue of the Bulletin pertaining to registration by coordination.

Registrations which go effective with the SEC ten days after filing, may achieve simultaneous effectiveness in Ohio only if the filing with Ohio precedes the SEC filing by at least 5 days. This is in keeping with Section 1707.091 which requires as a condition precedent to simultaneous effectiveness, that the registration statement be on file with the Division for at least 15 days. Accordingly, if a registrant desires to achieve simultaneous effectiveness with Ohio and the SEC, and the registration statement will be effective 10 days after filing with the SEC, the Ohio filing must precede the SEC filing by 5 days in order to meet the Ohio 15 day "on-file" requirement.

TENDER OFFERS

Mobile-Marathon

On October 30, 1981 Mobil Corporation made a take-over bid for Marathon Oil Company, an Ohio corporation. Mobil Corporation filed a complaint in the Federal District Court for the Southern District of Ohio in Columbus seeking to enjoin the Ohio Take-over Act on constitutional grounds. Mobil did not file a Form 041 with the Division.

On Sunday, November 1, Judge Battisti of the Federal District Court in Cleveland, issued a TRO against Mobil on federal antitrust grounds. On the following day, the Division and the parties' Columbus counsel stipulated to a "stand-still" agreement for the duration of the Cleveland antitrust TRO plus two days.

On Wednesday, November 11, Mobil made a filing with the Division pursuant to Revised Code Section 1707.041. On November 17, Marathon requested a hearing. Hearings in federal court regarding the constitutionality of the statute began on November 18 and on the following day, U.S. Steel made a competing friendly bid for Marathon.

On November 20, the Division issued an order that it was unable to find cause for a hearing. Following the Division Order, the hearings on the constitutionality of the take-over statute were suspended indefinitely, ending the Division's participation in the takeover.

Mobil subsequently brought a shareholder suit against U.S. Steel, Marathon, and the Marathon Board of Directors for violation of federal proxy rules, federal disclosure rules, and state corporate fiduciary duties. Hearings on these issues began in front of Judge Kinneray on December 23.

Having issued a TRO to prohibit U.S. Steel from purchasing shares pending the hearing, Judge Kinneary modified the order on the weekend of November 28, allowing U.S. Steel to solicit shares, but not take them down. On Monday, December 7, Judge Kinneary turned down Mobil's request for the preliminary injunction. The Sixth Circuit Court of Appeals reversed Judge Kinneary, however, and ordered that the considerations given U.S. Steel for its offer were void because the Marathon Directors could not have had a legitimate corporate purpose for giving such consideration.

On Tuesday, December 8, the FTC announced that it chose to oppose the Mobil take-over on antitrust grounds and pursuant to the Scott-Hart-Rodino Act. Although this had no direct effect at the time, it does indicate the FTC is willing to challenge oil company mergers on antitrust grounds.

MAF Newco-Richardson

MAF Newco, Inc. a subsidiary of The MacAndrews Forbes Group filed a complaint for declaratory judgment against the Ohio Take-over Act on October 30, 1981, almost simultaneously with the Mobil complaint. On November 2, MAF announced a tender offer of $24.00 per share for any and all shares of the Richardson Company (an Ohio Corporation). MAF filed a Form 041 with the Division.

On November 9 Richardson filed a Form 041(B)(4) as a fomal request for a hearing. Richardson argued that MAF had made inadequate disclosures in its documents, and that the MAF purchases of 18.8% of Richardson stock prior to making the take-over bid, were in violation of O.R.C. Section 1707.041(B)(2). This section requires the announcement of any intent to make a take-over bid, upon the purchase of shares on the open market. On November 13, the Division ordered a hearing.

On November 17, the hearing officer met with counsel for the parties to discuss the limits of the hearing and set up a hearing schedule. During this conference, the hearing's scope was limited. The hearing's issues were identified as follows: (1) The "creeping tender" provisions of Section 1707.041(B)(2), and "Esmark-type" intent were to be explored. "Esmark-type" intent was discussed in the unpublished Division order In re Esmark, Inc., Ohio Division of Securities, File No. 041-12 (Decision, July 5, 1977). (2) Disclosures relevant to the control of MAF were to be explored during the hearings, viz. business practices, dealings with the target, control of the offeror, the corporate structure and practices of the MacAndrews Forbes Group. (3) Significant, on-going litigation was to be described in detail. (4) Increased disclosure of the financing of the offer was to be made, including loan sources, payment schedules, and certainty of financing, as well as, possible disposition of Richardson assets to service the loans. (The latter was of particular concern since Richardson was 2½ times larger than MacAndrews Forbes.) (5) Treatment of preferred shareholders whose shares had convertible features, was also to be explored.

Because this was a hostile bid, the hearing officer reaffirmed that the Division expected the target to sell itself to its shareholders subject to federal proxy requirements, rather than require the offeror to disclose exact financial details of the target.

Following the conference, the hearing officer sent a letter to counsel for MAF, summarizing and defining the issues to be discussed in the hearing. For instance, the letter stated "At this time, target has not made a showing that Mr. Perelman is an offeror as contemplated by the Ohio statute, however, his relationship to the offeror, past business practices, and acquisitions history are deemed to be within the scope of the hearing, because the Division considers him to be a material party to the transaction. His personal life will not be the subject of any investigation and his finances would only be a subject of investigation were he first deemed to be an offeror." The letter emphasized that the hearing officer had total authority to expand or limit the scope of the hearing and the hearing schedule.

Also following the conference, counsel for MAF provided a letter which guaranteed that MacAndrews Forbes would maintain the withdrawal rights of Richardson's shareholders, and would not accept shares for payment for seven days following the final Division Order. At the same time, MacAndrews Forbes reserved its right to challenge the constitutionality of the Ohio statute and to change or withdraw its offer.

Pursuant to the letter from MacAndrews Forbes stating that MAF would maintain withdrawal rights and not take down shares, on November 19 the Division issued an order providing for those same conditions. This stipulation was entered pursuant to the Division's take-over policy release. (See, Ohio Securities Bulletin, Issue 2, 1981 at 3.)

Unlike past hearings under Section 1707.041, an accelerated hearing schedule was adopted. Hearings were limited to five days and the hearing officer's report was also to be released on an accelerated schedule.

On November 18 counsel for MAF requested that the Division abandon the hearing officer format and conduct the hearings as an agency investigation. On Friday, November 20 the Division agreed to postpone the hearings for one week, in consideration of the emergence of a competing friendly tender offer of $27.00 per share by Whitco Chemical Corporation. The hearing officer put the postponement on the record on Monday, November 23.

The Division did not rule on the merits of MAF's motion for an agency hearing, although both parties had agreed to waive the ten day waiting period following the hearing officer's report. The hearings were postponed a second week.

Ultimately MAF chose to liquidate its holdings in Richardson by tendering to Whitco. Upon the abandonment of the MAF take-over bid, the Division closed proceedings under the Act.

L.T.V.—Grumman

L.T.V. Corporation, through its wholly owned subsidiary C.K.H. Corporation, announced a tender offer for shares of Grumman Corporation in October.

Ohio's tender offer statute was not applicable to the offer since Grumman is not an Ohio corporation or one with its principal place of business and substantial assets in Ohio.

Nevertheless, the Ohio Division of Securities issued a Cease & Desist Order against L.T.V. on October 9, 1981 under the Division's anti-fraud powers. Certain information had been presented to the Division which indicated that L.T.V. had formed the intent to dispose of Grumman's non-aerospace assets immediately after acquisition.

L.T.V. Corporation filed suit against the Division in Federal Court in Columbus challenging the Division's authority to issue such an order. However, before the case could be heard, the L.T.V. offer was enjoined on anti-trust grounds in the Federal District Court for the Eastern District of New York.

In response, the Division terminated its Cease & Desist order on November 19, 1981. The L.T.V. court challenge to the order was dismissed several days thereafter.

Division Sponsors Conference

On Friday, December 11, 1981 the Ohio Division of Securities sponsored its second annual securities conference at the Ohio Center in Columbus. Over 250 broker-dealers, foreign real estate brokers, and attorneys practicing in the securities area, were in attendance.

The Division's six advisory committees met in closed sessions in the morning, and the conference program commenced with a luncheon at noon. Attendees at the luncheon were enlightened by a presentation by Robert Stanger of The Stanger Report. Mr. Stanger's presentation was followed by eleven speakers, speaking on topics of interest to brokers, salesmen and securities attorneys.

For whose who did not have an opportunity to attend the conference, we have included the following summaries of their presentations:

Robert A. Stanger

The conference luncheon speaker was Robert A. Stanger, publisher of The Stanger Report investment newsletter. Mr. Stanger discussed tax shelter investing, and the impact of the new tax legislation.

Mr. Stanger predicted that tax shelter investment would continue to go up in 1982. Although oil and gas sheltered investments should flatten out, he predicted sheltered investments in real estate would grow as the new tax law takes effect and the fundamentals of the economy shift.

Because the upper tax rates have been reduced, the tax shelter effect will be smaller for sheltered investment. Bracket creep will keep most investors' tax bills approximately the same.

Tax shelters are still superlative investments because: 1) the investor receives high leverage from tax savings, 2) the investor has direct ownership of assets removing any double taxation, and 3) shelters force the investor to hold assets over a long period of time. Mr. Stanger feels real estate syndication has been the most successful investment area over the past six years, and will remain so.

Mr. Stanger noted that, although oil prices are weak and will likely remain so in the near future, the supply of oil is as precarious as ever. Several factors favor investment in natural gas at the present time. Among these are new price designations for tight gas sand formations and natural gas found below 15,000 feet, and the Natural Gas Policy Act allowance for a gradual rise in price.

Because Ohio is the third or fourth most active state in syndication of oil and gas offerings, Mr. Stanger identified three problem areas to which attorneys and their clients should be alert: 1) "turnkey" contracts are frequently marked up unconscionably, 2) those persons who bear 100% of the cost, frequently earn no more than 30 to 38% of the revenues, 3) the reserve potential is often grossly overestimated and the declining productivity curve is frequently ignored.

David Hayes

David Hayes, C.P.A., Vice President with Bache, Halsey, Stuart and Shields of Washington, D.C. spoke on tax reform and tax shelters. Mr. Hayes discussed how tax shelters, particularly real estate, have become even more attractive to the qualified investor. Comparison slides, showing the old and new tax treatment and various income ranges, illustrated the discussion.

Mr. Hayes explained that the big "loop-hole" in the new tax law is long term capital gain. One can go into a shelter in a 50% tax bracket and come out at 20%. Even if the taxpayer is not in the 50% tax bracket, the change in the tax preference issue will yield larger deductions than ever before because of the conversion of earned income into unearned income.

Mr. Hayes feels real estate is the clear winner in the tax reform bill because of the cumulative effect of the tax changes. Some of the changes include the following: allowing residential property to be depreciated using the 175% declining balance depreciation method; shortening the time period over which real and personal property may be depreciated; reducing the maximum tax on capital gains; and liberalizing the "at risk" rule. Since these changes have their greatest effect upon real estate investment, Mr. Hayes feels that it is currently the best investment.

Mr. Hayes also pointed out that the penalty for over-evaluation and the 20% interest on any additional tax due, will create a far greater risk for the more exotic tax shelters.

Michael R. Sturgess

Michael R. Sturgess, C.P.A. with Cranston Securities Company of Columbus, spoke on the topic of "Adaptive Use-Historical Preservation Projects." Mr. Sturgess' presentation was of much interest to Ohio broker-dealers.

Mr. Sturgess reviewed the new 25% investment tax credit on qualifying rehab expenditures. This tax credit which requires no reduction in appreciable base, becomes effective January 1, 1982.

Mr. Sturgess' presentation was highlighted by slides of a historic rehab project in Savannah, Georgia. Cranston Securities Company, which had participated in the project, helped coordinate the city and county governments, financial institutions, HUD, and the community in making the historic rehabilitation a reality.

Peter D. Van Oosterhout

Peter D. Van Oosterhout, President of Clarion Capital Corporation of Cleveland, Ohio spoke on the role of the venture capital corporation, as an alternative to an offering.

As a part of his presentation, Mr. Van Oosterhout provided some industry statistics on the funding supplied each year to small business enterprises by venture capital corporations, and described the analysis performed by his company in determining whether to assist an applicant.

Of particular interest to the audience, was Mr. Van Oosterhout's description of the equity position his company takes in an enterprise, and the management assistance available, through Clarion Capital Corporation.

Paul F. Sefcovic

Paul F. Sefcovic, from the law firm of Squire, Sanders and Dempsey, spoke to the conferees on the topic of "Industrial Development Revenue Bonds". Mr. Sefcovic began his presentation by reviewing the basic policy concepts underlying this form of security.

Mr. Sefcovic also examined the requirements for the project eligibility, federal tax requirements, the purchase and marketing of the bonds, and the roles of various persons involved in the registration and sale of the bonds. He also reviewed topics such as substantive provisions of the bond issuance (public purpose, tax considerations, areas of negotiation, etc.), documentation format, mortgage provisions, existence of a second security, and duration of the financing.

John R. Thomas

John R. Thomas, of the Columbus law firm of Emens, Hurd, Kegler & Ritter, spoke to the conference on the topic of "ESOPs and the Ohio Securities Laws." Mr. Thomas stressed that, despite certain tax advantages and other benefits of ESOPs to both the employer and employee, the employer must comply with the federal and state securities laws applicable to ESOPs and TRASOPs.

The speaker pointed out that there are no federal securities problems in regard to an interest in a plan that is involuntary and non-contributory. With regards to non-contributory plans, the Ohio Division of Securities has taken the position that there is no security as to the interest in the plan itself.

The speaker pointed out several situations that raise other securities issues, e.g., the conversion of old employee benefit plans into ESOPs, the purchase of stock by the plans from insiders, and transactions in securities subsequent to issuance of the stock to the plans. Mr. Thomas then discussed the possibility of exempting the plans from registration under the Ohio Securities Act.

Mr. Thomas concluded by addressing the broker-dealer licensing issue as it relates to ESOPs. He stated that registration and broker-dealer exemptions may not be co-extensive and that a company may have to be licensed as a broker-dealer in order to establish an employee benefit plan in Ohio. Mr. Thomas also pointed out that pending revisions of the Ohio Securities Act may provide relief from this requirement for some issuers, particularly foreign corporations with employees in Ohio.

Alfred Johnson

Alfred Johnson gave a very informative presentation on money market funds. Mr. Johnson is Vice President and Chief Economist for the Investment Company Institute.

Until 1970, mutual funds were a medium through which one purchased equitable interests in a diversified list of stocks chosen by professional investment managers. Once one purchased shares in a mutual fund, one's investment managers used the money to buy the securities of other companies. A drawback to purchasing this kind of financial product was its non-liquidity and its susceptibility to being eroded by inflation.

These disadvantages became salient in the 1970's with high interest rates and double digit inflation. As a response to this financial environment, mutual funds diversified their financial products. One of the examples of this diversification was the money market fund. Instead of purchasing long-term equity interests, investment managers used their customer's money to purchase short-term instruments of high quality, such as treasury bills, commercial paper and banks' certificates of deposit.

Although money market funds are not insured, investments in such funds derive their safety from the low average maturity of the securities purchased (from 35 to 40 days) and the high quality of the issues. Other advantages of money market funds are the high rate of return and the liquidity of one's investment, the latter factor enabling one to quickly cash in one's investment in order to anticipate the depreciation of one's profit by inflation.

Joel K. Bedol

Joel K. Bedol of the law firm of Calfee, Halter & Griswold in Cleveland gave an informative overview of going private transactions, encompassing both state and federal law considerations.

In the state law area, Mr. Bedol discussed Ohio statutes which limit the ability of corporations to impair capital.

He also reviewed recent case law dealing with the corporate purpose doctrine and indicated an attempt by the courts to delineate what is a valid corporate purpose as it pertains to an issuer's repurchase of its own stock.

In the area of federal regulation, Mr. Bedol outlined various rules which prohibit "fraudulent and deceptive acts or practices and the making of material misstatements or omissions" in connection with a tender offer by a non-affiliate or an issuer. Mr. Bedol briefly touched upon the informational disclosure requirements of Rule 13e which includes: a statement of material terms of the transaction, plans of the issuer following the transaction, source and amounts of funds utilized in the transaction, purpose of the transaction, dissenting shareholders' remedies under state law, and an opinion as to the fairness of the transaction. After citing some exemptions under Rule 13e, Mr. Bedol concluded his presentation by highlighting proposed amendments to that rule.

Nodine Miller

Ms. Nodine Miller of the Columbus law firm of Zacks, Luper & Wolinetz presented a highly informative talk on the current efforts of the Securities & Exchange Commission (SEC) and the North American Securities Administrators Association (NASAA) to develop a Uniform Limited Offering Exemption.

Ms. Miller summarized the elements of the SEC's proposed Regulation D and NASAA's legislative proposals, Option A and Option B. Regulation D would eventually replace the existing exemptions now available under Rule 146, 240 and 242, and the NASAA proposals for state legislation would make state filings compatible with the federal.

Ms. Miller, formerly Deputy Commissioner of the Ohio Securities Division, applauded the efforts of the federal government and the states to coordinate securities filings and to facilitate small business financing through uniformity of exemption.

Richard Emens

Richard Emens presented information on proposed legislation which would amend the Ohio Securities Act. Mr. Emens is a partner in the law firm of Emens, Hurd, Kegler & Ritter, and is chairman of the Securities Legislation Sub-Committee of the Ohio State Bar Association's Corporation Law Committee.

Mr. Emens reported recent efforts by the S.E.C. and the Ohio Division of Securities to encourage capital formation, and to provide capital to small businesses. Toward that end, the S.E.C. promulgated new rules, including Rule 242, to ease the burden of registration on small companies. Following the commission's lead, the Corporation Law Committee and the Ohio Division of Securities recommended amendments to the Ohio Securities Act which would encourage formation and capitalization of businesses in Ohio.

Under the proposed amendments, section 1707.06 O.R.C. would be expanded so that businesses could raise larger amounts of capital while still utilizing registration by description. The amendments would also add a section 1707.03(V) which would allow the Division of Securities to add new exemptions by rule rather than by the more lengthy process of amending the statute. Under the proposed statute, the Division could add new exemptions which would coordinate with their federal counterparts, and thus expedite the capital formation process.

A. A. Sommer

The program continued with a presentation by A. A. Sommer, who enlightened the group with his discussion of due diligence. Mr. Sommer was formerly a member of the Securities and Exchange Commission, and is currently a partner in Morgan, Lewis and Bockius of Philadelphia and Washington, D.C.

After reviewing the standards set forth by the courts in the BarChris and Feit vs. Leasco cases, Mr. Sommer emphasized that attorneys must examine the business' vulnerable areas, and that these vulnerable areas vary, depending on the type of business involved. Mr. Sommer pointed out that an attorney cannot merely follow a checklist in making a due diligence analysis and that neither counsel nor the underwriter can rely solely on statements of insiders.

Mr. Sommer also suggested the attorney make an accurate record of his due diligence inquiries and recommended the N.A.S.D. publication "Special Report-Due Diligence Seminars" which was made available to particpants at the Conference.

Robert Wimbush

The final conference topic concerned "Working with Your Financial Printer", and was presented by Robert Wimbush of the Sorg Printing Company, Chicago, Illinois. The important part played by the financial printer in making an effective filing, was highlighted by Mr. Wimbush. Coordination, communication and cooperation are essential in accomplishing all the requirements of registration filings.

The banker, lawyer, and underwriter, in cooperation with the financial printer, work together as a filing team to assist the client in all aspects of the filing process. In getting organized to file, a control person or "quarterback" should be designated early to coordinate the efforts of the team. Listing types and quantities of documents to be prepared, establishing a realistic timetable and selecting format and style are some of the organizational considerations to be resolved.

Mr. Wimbush set forth a detailed checklist of items to be observed at various stages of document preparation, filing and distribution. His suggestions progressed from the document drafting stage to revision of the printer's draft, and arrangements for filing and post-filing activities. Informative booklets entitled "Financial Printing Checklist for Going Public" and "Going Public" were distributed at the Conference.

NICHOLAS KIRALY

The Division was greatly sorrowed by the recent death of Nicholas Joseph Kiraly. Mr. Kiraly, an attorney, served as assistant chief of the Division of Securities until his retirement in 1968. After retirement, he joined the Bricker and Eckler law firm in Columbus where he remained until his death.

Mr. Kiraly was also a past president of the North American Securities Administrators Association.

NOTICE OF PUBLIC HEARING

The Division of Securities, Department of Commerce, State of Ohio, will hold a public hearing at 10:00 a.m. on April 19, 1982 in the State Office Tower, 30 East Broad Street, Columbus, Ohio to consider the adoption of rules relating to the Ohio Securities Act, Chapter 1707., O.R.C.

The proposed rules, as filed with the Legislative Reference Bureau and the Clerk of the Senate, would amend rules 1301:6-3-09 and 1301:6-3-33 of the Ohio Administrative Code.

These amendments would provide a longer period of effectiveness for certain registrations by qualification, would modify diversification requirements for investment companies, and would eliminate post-effective review of advertising.

The amended rules would also permit standarized disclosure documents to be submitted in place of certain documents attached to foreign real estate filings, and would permit the Division to require disclosure of specific risk factors to purchasers of foreign real estate. The rules would also require that certain disclosures be made to purchasers of time-share exchange programs, and would permit issuers or dealers to give gifts or other forms of consideration to purchasers of foreign real estate when they refer the names of qualified prospective purchasers, as long as the consideration is not continguent upon a purchase or commitment to make a purchase by the prospective purchaser.

Information concerning the hearing, and copies of the proposed rules may be obtained from the office of the Commissioner of Securities, 3rd Fl., Two Nationwide Plaza, Columbus, Ohio 43215, thirty days prior to the date of the hearing. Copies will be mailed upon request as provided in Section 119.03 of the Revised Code.

BULLETIN GETS NEW EDITOR

The position of Editor of the Ohio Securities Bulletin has traditionally been rotated on an annual basis among attorneys in the registration and enforcement sections of Division. After eighteen months and seven issues, I am pleased to announce that Janet Gibson will take over responsibilities for the Bulletin beginning with its next issue.

In addition, Ms. Gibson will continue to serve in her present position as attorney examiner, reviewing oil and gas registrations.

Nancy Ivers Ferguson
Editor

ENFORCEMENT

Franklin J. Cristiano

On April 1, 1981, the Ohio Division of Securities filed a civil action in the Franklin County Court of Common Pleas against Franklin J. Cristiano dba Pisa Pizza, Inc. and dba Medical Equipment Products. The Division alleged that Cristiano had sold unregistered securities in the state of Ohio, and had sold securities without a license. The complaint also alleged that Cristiano had committed certain fraudulent acts in the sale of securities.

On December 8, 1981, Franklin J. Cristiano entered into a consent decree, enjoining Cristiano from engaging in any acts prohibited by the Ohio Securities Act.

The Division's action resulted from an investigation conducted by David LeGrand, former Staff Attorney at the Divison.

Jack L. LaMarca

On November 20, 1981 the Commissioner of Securities issued an order that Jack L. LaMarca Cease and Desist from the sale of any partnership interests in violation of Chapter 1707 of the Ohio Revised Code. An investigation by the Division indicated that Mr. LaMarca sold partnership interests in Zodiac, a bar and disco in Cleveland, Ohio. The partnership interests were not registered with the Division of Securities and were not exempt from registration.

John A. Calandros

On February 1, 1982 John A. Calandros pleaded guilty to four counts of selling unregistered securities. Mr. Calandros is president of Tracker Security Systems, Inc., a company formed to market security systems in Columbus and other Ohio cities.

Barry Moses, former Staff Attorney with the Division and now an Assistant Attorney General, and Karen Banks, an investigator with the Division, began an investigation of Tracker Security Systems in March of 1981. Their investigation indicated investors' money was used by Calandros for personal expenses. The case was referred to the Franklin County Prosecutor in October, 1981.

Calandros is scheduled for sentencing by the Franklin County Common Pleas Court on March 22, 1982.

Plaza Investments

As a result of a routine examination by the Divison's examination section, on October 21, 1981 the Division issued an order that Plaza Investments "show cause" why its license should not be suspended or revoked. An investigation indicated that Plaza Investments had not maintained adequate books and records, had not submitted its audited financial statements for the years 1979 and 1980, and failed to meet the net worth requirements as required by Ohio Administrative Rule 1301:6-3-15 and section 1707.19 O.R.C.

Plaza Investments chose to place its license on a permanently inactive status.

Form 3-Q's Declared Null and Void

Pursuant to various Division Orders, the application for exemption of certain limited partnership units in the following companies, have been declared null and void by the Division on grounds that an 11% commission was paid in connection with their sale, and/or that the commission was paid to an unlicensed dealer (Betty Sue Associates — see following article):

1) The Barrymore Collection
2) Langston Equipment Collection
3) The Browning Collection
4) The Madison Library
5) The Amherst Collection
6) The Barclay Collection
7) The Hamilton Collection
8) The Wellington Collection
9) The Winfield Collection

Betty Sue Associates, Inc.

On September 25, 1981 the Division issued an order that Betty Sue Associates cease and desist from the sale of securities in Ohio in violation of Chapter 1707 Ohio Revised Code.

A review of several filings made at the Division indicated that Betty Sue Associates had sold certain partnership units in the state of Ohio without being licensed. Such sales were thus in violation of section 1707.44(A) O.R.C.

PMA Securities, Inc.

A routine examination of the Division's examination section indicated PMA Securities had committed the following violations of the Ohio Securities Act:

1) Failure to file audited financial statements for the fiscal year 1981;

2) Failure to maintain the minimum net worth requirements as required by Rule 1301:6-3-15.

Accordingly, the Division issued an order revoking the broker's license of PMA Securities.

McCarthy and Associates, Inc.

On November 3, 1981 the Division issued a Cease and Desist order against McCarthy and Associates, Inc. An investigation by the Division indicated McCarthy and Associates had acted as a securities dealer for Equidyne 1980 Petro/Coal Program 1, and was not licensed as a securities dealer or salesman in the state of Ohio.

Church and Institutional Finance, Inc.

Pursuant to a routine investigation by the Division's examination section, Church and Institutional Finance, Inc. was charged with the following violations of the Ohio Administrative Code and Ohio Securities Act:

1) Failure to submit a statement of financial condition certified by an independent certified public accountant or independent public accountant;

2) Failure to establish and maintain adequate books and records as a securities dealer;

3) Failure to maintain the net worth requirements provided in Ohio Administrative Rule 1301:6-3-15(E).

Church and Institutional Finance, Inc. agreed to put its license on a permanently inactive status.

Tourca Breeding Associates

On November 20, 1981 the Ohio Division of Securities issued an order nullifying the claim of exemption by Tourca Breeding Associates pursuant to Section 1707.03 (Q) O.R.C. The Form 3-Q, and the claim of exemption filed pursuant thereto, was found defective because Tourca paid a commission in excess of 10% to its broker-dealer.

Coal Revenue Research of Ohio

On November 27, 1981 the Division issued a Cease and Desist Order against Coal Revenue Research of Ohio (hereinafter "Coal Revenue"). Coal Revenue is a wholly owned subsidiary of Continental Companies of Kentucky and the marketing arm for Conticoal Resource Exchange, Inc., both located in Bowling Green, Kentucky.

Pursuant to the order, the Division found Coal Revenue to have violated the following provisions of the Ohio Securities Act:

1) Coal Revenue failed to register the securities it sold in violation of 1707.44(C)(1) O.R.C.;

2) Coal Revenue sold securities without being licensed by the Ohio Division of Securities in violation of 1707.44(A) O.R.C.;

3) Coal Revenue knowingly made false representations of material and relevant facts to prospective security-holders for the purpose of selling its securities in violation of 1707.44(B)(4) O.R.C.;

4) Coal Revenue neglected to disclose material and relevant information to prospective security-holders in violation of 1707.44(G) O.R.C.

To wit, it failed to disclose that a Show Cause Order was issued against Coal Revenue on August 31, 1981.

The Division found that Coal Revenue's offer to sell a cash delayed coal sales contract constituted an "investment contract" and was therefore a security pursuant to section 1707.01(B) of the Ohio Revised Code.

STATE OF OHIO
DEPARTMENT OF COMMERCE
DIVISION OF SECURITIES
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