OHIO SECURITIES BULLETIN

RICHARD F. CELESTE, GOVERNOR | KENNETH R. COX, DIRECTOR OF COMMERCE | MARK HOLDERMAN, COMMISSIONER OF SECURITIES

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Articles

ARBITRATION OF BROKERAGE DISPUTES

Introduction

As in 1986, which saw insider trading and merger acquisition dominate as major topics of discussion, the securities industry had for 1987 a topic of major interest with the U.S. Supreme Court's decision in *Shearson/American Express v. McMahon.*[1] In *McMahon,* the Supreme Court held that investors who alleged a brokerage firm violated section 10(b) of the 1934 Securities Exchange Act (1934 Act) or the Racketeer Influenced & Corrupt Organizations Act (RICO)[2] must submit this claim to arbitration rather than to federal court, when a predispute agreement between the investor and broker-dealer provides for such a forum. Combined with the fallout from "Black Monday," this decision has turned arbitration in the securities industry into one of the hottest legal forums in the country. Until *McMahon,* however, most federal courts held that predispute arbitration clauses contained in brokerage contracts were invalid in the face of substantive investors' protection in the Securities Act of 1933 (Securities Act) and the 1934 Act. With *McMahon,* along with its predecessor, *Dean Witter Reynolds, Inc. v. Byrd,*[3] securities dealers may now be able to force their disgruntled clients into litigation.

Arbitration

Virtually all major brokerage firms require the majority of their clients to sign agreements committing the client to mandatory binding arbitration of all disputes as a precondition to engaging the broker's services. Typical of the agreements was that used in *McMahon.* Key provisions of that agreement read:

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New Stock Exchange, Inc. and/or the American Stock Exchange, Inc. as I may elect.[4]

The disparity of bargaining power between the broker and client when signing the agreement and the adequacy of the arbitration process itself have been subjects of considerable discussion since the *McMahon* decision. A focal point of these discussions has been whether industry-related self-regulatory panels provide a watered down due process procedure for investors who entered into the agreement on unequal footing and without a complete understanding of the contract. Although there is no uniformity as to the wording of an arbitration clause in brokerage contracts, most brokerage firms fails to include in their customer agreements any provision giving the customer a choice to choose the American Arbitration Association over the industry-related self-regulatory panels.

It is the contention of many that such agreements, which compel an investor to arbitrate securities claims before a panel composed of industry-affiliated decision-makers, represent an aspect of arbitration that appears to be contrary to the policy of investor protection. These critics argue that a forum composed of individuals drawn from the public would offer investors an alternative to the SRO panels that are perceived to be composed of individuals sympathetic to the securities industry.

This criticism was addressed by the American Arbitration Association which issued rules on September 4, 1987, designed to allow parties to submit to a forum not affiliated with the securities industry. These rules are of no benefit if the client knows nothing of the AAA or if the agreement specifically precludes it.

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This perception, whether or not justified, may be addressed by legislation which provides customers a contractual right to choose an arbitration panel from among all arbitration services. Even without charge of industry bias, a whole host of criticisms has been leveled at the process. Among the criticisms aimed at arbitration are the following:

(1) No need to follow administrative precedent;

(2) No need to comply with any rules of evidence or procedure;

(3) No record;

(4) No written opinion;

(5) No recording of the vote;

(6) Very limited standard of review upon appeals;

(7) No powers of subpoena;

(8) No power to enforce judgments;

(9) No power to allocate legal fees.

Pre-McMahon

In 1953, the U.S. Supreme Court first addressed the validity of a predispute arbitration agreement in the face of a claim under section 12(b) of the Securities Act in *Wilko v. Swan.*[5] In *Wilko,* the Supreme Court held that a securities investor has a right to litigate a claim under section 12(b) of the Securities Act notwithstanding any predispute arbitration agreement with the broker-dealer. The *Wilko* court recognized that the Securities Act sought to place investors on equal footing with those in the securities industry through full disclosure of material facts and provide a right to sue for misrepresentation or fraudulent practices by the securities industry to persons who were harmed by such action. Accordingly, the court declined to permit the waiver of the investors' right to a judicial forum by enforcing any predispute arbitration agreement.

In the aftermath of *Wilko,* the lower courts extended the *Wilko* ruling by attaching a privileged status to investors' claims under section 10(b) of the 1934 Act, and thereby refused to enforce predispute agreements for the removal to arbitration. As *amicus curiae* to the *Wilko* court, the S.E.C. argued against the arbitration process. Following through on *Wilko,* the S.E.C. passed Rule 15C2-2[6] which requires securities dealers to disclose that predispute arbitration provisions were nonenforceable as to all claims under all federal securities law.

McMahon

The *McMahon* decision represented the first time the Supreme Court actually addressed the issue of extending the ruling of *Wilko* to implied civil remedies. As noted in Justice Blackmun's dissent, the issue never existed until dicta in Justice White's concurring opinion in *Dean Witter Reynolds, Inc. v. Byrd*[7] engendered a split in the circuit courts that had previously unanimously extended *Wilko* to 1934 Act claims.

The *McMahon* court, however, ruled that *Wilko* could be differentiated by distinguishing the underlying policies of the Securities Act and the 1934 Act. Writing for the majority, Justice O'Connor noted that the Federal Arbitration Act[8] mandated enforcement of arbitration agreements. Only express congressional command to the contrary could overrule that Act. Thus, the express civil remedies of the Securities Act are nonarbitrable, but implied remedies under the 1934 Act do not carry the same congressional imprimatur.

Though not expressly overruling it, the *McMahon* decision has caused courts to reassess the validity of *Wilko.* Two early decisions have held that *Wilko* was not overruled by *McMahon.* The Second Circuit Court of Appeals held in *Chang v. Lin*[9] that although the U.S. Supreme Court questioned the reasoning behind the *Wilko* decision, it nevertheless did not overrule *Wilko* and, therefore, the *Wilko* rule precedent controls for Securities Act cases. The U.S. District Court for Middle Georgia[10] also restricted the impact of *McMahon* by holding that congressional intent to make nonarbitrable claims under section 12(b) of the Securities Act is clearer than it was for claims arising under the implied civil remedies of the 1934 Act.

At odds with *Chang v. Lin* is the decision of the U.S. District Court for Central California in the case of *Staiman v. Merrill Lynch Pierce Fenner and Smith, Inc.,*[11] In *Staiman,* Judge Ronald Lew ruled that the reasons given in *Wilko* for holding claims under the Securities Act to be nonarbitrable were rejected in *McMahon.* Thus, a predispute arbitration agreement was held to be valid even in the face of an investor's claim under section 12(b) of the Securities Act.

Response of the S.E.C.

Historically, the S.E.C. has consistently opposed mandatory binding arbitration and wrote an influential brief as *amicus curiae* to the *Wilko* court. The S.E.C. reversed itself in 1987 and took an *amicus* position in favor of arbitration before the *McMahon* court. The endorsement of arbitration by the S.E.C. may have been the most important single factor deciding *McMahon.*

The *McMahon* decision has prompted the S.E.C. to reconsider Rule 15C2-2, which conflicts with the court's ruling and with the Commission's new position that such predispute claims should be enforced. The Commission promulgated Rule 15C2-2 in response to *Wilko* and the lower court's extension of the *Wilko* ruling to require securities dealers to disclose that such predispute contract provisions were nonenforceable as to claims under federal securities law given the then-existing case law. However, given the *McMahon* ruling, the S.E.C. has reasoned that Rule 15C2-2 was no longer valid or appropriate and, therefore, rescinded it on October 21, 1987.[12]

The S.E.C. also issued a letter to the Securities Industry Conference on Arbitration (SICA) recommending changes in the SRO arbitration procedures but supporting its position that S.E.C. oversight authority over SRO procedures has expanded since *Wilko* and should enable the S.E.C. to ensure the adequacy of arbitration as an alternative to litigation.

Impact upon State Law

It remains to be seen whether the *McMahon* decision will have any impact upon the ability of an Ohio investor to select a judicial forum in a suit under Revised Code section 1707.43, notwithstanding a predispute arbitration agreement. Substantially similar to the Federal Arbitration Act, the Ohio Arbitration Act has been consistently construed in a manner favoring the arbitration of disputes. However, the Ohio Arbitration Act provides that arbitration agreements are valid "save upon grounds as exist at law or equity for the revocation of any contract." (O.R.C. 2711.01). Because the Ohio Securities Act provides rescission as the sole remedy for a claim under section 1707.43 of the Ohio Securities Act, it would seem that section 2711.01 would bar the application of an arbitration agreement to such a claim. The application of such an agreement to other actions under the Ohio Securities Act and other derivative state law claims would be subject to an analysis equivalent to that in *Chang v. Lin.*

C. Crognale

[1] 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987).

[2] 18 U.S.C. § 1961-68 (1982).

[3] 470 U.S. 213 (1985).

[4] 107 S.Ct. at 2335.

[5] 346 U.S. 427 (1953).

[6] 17 CFR 240, 15C2-2, Rel. No. 34-20397 (1983).

[7] 470 U.S. 213, 244 (1985).

[8] 9 U.S.C. § 1 *et seq.*

[9] 824 F.2d. 219 (2d Cir. July, 1987).

[10] *Schultz v. Robinson-Humphrey/American Express, Inc.*, CA 85-1115-1-MAC, (D.C. M.Ga., August, 1984).

[11] No. CV-87-1057, RSWL (July 6, 1987).

[12] Rel. No. 34-25034, 52 FR 39216.

MERGERS AND REORGANIZATIONS UNDER THE OHIO SECURITIES ACT

The Division of Securities receives daily requests for information concerning the application of the Ohio Securities Act to statutory mergers and reorganizations. Because internal corporate reorganizations take so many forms, application of seemingly specific provisions of the Act to new or unusual transactions can often raise questions in the minds of cautious counsel.

The purpose of this article is to outline the various relevant provisions of the Ohio Securities Act and to allay certain fears of counsel when applying the unusually broad exemptions available.

Basic provisions

Revised Code Chapter 1707 requires the registration of all securities sold in Ohio. While this is not the place to delve deeply into the definition of a "security" or "sale," suffice it to say that there is a sale of a security whenever any person's interest in an association is exchanged or redefined, unless that person is receiving nothing but cash for his security. Thus, statutory mergers and reorganizations, such as those found in Revised Code sections 1701.75 *et seq.* and 1707.01(Q), (R), and (S) are subject to the provisions of the Ohio Securities Act. Naturally, similar transactions in noncorporate business associations are also subject to the Act.

Luckily for the securities practitioner (and the securities staff) several of the numerous exemptions from the Act are specifically applicable to mergers and reorganizations, and many of the more general exemptions can be applied also. Among the general exemptions that have been found frequently applicable are: the "bank" exemptions §§1707.02(C) and .03(J); the small offering exemptions, §§1707.03(O), (Q), (W) and .06; and the executor-type exemptions, §§1707.03(C), (E), and (F).

The specific reorganization provisions of the Act are found in §§1707.03(K), .03(U), and .04. The exemptive provisions found in section 3 require no filing and coordinate with dealer licensing exemptions found in section 14(B). Takeover provisions are found in § 1707.041.

Exchanges or Distributions by the Issuer: § 1707.03(K)

The exemptions found in sections 3(K)(1) and (2) of the Act apply to share dividends, other internal exchanges, and spin-offs of wholly owned subsidiaries exclusively to its existing security holders. These transactions can almost be said to be nonsales because the shareholder may have little discretion in the transaction, because his status is likely to be changed very little, and because there is no intervening party in the "internal transaction." Share dividends and spin-offs have no effect upon shareholder interests provided that the transactions are exclusively among the shareholders themselves. The intent of the drafters of the predecessor to 3(K) was to exempt many of the common "internal affairs" of the typical corporation. (1:42 OBAR 43 (1929)).

In 1984, amendments to this exemption added "exchange or distribution . . . of the securities of any of the issuer's wholly owned securities exclusively with or to its existing security holders . . .." This provision is fairly specific, narrow, and straightforward, with one exception. In circumstances in which the issuer can be deemed to be engaged in the transaction as an underwriter, the exemption would be inapplicable. The tests for defining an underwriter are found in common law. Absent this limitation, it is conceivable that one might argue that many investment bankers could easily contrive to fall within this exemption unless common law standards are applied to give the statute the plain meaning for which it was written.

Fairness Hearings: § 1707.04

Section 4 of the Ohio Securities Act provides for an optional hearing upon the fairness of the terms of a merger. The provisions are typically invoked by management attempting to secure an exemption from federal registration. On rare occasions, disgruntled shareholders request such a hearing. The procedure for a hearing pursuant to section 4 is not specifically codified in Division rules or guidelines, but the parameters of such a hearing can be established with reference to the Ohio Administrative Procedure Act, Revised Code Chapter 119, upon consultation with the Division.

Mergers and Reorganizations: § 1707.03(U)

The merger exemption found in section 3(U) of the Ohio Securities Act is exceedingly broad and is intended to include almost any kind of reorganization. Without reprinting the exemption in full, suffice it to say that the original exemption was intended to cover almost any kind of internal transaction imaginable.

The exemption is not free, however, because it requires either: (a) federal registration, or (b) disclosure "substantially equivalent" to federal proxy materials submitted to the security holders twenty days prior to the execution of the corporate action.

Although the exemption was drafted with a broad brush, numerous questions arise concerning specific language in the exemption. These questions are most easily disposed of in a question and answer format.

Q: Does this exemption apply to reorganizations of business associations other than corporations?

A: Yes. 3(U) discusses sales with regard to the security holders of a "person." Although students of business associations know that partnerships, limited partnerships, and some other associations are not "persons" under the law, the remainder of the first sentence of 3(U) expressly includes such things as a "partnership agreement, declaration of trust, trust indenture, or similar controlling instrument." Thus, it is clear that these types of associations were intended to be included within the ambit of the exemption. This view is strengthened by the definition of "person" found in section 1707.01(D) which includes a number of associations without the status of a person at law. In light of the express application of certain provisions of the Act to certain explicit business associations, for the purpose of this exemption, these enumerations should be viewed expansively.

Q: The statute discusses sales "so far as the security holders . . . are concerned." What does this mean?

A: The statute means "sales to" the security holders by the person whose securities they hold. In a merger context, this would mean that the securities of the acquiring corporation being issued to shareholders of the dissolving corporation would be exempt because they are distributed to those shareholders pursuant to the controlling instrument of the dissolving corporation. However, an exchange offer is not included within the ambit of 3(U) because it is not made pursuant to the controlling instrument of the offerees' corporation.

Q: The first sentence of 3(U) requires a shareholder vote or consent. Does this mean that corporations must register short form mergers?

A: The first portion of 3(U) seems to be in direct contradiction with the language of 3(U)(b) which includes transactions ". . . on which corporate action may be taken when no meeting is held . . .." While a meeting is not always necessary for shareholder consent, it would seem strange that the type of transaction in which no meeting was considered necessary would not be entitled to the exemption while those transactions which the legislature felt required the protection of a shareholder vote did not register. Maybe the legislature felt that registration was necessary for those transactions not subject to the protection offered by a vote.

In the absence of legislative history, it would seem more likely that the intent of the 3(U) provision was to codify into Ohio law the sorts of considerations expressed at federal law by the Supreme Court in the case of Santa Fe v. Green, 430 U.S. 462 (1977). Specifically, courts will be less ready to extend the ambit of the securities laws to those transactions subject to protection by the state regulation of internal affairs. While it is true that Blue Sky laws are far broader in scope than federal disclosure laws, it would seem that subject to the same rationale set forth at federal law, these conflicting provisions should be resolved in favor of extending the exemption to short form mergers, and relying upon the protections of disclosure and state business association laws.

C. Kahrl

Registration

RE-REGISTRATIONS OF LIMITED PARTNERSHIPS

Because Ohio has no statutory renewal provisions, requests for extensions of a registration period are deemed re-registrations. No provision in the Ohio Securities Act precludes the Division from denying re-registrations requests. Stated Ohio policy applies extended shelf registrations only to debt offerings on registration form S-3. (1982:2 Ohio Sec. Bull. 5; 1982:3 Ohio Sec. Bull. 13).

Due to the number of inquiries in recent months, the Division would like to reiterate that Ohio does allow the registration of nonspecified limited partnership programs. The predominant limited partnership programs are real estate, the reviews of which are subject to all sections of the NASAA Real Estate Guidelines adopted by Ohio. These Guidelines are applied by analogy in the review of other limited partnership programs that are without specific NASAA parameters. (1986:3 Ohio Sec. Bull. 18).

The NASAA Real Estate Guidelines provide for a one-year period of effectiveness for nonspecified programs. (NASAA Real Estate Guidelines, VI(D), eff. 1/1/87, NASAA Rpts (CCH) at 1901).

In recent months, the Division has re-evaluated its position regarding re-registration requests in connection with section VI(D) of the Guidelines. Current policy permits re-registrations of the original effective period under certain conditions. The proceeds must still be invested however, within twenty-four months of the original effective date.

Two sets of circumstances allow for re-registration of a nonspecified program in Ohio.

First, in a minimum/maximum offering, the subscriber's proceeds are held in a proceeds escrow until such time as the minimum subscription requirement is met. At that point, the sponsor may break the proceeds out of escrow and use the money. The maximum length of time during which the escrow may extend in Ohio is one year.

Ohio has taken the position that re-registration is available for those offerings that fail to reach minimum subscription requirements within the one-year period. As a condition to re-registration, the sponsor of the program must submit to the Division proof of an offer of rescission to the original subscribers.

Once this rescission offer has been made and proof thereof accompanies a request to the Division for a re-registration, the effective period of the offering in Ohio may be extended.

If the Division receives a request for re-registration and the sponsor has met the minimum subscription requirements, the Division then focuses on the second set of circumstances for which re-registration may be granted.

Among the risks associated with nonspecified programs or blind pools is the inability to make an adequate evaluation of the target investment. This inability is the primary basis for precluding registration of non-limited partnership blind pools and limiting the selling period of nonspecified limited partnership programs. It is also the basis on which Ohio makes its determination permitting re-registration.

If at the time of re-registration, the sponsor can show that 75% of the net proceeds of the total offering amount including the green shoe is committed or specifically allocated, re-registration may be granted.

A nonspecified limited partnership program that cannot specifically allocate 75% of the net proceeds of the total offering or total program amount cannot re-register in Ohio pursuant to NASAA Guideline Section VI(D).

The Ohio Division of Securities applies the commodity pool guidelines of the North American Securities Administrators Association to all registrations by qualification or coordination of commodity pool programs.

D.D. Joyce

Enforcement

NULL AND VOID ACTIONS

Ohio Administrative Code Rule 1301:6-3-03(A)(2) describes the administrative procedure the Division must follow in order to declare null and void a claim of exemption filed pursuant to Ohio Revised Code Sections 1707.03(O) or 1707.03(Q) (hereinafter "3-O" and "3-Q"). Generally, the basis for a null and void action occurs when the Division determines that the conditions necessary to perfect the 3-O or 3-Q exemption were not satisfied at the time of filing for the exemption. This determination is made subsequent to the filing of the exemption form which, on its face, purported to satisfy the statutory requirements. The null and void procedure is often initiated when a Division examination of the books and records of the issuer reveals either of the following defects:

(1) The facts reported on the Form 3-O or Form 3-Q did not exist at the time that the exemption form was filed with the Division.

(2) Facts existing at the time of the filing of the Form 3-O or Form 3-Q which would have made the claim of exemption impossible were not reported on the claim of exemption form.

The most common basis for a null and void action occurs when the claimant of a 3-O or 3-Q exemption did not comply with Ohio Revised Code sections 1707.03(O)(7) or 1707.03(Q)(4) when the exemption form was filed. Both sections require the claimant to file the appropriate exemption form no more than sixty days after the date of sale of the securities for which the exemption is claimed. If a Division examination of the claimant's books and records subsequently reveals that the dates of sales were incorrectly reported on Forms 3-O or 3-Q, in that the dates of sales occurred more than sixty days before the filing, the null and void procedure will be initiated.

A null and void action may cause the Division to institute further administrative action in the form of a Notice to Show Cause alleging violations of Ohio Revised Code sections 1707.44(A), 1707.44(B)(4), and 14707.44(C)(1) (hereinafter "44(A)," "44(B)(4)," and "44(C)(1)"). Section 44(A) violations result from null and void actions because many claimants of the 3-O or 3-Q exemption do not have a securities license and have relied upon the exception from licensure provided by section 1707.14(B)(1). One of the conditions of this licensure exception is that the claimant sell only securities which are the subject matter of a 3-O or 3-Q exemption. If the Division determines that the 3-O or 3-Q claim of exemption is null and void and of no effect when made, then the claimant will have no claim to such licensing exception. Absent any other licensing exception, the claimant may be in violation of section 44(A).

Likewise, unregistered sales violations under section 44(C)(1) result from null and void actions because a null and void action deems the 3-O or 3-Q claim of exemption from registration of no effect when made. Therefore, the claimant sold securities without an exemption from registration. If the Division finds that these sales were not otherwise exempt, and not registered, a violation of section 44(C)(1) has occurred.

Finally, a violation of section 44(B)(4) may be alleged by the Division within the context of a null and void action, when a 3-O or 3-Q filing contains material misrepresentations.

If the Division decides that a 3-O or 3-Q claim of exemption should be declared null and void and of no effect when made, the Division will issue a Notice to the claimant. Such Notice will include allegations pertaining to the null and void action and may also include allegations of the previously mentioned violations of 44(A), 44(B)(4), and 44(C)(1). According to the provisions of Ohio Revised Code Chapter 119 and the provisions of Ohio Administrative Rule 1301:6-3-03(A)(2), the Notice will afford the claimant an opportunity to appear at a hearing to offer proof that the exemption was properly claimed and to show cause why a Cease and Desist Order should not be issued.

The claimant's burden of proof at such hearing is to offer "satisfactory proof" to the Division that the claimant was entitled to the exemption. In the absence of satisfactory proof, the Division's response is clearly set forth in Rule 1301:6-3-03(A)(2), which provides that the Division shall make a finding that the facts necessary for claiming such exemption did not exist at the time such exemption was claimed and that the claim of exemption was null and void and of no effect when made.

D. Malkoff

CRIMINAL CASES

Ralph Lee; William Baer

On July 15, 1987, Ralph Lee of Columbus and William Baer of Lancaster were indicted in Licking County on four counts each for the sale of unregistered securities in violation of Ohio Revised Code Section 1707.44(C)(1) and for selling securities without a license in violation of Ohio Revised Code Section 1707.44(A). Lee and Baer had sold promissory notes totalling $19,000.00 to a Newark, Ohio couple. The notes were purportedly payable by Group III Marketing, Inc., an advertising company of which Lee was President and Baer was Secretary-Treasurer. The investors complained to the Division after interest payments on the notes became past due, and conflicting explanations were provided by the company.

This case was investigated and referred to the Licking County Prosecutor by Norman Essey.

Gary C. Davies

On October 26, 1987, Gary C. Davies was indicted in Seneca County on four counts of theft by deception. Davies sold shares of stock in a phony mutual fund known as The Mezzanine Fund, Inc. to four residents of Tiffin, Ohio. Invested funds totalled approximately $35,000.00. Davies, who lived for a period of time in Columbus and central Ohio, subsequently relocated to Texas. Pursuant to the indictment, Davies was arrested in Texas in November and is expected to be brought to Ohio for trial.

Seneca County Assistant Prosecuting Attorney Paul Kutscher was assisted in his investigation of this matter by Norman Essey of the Division staff.

Robert D. Westfall

On November 6, 1987, Robert D. Westfall entered a guilty plea to one count of selling securities without a license and to two counts of selling unregistered and unexempted securities in Ottawa County. Mr. Westfall sold non-existent industrial revenue bonds to Ohio residents.

This case was investigated and referred for criminal proceedings by Corey V. Crognale.

James Kevin Brown; Charles Walden; Gem City Life Holding Company

On November 10, 1987, James Kevin Brown and Charles Walden, company promoters for Gem City Life Holding Company, were each sentenced in Montgomery County to one year in prison on each of four counts, to be served concurrently. Both men pled guilty to counts of selling unregistered securities, selling securities without a license, securities fraud, and grand theft on October 13, 1987. Imprisonment was suspended and both men were placed on probation for five years and ordered to pay restitution.

Walden and Brown formed Gem City Life Holding Company and sold stock to approximately 300 Montgomery County residents. The proceeds from the sale of the securities were to be held in escrow until such time as the insurance company was to formed, however, the funds were misappropriated. This case was investigated by former Acting Commissioner Phillip Lehmkuhl and former staff attorney Tina K. Manning.

Richard S. Shepard; Republic Oil Company

On November 12, 1987, Richard S. Shepard, former CEO and Director of Republic Oil Company, entered a plea of guilty in Franklin County Court of Common Pleas to three counts of violations of Ohio Revised Code Section 1707.44(B)(4). The plea was a result of a Division investigation which revealed several misrepresentations made in connection with the sale of Republic Oil Company common stock, Republic Owensville, Ltd. limited partnership interests, and Republic Karl Road, Ltd. limited partnership interests. A date has not been set for sentencing at this time.

This matter was investigated and referred by staff attorney Daniel Malkoff.

ADMINISTRATIVE ORDERS

The Heritage Company, formerly known as Pennington and Scott Enterprises; Barry H. Katz; Jack Matson

On August 20, 1987, a Cease and Desist Order was issued against The Heritage Company, formerly known as Pennington and Scott Enterprises, of Davie, Florida. The Division found that representatives of the Heritage Company and Pennington and Scott made unsolicited telephone calls to Ohio residents while they were unlicensed to sell securities and sold unregistered oil and gas partnership interests in three separate partnerships. The Division also found that false and misleading representations were made to investors. Ohio Revised Code Sections 1707.44(A), 1707.44(B), 1707.44(C)(1), and 1707.44(G) were violated.

Family Resorts of America dba Mohican Run Resort; Butch McKinley

On September 14, 1987, a Cease and Desist Order was issued against Family Resorts of America dba Mohican Run Resort and Butch McKinley, project director, of Loudonville, Ohio.

The Division found that Family Resorts of America was operating a campground, known as Mohican Run Resort, which gave prospective purchasers unregistered certificates of beneficial interest (bond certificates) while they were unlicensed to sell securities, in violation of Ohio Revised Code Sections 1707.44(A) and 1707.44(C)(1).

Cape Cod Inn, Ltd.; Fran-Ber, Inc; Barry Kessler; Fran Plum

On September 24, 1987, a Cease and Desist Order was issued against Cape Cod Inn, Ltd., its general partner, Fran-Ber, Inc., and its sole shareholders, officers, and directors, Barry Kessler and Fran Plum of Columbus, Ohio. The Division found that unregistered limited partnership units were sold and that the private offering memorandum omitted material and relevant facts, in violation of Ohio Revised Code Sections 1707.44(C) and 1707.44(G).

The Division also found that a Form 3-Q, Report of Sale of Securities, filed with the Division on behalf of Cape Code Inn, Ltd., was not a valid claim of exemption as the form was not filed within sixty days of all dates of sale as reported. On September 24, 1987, the Division declared Null and Void the Form 3-Q, File Number 331969, filed on behalf of Cape Code Inn, Ltd.

Donald E. Bradford; Patricia A. Maloney; White Pine Limited Partnership; Cyber Soft, Inc.

On October 14, 1987, a Cease and Desist Order was issued against Donald E. Bradford of Newport, Kentucky, Patricia A. Maloney of Cincinnati, Ohio, White Pine Limited Partnership of Cincinnati, Ohio, and Cyber Soft, Inc. of Newport, Kentucky. The Division found that unregistered units of White Pine Limited Partnership and common stock of Cyber Soft, Inc. were sold by unlicensed securities salespeople and false representations were made to investors, in violation of Ohio Revised Code sections 1707.44(A), 1707.44(B), 1707.44(C), and 1707.44(G).

Sports Enterprises, Inc,; John H. Davis

On October 23, 1987, a Cease and Desist Order was issued against Sports Enterprises, Inc. of Munroe Falls, Ohio, and John H. Davis of Cuyahoga Falls, Ohio. The Division found that Sports Enterprises, Inc. and its president, John H. Davis sold or caused to be sold unregistered shares of common stock while they were unlicensed to sell securities, in violation of Ohio Revised Code Section 1707.44(A) and 1707.44(C)(1).

Kenneth Wilmouth; Jeanette Spaller; Gordon Jay Alexander; Maurice Wilbert; Robert Nichols; Geraldene Wheeler; James L. Shipley; Robert Cummins; Nadean Piciacchia; Steven Wijnberg; Victoria Wijnberg; Donnie Roberts

On October 23, 1987, a Cease and Desist Order was issued against Kenneth Wilmouth, Jeanette Spaller, Gordon Jay Alexander, Maurice Wilbert, Robert Nichols, Geraldene Wheeler, James. L. Shipley, Robert Cummins, Nadean Piciacchia, Steven Wijnberg, Victoria Wijnberg, and Donnie Roberts, all of Ohio. The Division found that all of these individuals were employed by Sports Enterprises, Inc. as marketing representatives/vice-presidents or other officers and sold unregistered shares of Sports Enterprises while they were unlicensed to sell securities, in violation of Ohio Revised Code Sections 1707.44(A) and 1707.44(C)(1).

Petroleum Research Corporation; Arizona Petroleum Research Corporation

On November 3, 1987, a Cease and Desist Order was issued against Petroleum Research Corporation of Las Vegas, Nevada, and Arizona Petroleum Research Corporation of Phoenix, Arizona. The Division found that Petroleum Research Corporation and Arizona Petroleum Research Corporation sold unregistered partial assignments of forty (40) acre parcels of federal oil and gas leases, were unlicensed to sell securities, and failed to disclose material facts. These facts included: (1) Many of the leases they offered and assigned were noncompetitive leases that were not located within any known geological structure of a producing oil and gas field; (2) Many of the leases they offered and sold were originally made available to the public by a random drawing or lottery administered by the Bureau of Land Management for a minimal application fee; and (3) There was no history since at least 1983 of any investor reassigning (selling) his partial assignments of oil and gas leases for profit, let alone reassignments to an oil and gas company, however, the investors were led to believe they could expect a profit in a short period of time by reassigning their leases. Ohio Revised Code Sections 1707.44(A), 1707.44(B)(4), and 1707.44(C)(1) were found to have been violated.

Lake West Towers, Ltd.; Wayne F. Lang and Daniel S. Tyler, General Partners

On October 30, 1987, a Cease and Desist Order was issued against Lake West Towers, Ltd. and its General Partners, Wayne F. Lang and Daniel S. Tyler, of North Royalton, Ohio. The Division found that the General Partners made personal loans totalling approximately $184,053.00 during the thirteen (13) month period of effectiveness of the registration by qualification filed on behalf of Lake West Towers, Ltd. Additional loans totalling approximately $48,300.00 were made during the same time period to companies and/or partnerships controlled by the General Partners.

The Division also found that the General Partners purchased remaining limited partnership units of the offering but tendered no cash, contrary to the offering circular. The Division was informed that a promissory note had been issued for these units; however, it was not made available to the Division. In addition, the Division found that the General Partners sold unregistered securities when they resold the remaining units of the offering that they purchased, after the thirteen (13) month period of effectiveness expired. Finally, the Division found that during the period of effectiveness, the offering was extended beyond the termination date reported to the Division, causing the information reported in the offering circular to be false. Ohio Revised Code Sections 1707.44(B)(2), 1707.44(B)(4), 1707.44(C)(1) and Ohio Administrative Code Rule 1301:6-3-09(D)(5) were found to have been violated.

Remedial Corporation

On November 5, 1987, a Cease and Desist Order was issued against Remedial Corporation of Mansfield, Ohio. The Division found that false dates of sale were reported on two Form 3-O filings filed with the Division on behalf of Remedial Corporation. Ohio Administrative Code Rule 1301:6-3-03(K) determines the date of sale to be the date the purchaser transfers or loses control of the purchase funds. O iio Revised Code Sections 1707.44(A), 1707.44(B)(4), and 1707.44(C)(1) were found to have been violated.

The Division declared Null and Void the two Form 3-O filings filed with the Division on behalf of Remedial Corporation, File Number 337519 and Number 351408, which reported false dates of sale.

Anlo Financial Corporation

On November 10, 1987, the Division revoked the Ohio broker-dealer license of Anlo Financial Corporation of Shreveport, Louisiana. The Division found that Anlo Financial Corporation failed to timely file its annual audited financial statement, as required by Ohio Administrative Code Rule 1301:6-3-15(I)(1).

Joe Schaefer III

On November 30, 1987, a final Order was issued suspending the right of Joe Schaefer III, Columbus, Ohio to sell securities in Ohio pursuant to a mailing in which he promised to double any amount invested at the end of a 90-day period from the date of investment as long as he received $1,000.00 from 100 people in 30 days. Said securities were sold in violation of Ohio Revised Code Sections 1707.44(A) and 1707.44(C)(1).

AEI Group, Inc.; Meridian Reserve, Inc.

On July 16, 1987, a Cease and Desist Order was issued against AEI Group, Inc. and Meridian Reserve, Inc. The Division found that AEI Group, Inc. and Meridian Reserve, Inc. violated Sections 1707.44(B)(4), 1707.44(G), and 1707.44(J) of the Ohio Revised Code. The Division found that salesmen of AEI Group, Inc., an Ohio licensed broker-dealer, sent information pertaining to Meridian Reserve, Inc. to potential investors which contained false representations and omissions of material and relevant fact, including outdated financial information. Meridian Reserve, Inc. and AEI Group, Inc. appealed the Order in Franklin County Court of Common Pleas on July 17, 1987. An Order to Stay the Cease and Desist Order was granted by the court on July 21, 1987.

Farson and Associates, Inc., dba Advantage Optical; Mark T. Farson

On August 20, 1987, the Division issued a Cease and Desist Order for violations of Ohio Revised Code Sections 1707.44(B)(4) and 1707.44(G) against Farson and Associates, Inc., dba Advantage Optical, and Mark T. Farson. Farson, of Mogadore, Ohio sold $28,000.000 worth of stock in his optical business to an Akron, Ohio resident. The Division found that Farson made material misrepresentations and omissions of facts in the sale of the stock, and that his conduct operated as a fraud upon the purchaser. Specifically, Farson made misstatements as to the number of shareholders in the company and the price they paid for their shares. He also failed to disclose that the company had an outstanding business debt in excess of $14,000.00 and that a portion of the Akron resident's invested funds would be applied to pay that debt.

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