OHIO SECURITIES BULLETIN

A QUARTERLY PUBLICATION OF THE OHIO DIVISION OF SECURITIES

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A Decade of Scams: Investors Victimized by Greed and Lack of Knowledge Among Securities Sellers

In reviewing the past dozen years of the life of the Division, one thing becomes apparent. There is always an endless stream of dubious investment vehicles designed by unscrupulous or uninformed sellers to separate the unsuspecting public from their money. These investment products range from legitimate instruments that are unsuitable to all but the narrowest slice of the investing public to those that are out-right scams. The Division's mission is outlined in Ohio's Blue Sky laws, Chapter 1707 of the Ohio Revised Code—so named because in the old pre-regulation days, securities sellers would sell anything to the investing public, including a piece of the blue sky. In reviewing some of the problematic investment trends below, the blue sky may not seem like such a bad investment by comparison.

The Penny Stock Craze

The early nineties were a time of financial turmoil for many people. The country was just emerging from a recession, and people were looking for novel ways to invest money. A new type of investor was emerging: the small investor, who had little, if any, investment experience, and limited resources for investment. Their participation was encouraged by intrastate brokers, who were not members of the National Association of Securities Dealers (NASD) and who were making markets for securities sold by small, start-up companies. Naturally, these companies provided risky investment opportunities. However, many small investors who bought the cheap stock were not apprised of the risk their purchases carried, and many Ohioans lost millions of dollars.

Some major players in the penny stock trade during the heyday of these securities were Dublin Securities, Inc., Worthington Securities, Inc. and Columbus Skyline Securities, Inc. The Division took enforcement actions against all these entities, some of which

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eventually led to civil court cases that helped shape the legal framework within which the Division operates to this day.

One of the most important cases was *In re Columbus Skyline Securities*, 74 Ohio St. 3d 495 (1996). This case is notable in that it upheld the constitutionality of applying federal standards to determine fraudulent conduct under Chapter 1707. The Division had revoked Columbus Skyline Securities, Inc.'s ("Skyline") Ohio Securities Dealer License for fraudulent conduct in the form of continued sale of securities at a price that was set at 300 percent to 567 percent above what was then the standard markup. To buttress its allegation that Skyline was selling securities at an unreasonable markup, the Division used formulas that had been set forth in case law that originated from Securities and Exchange Commission (SEC) actions. Skyline appealed the Division's action to the Franklin County Court of Common Pleas, which considered the SEC case law, as well as a five percent mark-up guideline devised by the NASD. That court concluded that even though Skyline was not a member of the NASD, it's mark-up was so divergent from the industry standard that it should have noticed it would be challenged for such a high mark-up. (See *Columbus Skyline Securities, Inc. v. Mark V. Holderman as Commissioner of Securities,* No. 92 CVF9-7516 (Franklin Cty. C.P. April 28, 1993) for opinion). Skyline appealed this decision to the Court of Appeals, where it prevailed. The Division in turn appealed the matter to the Ohio Supreme Court, which upheld the use of extraneous standards. So, this case cemented the Division's use of extraneous standards to support actions it brings based on the Ohio Securities Act.

Another case involved Dublin Securities, Inc. This case is notable because it clarified R.C. 1707.12, which deals with disclosure of Division records to the public. In *State ex rel Dublin Securities, Inc. v. Ohio Division of Securities,* 68 Ohio St. 3d 426 (1994), the Ohio Supreme Court held that R.C. 1707.12 governed the disclosure of Division records to the public, and that the general public records statute, R.C. 149.43, did not apply to documents in the Division's possession. The case originated when Dublin Securities, Inc. ("Dublin") requested copies of investor complaints during the Division's investigation of the broker-dealer. The Division relied on R.C. 1707.12(C) to deny Dublin the information it was seeking. That section denies the party requesting the documents access to the same if the records are confidential law enforcement investigatory records or trial preparation records. Dublin argued that, as a target of a Division investigation, it was entitled to the records as it had a "direct economic interest in the information," in which case it would be allowed access to the records under R.C. 1707.12(B). The Court rejected Dublin's argument, stating that the General Assembly meant for the provision to apply to Ohio consumers, not necessarily the target of an investigation. As it

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The *Ohio Securities Bulletin* is a quarterly publication of the Ohio Department of Commerce, Division of Securities. The primary purpose of the *Bulletin* is to (i) provide commentary on timely or timeless issues pertaining to securities law and regulation in Ohio, (ii) provide legislative updates, (iii) report the activities of the enforcement section, (iv) set forth registration and licensing statistics and (v) provide public notice of various proceedings.

The Division encourages members of the securities community to submit for publication articles on timely or timeless issues pertaining to securities law and regulation in Ohio. If you are interested in submitting an article, contact the Editor for editorial guidelines and publication deadlines. The Division reserves the right to edit articles submitted for publication.

Ohio Division of Securities

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reached this conclusion, the Court did not consider whether the records in dispute were confidential law enforcement records or trial preparation records. This case has been valuable in giving the Division guidance regarding what records are subject to public inspection and what must remain off-limits.

The Derivatives Scandal

The penny-stock craze having run its course by the mid-nineties, a new money-sucking villain rose on the horizon. The new money trap *dujour* was derivatives, and the troubles they wrought affected a wider swath of the public than did the penny-stock problem. For this investment scheme was not aimed at individuals, but at public-sector institutional investors. Derivatives were instruments whose value was derived from another financial instrument or asset. Most of the derivatives that were sold by companies targeted for Division action were mortgage-backed securities that were tied to interest rates. The value of these derivatives was dependant upon fluctuations in interest rates. These investments could be potentially lucrative for the public entities that purchased them to cushion their sagging treasuries. However, if interest rates moved away from the direction favorable to their value, these instruments could create havoc.

There were several brokers who specialized in selling these securities, including Hart Securities, Inc. and Government Securities Corporation (GSC). The Division revoked the licenses of both brokers in 1995. Hart Securities, Inc. lost its license because it failed to meet minimum capital requirements set forth in the Ohio Administrative Code. The Division revoked GSC's license because it failed to supervise a salesman who sold derivatives to several public entities in Ohio. The salesman failed to ascertain the suitability of these investments for public treasuries, and made material misrepresentations and omissions regarding derivatives to the managers of these funds.

The end result of these companies' sales tactics, as well as those of other brokers who sold these investments to public sector treasuries all over the country, was that many government entities ended up broke, and had to cut back on services or raise taxes to make up the loss of funds. So, in the end, though these securities were sold to institutional investors, their downside was still felt by the same small investor who might have been victimized by penny stocks, or any other of the dubious investments under discussion in this article.

Promissory Notes/ Unpromising Investments

By the end of the nineties, the investing public was becoming savvier. However, this new sophistication was not sufficient to protect investors from the Next Big Thing in chancy investments: promissory notes. Promissory notes were a huge problem beginning in about 1997. Issuing companies recruited marketing agents, mostly in the insurance industry, who, in turn, recruited local agents. The agents steered their clients away from traditional "safe" insurance products, such as annuities, so that they could invest in the notes. Investment advisers and securities salespersons also promoted note sales.

Promissory notes became a nationwide investment scandal, winning much media attention. Newspapers ran stories of elderly people working at minimum wage jobs because they had sunk all their retirement savings into promissory notes that they thought were insured. Almost all purchasers were told their principal contributions would be insured by bonding companies. Most of the issuing companies were risky, start-up ventures, so investors were reassured when they were given certificates showing their investments were guaranteed. They did not know, however, that these bonding companies were, for the most part, phantom offshore outfits that could not cover companies' inability to pay investors.

The Division took action against many individuals and entities involved in marketing and selling promissory notes. The Division issued orders against companies such as Worldvision Entertainment, Inc., South Mountain Resort and Spa, Inc. and Tee to Green Golf Parks, Inc. The Division also suspended or revoked many securities salesperson licenses, including that of Andrew P. Bodnar, who faced a final suspension in 1998.

Trends for New Times

There are always new money traps awaiting the investing public. Since 2000, there has not been any one major trend in dubious investment vehicles on the scale of what is outlined above from previous years. However, there are a number of new investment vehicles that would be deemed "investment contracts" under the Chapter 1707 definition of what constitutes a security. These include viatical settlements (which were expressly included in the definition of what constitutes a security when R.C. 1707.01, the definitional section of Chapter 1707, was amended in 2001), income stream plans deriving from payphones and ATM machines, as well as internet booths. Companies selling contracts for these plans generally attempt to characterize them as business opportunities or franchises, which are more loosely regulated than securities. In determining whether an income-producing vehicle is a security, the Division looks to the entire character of the agreement or transaction and whether it meets the requirements of an investment contract as set forth in case law such as *State v. George,* 50 Ohio App. 2d 297 (1975). (For a more detailed discussion of investment contracts, see OSB Issue 2003:4).

Not all of the investment vehicles outlined above are inherently fraudulent. Too often, however, issuers and sellers, in their zeal to make money off the investing public, do not adhere to the Blue Sky laws. These laws were meant to protect the investors so that the integrity and health of the securities industry is maintained. When they are ignored, the results to any investor are usually disastrous. The Division aims to ensure that the blue skies don't fall and hit investors where it hurts.

Anti-Fraud Dilemma: Defining Materiality

Gary P. Kreider[1]

Materiality is one of the more important and oft-used concepts in interpreting the requirements of the federal securities laws. Yet the term has never been definitively defined by the administrator of those laws, the Securities and Exchange Commission. This is as it should be in the eyes of this commentator.

Nevertheless, the clamor for certainty through an SEC administrative definition of the term "material" never ceases. Though the Grand Inquisitor may have been correct in noting in while administering his charge that at some point there must be certainty, that necessity may not exist in this area. In the securities area, the search for certainty is rather like the quest for the holy grail. It is the quest itself however, that continually modifies and refines the concept and therefore the definition of materiality. It is the common law development of securities law interpretations at its best. It is a practical recognition that materiality can differ over time and circumstance.

A hard and fast definition would require courts and administrators to find new tools to accomplish the purposes of the securities laws in this area and the fulfillment of the overall objective of those laws, namely the protection of investors and the stimulation of efficient, free and fair markets. Such a development would, at least in the short run, lead to a greater uncertainty than now exists in this area. The purpose of this article is to explore the development of the meaning of materiality, to place it in its various contexts within the securities law scheme and finally to attempt the impossible job of offering a contemporary working definition of the oft-damned term.

The proposal by the SEC to adopt Regulation FD in December 1999[2] was the occasion for renewed demands for a definition of materiality. Regulation FD regulates the dissemination of material nonpublic information.[3] An earlier SEC enforcement case, Dirks v. SEC,[4] created the requirement for a showing of breach of fiduciary duty as a predicate to establishment of a violation of Rule 10(b)(5).[5] Although the SEC had some success in cases in which the tipper of the information did not trade or benefit monetarily from such activities, those cases were particularly fact dependent. For example, breach of fiduciary duty was found when a CFO tipped an analyst on an impending earnings shortfall in order to protect his own reputation.[6] The analyst and his clients were thus able to "steal a march" on the unsuspecting buying public.[7] In the main, however, company officials found it increasingly necessary for the benefit of their company to curry favor with the analyst community by selectively disclosing nonpublic material information to them. These activities generally would not involve a breach of fiduciary duty since they were done for the benefit of the company. As a result, the SEC lacked effective tools to stop this activity in order to protect unsuspecting trading markets. At the same time, most of these same company officials scrupulously adopted and observed strictures against trading by themselves and other similarly situated until after such information was released to the general public. This general behavior was rational in that it recognized the materiality of the information where sanctions existed and disclosed the information where there were no sanctions. One unintended result of this process was to turn many analysts into mere tippees. The growing awareness of this practice of selective disclosure led to increasing concern by the public and regulators even in the midst of the explosions of the late 1990's bull market.

In the final release adopting Regulation FD,[8] the SEC staff refused to define materiality stating:

> [W]hile we acknowledge in the "Proposing Release" that materiality judgments can be difficult, we do not believe an appropriate answer to this difficulty is to set forth a bright-line test, or an exclusive list of "material items" for purposes of Regulation FD. The problem addressed by this Regulation is the selective disclosure of corporate information of various types; the general materiality standard has always been understood to encompass the necessary flexibility to fit the circumstances of each case.[9]

While not defining the term "materiality" the Commission gave some interpretative guidance by listing types of information or events that would call for careful review to determine whether they are material, namely, (1) earnings information; (2) mergers, acquisitions, tender offers, joint ventures or changes in assets; (3) new products or discoveries, or developments regarding customers or suppliers (e.g., the acquisition or a loss of a contract); (4) changes in control or in management; (5) changes in auditors or notification that the issuer may no longer rely on an auditor's audit report; (6) events regarding the issuer's securities such as defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of security holders, public or private sales of additional securities; and (7) bankruptcies or receiverships.[10] In what only can be characterized as a statement of accommodation, or perhaps a sign of weakness, the staff made the extraordinary statement: "...issuers need not fear being second-guessed by the Commission in enforcement actions for mistaken judgments about materiality in close cases."[11] Don't bet the ranch on that one!

The primary source of litigation and the concerns about the meaning of materiality comes from SEC Rule 10b-5[12] which makes it unlawful to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.[13] Language in this regulation came not from Section 10(b) of the Securities Exchange Act of 1934[14] itself, but rather from Section 17(a)(2) of the Securities Act of 1933.[15]

The term and concept of materiality is also used in the Ohio Securities Act.[16] Section 1707.41[17] establishes civil liability for "the loss or damage sustained by [a] person by reason of the falsity of any material statement ... or omission ... of material facts..." from any prospectus or similar document offering a security for sale.[18] Section 1707.44(B)[19] states that "[n]o person shall knowingly make or cause to be made any false representation concerning a material and relevant fact, in any oral statement or in any prospectus, circular, description, application, or written statement...."[20] Subparts (J)[21] and (K)[22] establish violations for statements and reports which are false in any material respect.[23] The concept is also utilized with respect to the disclosure called for in control bids in Sections 1707.041[24] and 1707.042.[25]

The classic definition of materiality remains that set forth by the U.S. Supreme Court in 1976 in TSC. v. Northway.[26] It must be remembered that TSC involved the affect of the omission of information on the voting process under the proxy rules of Regulation 14A.[27] Regulation 14a-9[28] prohibits solicitations of proxies containing statements which, at the time and in the light of the circumstances under which made, are false or misleading with respect to any material fact, or which omit to state any material fact necessary in order to make the statements made not false or misleading.[29] The question presented was whether the omission of certain facts regarding a change in control of TSC were material.[30] The Supreme Court granted certiorari because of a conflict among the Courts of Appeals in defining materiality.[31] The Court discussed the several definitions of materiality that had been utilized by various courts, including:

- All facts which a reasonable shareholder might consider important.
- Whether a reasonable man would attach importance to the facts misrepresented or omitted in determining his course of action.
- Whether there is a substantial likelihood that the misstatement or omission may have led a stockholder to grant a proxy.
- Facts which in reasonable and objective contemplation might affect the value of the securities.
- That the defect have a significant propensity to affect the voting process.[32]

Finally, the court established the definition that is used today when it stated "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.... Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix'of information made available."[33]

The test was further refined for contingent or speculative events by Basic v. Levinson in 1988.[34] The court there defined materiality concerning possible future events as depending upon a balancing of both the indicated probability that the event would occur and the anticipated magnitude of the event.[35]

For example, in declining to find materiality in Abbott Laboratories vs. Airco, Inc.[36] the court noted that the fact that the market did not have a significant reaction to the ultimate disclosure of the particular information indicated that the information was not material.[37] It is of course much harder to measure the impact of nondisclosure of information on the voting process than is the case in market manipulation cases in which courts can look with 20/20 hindsight at actual market reactions when information does become public as a measure of whether it was actually material. Nevertheless, TSC has become the standard for market manipulation cases.

In construing its statutes, Ohio courts have spoken in terms of particular disclosures being "...misleading to appellate as reasonable investors..."[38] and again the same court spoke in terms of a test being that reasonable minds could not come to but one conclusion[39] and again spoke of the conclusions of a reasonable juror in connection with a disclosure of environmental costs in a prospectus issued by Mid-American Waste Systems, Inc.[40]

Although the SEC has always refused to define materiality in a specific sense with respect to its anti-fraud rules, it has in fact established quantitative tests in accounting areas. For example, Item 2 of Form 8-K requires disclosures concerning acquisitions or dispositions of a significant amount of assets.[41] The term "significant" is defined by a quantitative test of ten percent of total assets.[42] A similar definition is used in Regulation S-X,[43] 1933 Act Rule 405[44] and 1934 Act Rule 12b-2[45] defining significant subsidiary. Note that the term "significant" rather than "material" is used. However, in August 1999 the SEC staff issued Staff Accounting Bulletin 99 in which it discussed materiality in financial statements and concluded that purely quantitative steps should be rejected in favor of a test that looks to surrounding circumstances and necessarily involves both quantitative and qualitative considerations for materiality.[46] The staff acknowledged the usefulness of the rule of thumb five percent test but noted that consideration of all relevant circumstances could well result in a judgment that misstatements below five percent are material.[47]

Quantitative materiality remains a useful context in many areas. Usually it is expressed in terms of a percentage of assets, shareholders equity, net income or operating income. While some types of information may be extremely important to a company, they may not be important to shareholders in the market and therefore their statement or omission would not be material. For example, the creation and implementation of a strategic plan for a midwest service based company to enter into the northeast market may be a prime concern to the company and involve strict security to maintain the confidentiality of the move from competitors. However that information could involve less than one percent of assets or projected revenues. From a quantitative perspective such information would not be material to investors.

There is good reason to analyze the test of materiality differently in voting and market situations. In the voting circumstance, the judgment of whether a particular incorrect statement or omission is material must involve a subjective analysis of factors affecting voting decisions. In that sense, the concept of the "reasonable investor" is about as good as we can find. In the market area, however, the test can be more objective by measuring the impact of the disclosure on the market. Here there is no reason to confine the test to reasonable investors. A reasonableness test may well exclude a majority of investors in many of the recent roman candle Nasdaq flare-ups and flame outs. Even an unreasonable investor, however, deserves the protection of the securities laws. If, as is generally accepted, we analyze the market from the efficient market theory, then any act or omission which noticeably affects that market is material because the efficient market depends on the free flow of correct and complete information. Therefore, building on Basic vs. Levinson and the implication of TSC in market cases, one can say that a fact or omitted fact is material if an eventual disclosure causes a notable market reaction. Thus, at various times a misstatement of one percent in earnings could be material and in another day it may require a ten percent change to have a noticeable effect. Therefore, defining materiality is a nearly impossible task to achieve, but one that continues to evolve in our *common law tradition.*

But there is another view of materiality that must also be considered and that is qualitative materiality. Consider the requirement that the ages of directors and executive officers be set forth in proxy statements. Even if several ages were stated incorrectly by twenty percent, for example a 55 year old executive described as being 44, the information would not meet the TSC test of materiality. However, if the age of a dominant founder of a public company in the later stages of life were so understated it would be a material miss*tatement. One thinks of Walt Disney, Edward Lamb or at some point Bill Gates.*

Likewise, breaches of fiduciary duty are almost always found to be material even though the amounts involved may involve a very small percent of assets. The case of the service business described above could also be material if the move signals a shift in business strategy involving greater risk or loss of a business advantage.

Thus it must be recognized that materiality is defined in the eyes of the beholder. This concept was noted by SEC Chairman Arthur Levitt, Jr. in a speech in September 1999 when he remarked:

> ....materiality [is] a word that captures the attention of both attorneys and accountants. Materiality is another way we build flexibility into financial reporting. Using the logic of diminishing returns, some items may be so insignificant that they are not worth measuring and reporting with exact precision.
>
> But some companies misuse the concept of materiality. They intentionally record errors within a defined percentage ceiling. They then try to excuse that fib by arguing that the effect on the bottom line is too small to matter. If that's the case, why do they work so hard to create these errors? Maybe because the effect can matter, especially if it picks up that last penny of the consensus estimate. When either management or the outside auditors are questioned about these clear violations of GAAP, they answer sheepishly......."It doesn't matter. It's immaterial."

In markets where missing an earnings projection by a penny can result in a loss of millions of dollars in market capitalization, I have a hard time accepting that some of those so-called non-events simply don't matter.

This phenomenon has been painfully observed in the flame out phase of the recent roman candle market. Announcements of declines or anticipated declines in earnings of a penny or less, or involving less than a percent in some cases, has sparked market declines of far greater proportion. This type of reaction can also affect blue chip companies. For example, in February 2001 a major Dow Jones company predicted a decline from 2.5 percent to 4 percent in its earnings for the quarter. The announcement promptly led to a 6.5 percent drop in its market price. That is the kind of information that, prior to Regulation FD, may have been selectively disclosed by some issuers to analysts thereby enabling the analysts and their clients to trade before market reaction set in once the news was publicly announced. The market reaction then would likely be gradual over time as the tippees sold but it would allow more unwitting buyers to take positions than is the case with a sudden market drop.

Shareholders in these recent instances seem to be technical or momentum investors to whom trends far outweigh other considerations such as dividend yields or price earnings ratios. This condition may not continue. Therefore, the one cent change so material to the market today may not be material in a more traditional market setting tomorrow. A hard and fast definition of materiality would serve neither market environment well. The "definition" of materiality has and will continue to differ over time and circumstance.

Meanwhile, the beat goes on. The Sarbanes-Oxley Act of 2002 employed the term "material" or a derivative thirty-two times.[48] However, in implementing standards of professional conduct for attorneys under that Act in 2003, the SEC stated "The final rule [SEC Rule 205] does not define the word 'material,' because that term has a well-established meaning under the federal securities laws and the Commission intends for that same meaning to apply here."[49]

Perhaps we can tweak the TSC definition, at least at it applies to market versus voting circumstances. This suggestion is that an omitted fact be considered material if there is a substantial likelihood that an active trading market would react to it.

(Endnotes)

1 Senior Partner, Keating, Muething & Klekamp P.L.L.; Chairman of the Ohio State Bar Association Corporate Bar Committee; Adjunct Professor of Law, University of Cincinnati College of Law. This article is dedicated to former Ohio Commissioner of Securities George Ward who always asked "What's important about this offering?"

2 Selective Disclosure and Insider Trading, Release No. 34-42259, 1999 SEC Lexis 2696 (Dec. 20, 1999).

3 See17 C.F.R. §§ 243.100-103 (2001).

4 463 U.S. 646 (1983).

5 See id.

6 See SEC v. Stevens, Litigation Release No. 12813, 1991 SEC Lexis 451 (Mar.19, 1991).

7 See id.

8 Selective Disclosure and Insider Trading, Release Nos. 33-7881, 34-43154, 2000 SEC Lexis 1672 (Aug. 15, 2000).

9 Id at *35-6.

10 See id at *37-8.

11 Id at *18.

12 17 C.F.R. § 240.10b-5 (2001).

[13] See id.
[14] 15 U.S.C. § 78j (2001).
[15] Id at § 77g.
[16] Ohio Rev. Code Ann. § 1707 (2001).
[17] Id at § 1707.41.
[18] Id.
[19] Id at § 1707.44(B).
[20] Id.
[21] Id at § 1707.44(J). The statute states:
No person, with purpose to deceive, shall make, issue, publish, or cause to be made, issued or published any statement or advertisement as to the value of securities, or as to the alleged facts affecting the value of securities, or as to the financial condition of any issuer of securities, when the person knows that such statement or advertisement is false in any material respect.
[22] Id at § 1707.44(K). "No person, with purpose to deceive, shall make, record, or publish or cause to be made, recorded, or published, a report of any transaction in securities which is false in any material respect." Id.
[23] See id at § 1707.44(J), (K).
[24] Id at § 1707.041.
[25] Id at § 1707.042.
[26] 426 U.S. 438 (1976).
[27] See id.
[28] 17 C.F.R. § 240.14a-9 (2001).
[29] See id.
[30] See TSC, 426 U.S. at 440.
[31] See id at 443-44.
[32] See id at 445.
[33] Id at 449.
[34] 485 U.S. 224, 231 (1988).
[35] See id at 238.
[36] 1984 U.S. Dist. Lexis 20074 (N.D. Ill. Jan. 26, 1984).
[37] See id.
[38] Federated Management Co. v. Coopers & Lybrand, 738 N.E.2d 842, 859 (Ohio Ct. App. 2000).
[39] See id.
[40] See id at 864; see also Byrley v. Nationwide Life Insurance Co., 640 N.E.2d 187 (Ohio Ct. App. 1994).
[41] See 17 C.F.R. § 249.308 (2001).
[42] See id.
[43] Id at § 210.
[44] Id at § 230.405.
[45] Id at § 240.12b-2.
[46] 7 Fed. Sec. L. Rep. (CCH) ıı 75,563, 75,701 (Aug. 12, 1999).
[47] Id.
[48] The Sarbanes-Oxley Act of 2002
[49] Implementation of Standards of Professional Conduct for Attorneys, Release Nos. 33-8185, 34-47276.

Colby Daniel Furlong

On June 8, 2004, Colby Daniel Furlong of Bellefontaine, Ohio entered into a Consent Agreement with the Division and consented to the issuance of a Cease and Desist Order, Division Order No. 04-123.

The Division found that Colby Daniel Furlong violated Revised Code section 1707.44(B)(4) by making false representations in the sale of securities. The Division also found that Furlong violated Administrative Code 1301:6-3-19(A)(5) by recommending the sale or purchase of securities that were not suitable for investors.

On September 15, 2003, the Division issued a Notice of Opportunity for Hearing, Division Order No. 03-182. The Division notified Furlong of his right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was initially requested by Furlong, but later withdrawn. As agreed to in the Consent Agreement, Mr. Furlong waived his right to an administrative hearing pursuant to Chapter 119 of the Revised Code. The Final Order to Cease and Desist was issued on June 8, 2004.

Sure Ventures Corporation aka Sure Ventures FX Group

On January 26, 2004, the Division issued Order No. 04-017, a Cease and Desist Order, against Sure Ventures Corporation. From May of 2003 through July of 2003, Sure Ventures Corporation sold to an Ohio resident options in foreign currency of governments other than those of the United States or Canada. These options are securities under the Ohio Securities Act but were not registered with the Division. Therefore, on November 5, 2003, the Division issued Order No. 03-203, a Notice of Opportunity for Hearing, against Sure Ventures Corporation for allegedly violating Revised Code Section 1707.44(C)(1), the unregistered sale of securities. Sure Ventures Corporation did not request a hearing pursuant to Chapter 119 of the Ohio Revised Code, thereby allowing the Division to issue its Cease and Desist Order No. 04-017 which incorporated the allegations set forth in the Notice of Opportunity for Hearing.

Paul Sims aka Paul Sims IV

On January 26, 2004, the Division issued Order No. 04-017, a Cease and Desist Order, against Paul Sims. From May of 2003 through July of 2003, Paul Sims as a representative of Sure Ventures Corporation sold to an Ohio resident options in foreign currency of governments other than those of the United States or Canada. These options are securities under the Ohio Securities Act but were not registered with the Division. Therefore, on November 5, 2003, the Division issued Order No. 03-203, a Notice of Opportunity for Hearing, against Mr. Sims for allegedly violating Revised Code Section 1707.44(C)(1), the unregistered sale of securities. Mr. Sims did not request a hearing pursuant to Chapter 119 of the Ohio Revised Code, thereby allowing the Division to issue its Cease and Desist Order No. 04-017 which incorporated the allegations set forth in the Notice of Opportunity for Hearing.

Joanne C. Schneider

On May 25, 2004, the Division issued Order No. 04-111, a Cease and Desist Order, against Joanne C. Schneider of Lakewood, Ohio. From May of 2000 through December of 2003, Ms. Schneider sold over seven million dollars worth of promissory notes to approximately 210 investors, including Ohio residents. These promissory notes are securities under the Ohio Securities Act but were not registered with the Division or exempt from registration. Ms. Schneider entered into a consent agreement with the Division wherein she waived the issuance of a Notice of Opportu-

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nity for Hearing as well as her right to such a hearing in accordance with Ohio Revised Code Chapter 119, thereby allowing the Division to issue its Cease and Desist Order No. 04-111.

Leon S. Heard

On June 23, 2004, the Division issued Order No. 04-135, a Cease and Desist Order, against Leon S. Heard. In May of 2001, Heard, on behalf of The D-Mo Group sold a promissory note to a resident of Ohio. Heard failed to disclose to the investor that Heard had been convicted of felony theft in 1991 and had been permanently disbarred from the practice of law in Ohio in 1990. Therefore, on July 18, 2003, the Division issued Order No. 04-110, a Notice of Opportunity for Hearing, against the Respondent for allegedly violating Revised Code Section 1707.44(G), for failing to disclose material facts. Mr. Heard did not request a hearing pursuant to Chapter 119 of the Ohio Revised Code, thereby allowing the Division to issue its Cease and Desist Order No. 04-135 which incorporated the allegations set forth in the Notice of Opportunity for Hearing.

The D-Mo Group

On June 23, 2004, the Division issued Order No. 04-135, a Cease and Desist Order, against The D-Mo Group. In May 2001, The D-Mo Group sold a promissory note to a resident of Ohio. The Respondent failed to disclose to the investor that one of its principal members had been convicted of felony theft in 1991 and had been permanently disbarred from the practice of law in Ohio in 1990. Therefore, on July 18, 2003, the Division issued Order No. 04-110, a Notice of Opportunity for Hearing, against the Respondent for allegedly violating Revised Code Section 1707.44(G), for failing to disclose material facts. The Respondent did not request a hearing pursuant to Chapter 119 of the Ohio Revised Code, thereby allowing the Division to issue its Cease and Desist Order No. 04-135, which incorporated the allegations set forth in the Notice of Opportunity for Hearing.

Edward J. Brzuski

On April 9, 2004, the Division issued a Cease and Desist Order, Division Order No. 04-085, to Edward J. Brzuski of Valley View, Ohio.

The Division found that Brzuski, an Ohio-licensed insurance agent, violated the provisions of Ohio Revised Code sections 1707.44(A)(1) and 1707.44(C)(1) by selling unregistered viatical settlements while unlicensed as a securities dealer. The Division's investigation stemmed from Brzuski's sale of viatical settlements of Imtek Funding Corporation and Beneficial Assistance of Maryland. The Division found that he earned commissions of 9% to 10.5% for selling the viatical settlements. On March 9, 2004, the Division issued a Notice of Opportunity for Hearing, Division Order 04-054, to Brzuski. The Division previously issued Cease and Desist Orders against Imtek Funding Corporation, Division Order No. 01-319, and Beneficial Assistance, Division Order No. 02-144.

The Division notified Edward J. Brzuski of his right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code. A hearing was not requested and the Cease and Desist Order was issued on April 9, 2004.

Mark Anthony Rizzi

On April 30, 2004, the Division issued Division Order No. 04-097, a Cease and Desist Order to Mark Anthony Rizzi of Lorain, Ohio.

The Division found that Rizzi violated the provisions of Ohio Revised Code sections 1707.44(B)(4), 1707.44(G) and 1707.44(K). Rizzi falsely represented himself to be a financial representative for Robert W. Baird & Co. and recommended the purchase of securities to an Ohio organization in which he was the secretary. He presented fictitious records relating to the opening of a securities account at a brokerage firm that included a bogus account number. Rizzi directed the withdrawal of funds from the organization to his own control and represented the funds were to be invested in purported shares in a bond fund. The Division found that Rizzi made false representations in the sale of securities, engaged in fraudulent acts in connection with selling securities and published false reports of securities transactions.

The Division notified Rizzi of his right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code in a Notice of Opportunity for Hearing, Order No. 04-070, issued on March 23, 2004. A hearing was not requested and the Cease and Desist Order was issued on April 30, 2004. *(See issue 2004:1 for summary of related criminal case)*

Alan McNaughton

On May 11, 2004, the Division issued Division Order No. 04-106, a Cease and Desist Order to Alan McNaughton of Lorain, Ohio.

The Division found that McNaughton violated the provisions of Ohio Revised Code sections 1707.44(C)(1), 1707.44(B)(4), and 1707.44(G) by selling unregistered securities in the form of promissory notes. The Division found that McNaughton sold and signed promissory notes to Ohio investors, many of whom are members of the Church of the Open Door in Elyria, wherein their money was going to be used to invest in stocks and to trade options, and investors were promised annual returns of 15% to 20%. Investors were told that Andrew Lech of Peterborough, Ontario, Canada would be responsible for the investments in stock and the trading of options. Investors were not given any disclosure documents describing the risk associated with the investment, or any background or financial information. Investors are now owed their principal. A Canadian judge appointed a receiver and guardian, and ordered an accounting of the funds.

The Division notified McNaughton of his right to an adjudicative hearing pursuant to Chapter 119 of the Revised Code in a Notice of Opportunity for Hearing, Order No. 04-084, issued on April 9, 2004. A hearing was not requested and the Cease and Desist Order was issued on May 11, 2004.

Criminal Updates

On May 18, 2004, **Joseph Yacapraro** appeared for a bond hearing in regard to a nine-count criminal complaint filed in Coshocton County on May 10, 2004. Yacapraro refused to enter a plea and asserted that the court had no authority or jurisdiction over him. The Judge found Yacapraro in contempt and ordered that he spend the night in jail. On May 24, 2004, a Coshocton County Grand Jury indicted Yacapraro on three counts each of securities fraud, making false statements, and selling unregistered securities. All nine counts are third degree felonies. Subsequently, on May 11, 2004, Yacapraro entered a plea of not guilty and signed a recognizance bond. The criminal complaint was subsequently dismissed as a result of the indictment. This case is scheduled for trial on October 5, 2004.

Robert T. Young was sentenced by Hamilton County Common Pleas Judge Thomas H. Crush on May 19, 2004, to five years imprisonment on each of two second degree felony counts of securities fraud and false reports of securities transactions, two years for the aggravated theft count and one year for a theft count. The sentences are to be served concurrently with each other. Young previously entered a guilty plea to a Bill of Information on these charges on April 15, 2004. Young, while a licensed broker with Money Concepts Capital Corp., falsified documents relating to customer accounts and committed securities fraud and theft in conjunction with brokerage accounts under his control. He also sold

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bogus bonds in a company he created, R.E.M. Group, Inc.

On July 7, 2004, **Greg Ballard** and **Paul Suchanek** each pleaded guilty in the Clermont County Court of Common Pleas to attempting to engage in a pattern of corrupt activity. They will be sentenced August 25th and face prison terms ranging from two to eight years. The guilty pleas stem from Ballard and Suchanek's August 2003 indictment in which they were each charged with one count of engaging in a pattern of corrupt activity, three counts of false representations in the sale of securities, three counts of securities fraud, four counts of securing writings by deception and two counts of the sale of unregistered securities. Ballard was also indicted on one count of unlicensed sale of securities.

The charges in the 2003 indictment originate from Ballard and Suchanek selling promissory notes to at least seven investors for $875,000. The investors were promised returns of up to 15 percent. However, none of the investors received any of their money back.

On June 3, 2004, **Stanley Cox** entered a plea of guilty to a Bill of Information before Hamilton County Common Pleas Judge Norbert Nadel to the following charges: one count of securities fraud; one count of false reporting of securities transactions; one count of selling unregistered securities; and one count of aggravated theft.

In concert with Cox's guilty plea to the above charges, on June 28, 2004, the Division issued Order No. 04-141, where Cox entered into a consent agreement with the Division to Cease and Desist any further activity.

Mr. Cox was selling a "Twelve Month Investment Certificate" offering very high returns on investor money, 30 to 400 percent, and guaranteeing the principal investment. The Division's investigation determined that, in actuality, Cox was not investing the money as promised, but using these funds to pay back investors or converting the funds for his own use. Cox targeted an affinity group and also promised profits from the alleged investments would go to valid charities. The Division's investigation showed that Cox fraudulently obtained approximately 7.9 million dollars of investor money, in this large scale Ponzi scheme. Cox will be sentenced on September 8, 2004.

Capital Formation Statistics*

Because the Division's mission includes enhancing capital formation, the Division tabulates the aggregate dollar amount of securities to be sold in Ohio pursuant to filings made with the Division. As indicated in the notes to the table, the aggregate dollar amount includes a value of $1,000,000 for each "indefinite" investment company filing. However, the table does not reflect the value of securities sold pursuant to "self-executing exemptions" like the "exchange listed" exemption in R.C. 1707.02(E) and the "limited offering" exemption in R.C. 1707.03(O). Nonetheless, the Division believes that the statistics set out in the table are representative of the amount of capital formation taking place in Ohio.

Filing Type	2nd Qtr 2004	YTD 2004
Exemptions		
Form 3(Q)	$604,952,377	$643,763,012
Form 3(W)	5,025,000	9,550,000
Form 3(X)	72,227,147,232	130,189,150,167
Form 3(Y)	7,900,000	8,790,000
Registrations		
Form .06	1,368,194,856	1,788,917,161
Form .09/.091	39,956,734,305	47,942,608,553
Investment Companies		
Definite	101,417,200	207,461,200
Indefinite**	489,000,000	1,091,000,000
TOTAL	**$114,760,370,970**	**$181,881,240,093**

**Categories reflect amount of securities registered, offered, or eligible to be sold in Ohio by issuers.*
***Investment companies may seek to sell an indefinite amount of securities by submitting maximum fees. Based on the maximum filing fee of $1100, an indefinite filing represents the sale of a minimum of $1,000,000 worth of securities, with no maximum. Consequently, for purposes of calculating an aggregate capital formation amount, each indefinite filing has been assigned a value of $1,000,000.*

Registration Statistics

The following table sets forth the number of registration, exemption, and notice filings received by the Division during the second quarter of 2004, compared to the number of filings received during the second quarter of 2003. Likewise, the table compares the year-to-date filings for 2004 and 2003.

Filing Type	2nd Qtr '04	YTD '04	2nd Qtr '03	YTD '03
1707.03(Q)	31	57	32	64
1707.03(W)	3	8	3	10
1707.03(X)	351	708	235	511
1707.03(Y)	3	5	2	2
1707.04/.041	1	1	1	1
1707.06	20	47	25	48
1707.09/.091	50	96	46	76
Form NF	1053	2224	1060	2194
Total	1511	3146	1404	2906

Licensing Statistics

License Type	YTD 2004
Dealers	2,325
Salespersons	124,653
Investment Adviser/Notice Filers	1,764
Investment Adviser Representatives	9,981

OHIO SECURITIES CONFERENCE 2004

October 15, 2004

Executive Conference and Training Center
Vern Riffe Center
77 South High Street, 31st Floor
Columbus, Ohio 43215

OHIO MERIT GUIDELINES FOR PUBLIC OFFERINGS AND PROCEDURES FOR REGISTRATION BY DESCRIPTION

Michael P. Miglets
Ohio Division of Securities

Mark R. Heuerman
Ohio Division of Securities

INVESTMENT ADVISER COMPLIANCE AND ETHICS PROGRAMS

Thomas E. Geyer
Bailey & Cavalieri

Paul N. Edwards
McDonald Hopkins

THE CORPORATE DIRECTOR IN THE 21st CENTURY

Nomination and Selection of Directors in Publicly Held Companies

Howard M. Friedman
University of Toledo, College of Law

<u>Expanding Roles of Board Committees - Audit, Compensation and Corporate Governance</u>

Gary P. Kreider
Keating, Muething & Klekamp

<u>The Independent Director - New Requirements and New Visibility</u>

Frances F. Goins
Ulmer & Berne

RECENT DEVELOPMENTS AT THE OHIO DIVISION OF SECURITIES

Michael P. Miglets
Acting Commissioner

Robert K. Lang
Attorney Inspector

Caryn A. Francis
Licensing Counsel

Presented by The Ohio Division of Securities & The Cybersecurities Law Institute at the University of Toledo College of Law

- This course has been approved by the Ohio Supreme Court Commission on Continuing Legal Education for 5.50 total CLE credit hours, with 0.00 of ethics, 0.00 hours of professionalism and 0.00 of substance abuse instruction.

- The meetings of the Ohio Division of Securities Advisory Committees will be held in conjunction with this Conference during the lunch break. Box lunches will be available for those attending a Committee meeting.

- The Conference brochure and registration form will be available at www.securities.state.oh.us on August 15, 2004 or you may call (614) 466-3440 to request a copy.