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Analysis of the Ohio Securities Act

Milton C. Boesel, Jr.

I. CHARACTER OF THE ACT

A. *Nature*

IN 1911 KANSAS passed the first securities act designed to protect local investors in securities.¹ This law was popularly called a "blue sky law," referring to the fact that its object was to prevent the sale of securities backed only by the "blue sky." Similar legislation was soon adopted in other states, until today every state except Nevada has a blue sky law of one sort or another.²

Ohio entered the field in 1913³ with an act that caused some unfavorable comment⁴ although it was held constitutional by the United States Supreme Court.⁵ Subsequently a committee composed of four separate groups⁶ was established in an attempt to make the law more comprehensible and easier to apply. Drawing heavily from the Indiana blue sky law,⁷ this committee constructed an entirely new Ohio securities act.⁸ It was enacted in 1929⁹

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¹ Kan. Sess. Laws (1911) c. 133, entitled "An act to provide for the regulation and supervision of investment companies and providing penalties for the violation thereof."

² For a discussion of blue sky legislation in general, see LOSS, *SECURITIES REGULATION* Chap. II (1951) and authorities cited therein.

³ 103 Ohio Laws 743 (1913). For discussion of the history of Ohio securities regulation, see Nida, *The Ohio Division of Securities and the Ohio Securities Act*, 13 OHIO ST. L.J. 427 (1952).

⁴ As one experienced member of the bar stated, it ". . . reads like a piece of the dictionary gone mad." See 18 Ohio L. Rep. 514. Main criticisms were that it was too vague and indefinite, as well as confusing.

⁵ Hall v. Geiger-Jones Co., 242 U.S. 539, 37 Sup. Ct. 217 (1917).

⁶ The Ohio Corporation, Blue Sky, Investment Bankers' Association, and Better Business Bureaus' Committees. Their reports are collected as supplements to 1 Ohio Bar. No. 42 of 1 Ohio Bar is the Sixth and Final Report of the two committees mainly responsible for drawing up the present blue sky law, viz., the Committee on Corporation Law and the Committee on Blue Sky Law. Page references are to this report, dated January 15, 1929.

⁷ 1 Ohio Bar, No. 42, p. 8.

⁸ Now found in OHIO REV. CODE §§ 1707.01 to 1707.45 (OHIO GEN. CODE §§ 8624-1 to 8624-49). Unless otherwise noted, section references are to the Ohio Revised Code, followed in parentheses by the Ohio General Code.

⁹ 113 Ohio Laws 216 (1929).

substantially as submitted, and constitutes, with a few minor changes,¹⁰ the present Ohio blue sky law.

Blue sky laws legitimately exercise state police powers in the prevention of fraud and deception in the sale of securities within a state's boundaries.¹¹ Although the approach adopted in fulfilling this objective varies from state to state, there are roughly four different types of laws:¹²

1) *Fraud type*.¹³ The securities themselves need not be qualified nor the dealers licensed; instead the statute attempts to prevent fraud in the sale of securities by authorizing investigative, injunctive and other proceedings, and by providing definite penalties for violations.

2) *Licensing type*.¹⁴ There is no regulation of the securities themselves, but dealers and salesmen must obtain licenses before selling.

3) *Inspection type*.¹⁵ There is no licensing of dealers, but securities are subject to regulation in the form of registration or qualification.

4) *Licensing and inspection type*.¹⁶ This type involves a combination of regulation of both the securities and dealers. It is the most common type of blue sky law.

Ohio's blue sky law is essentially a licensing and inspection type.¹⁷ However it is not limited to this, since there are also general anti-fraud provisions. By licensing and inspection, the administrators are able to set up certain minimum standards for both securities and dealers. Failure to comply with these standards may result in initial prohibition or subsequent suspension or revocation of licenses. The anti-fraud sections provide a means of preventing fraud in the sale of exempt securities, and of prosecuting violators.

¹⁰ Notably: the elimination of dealers' bonding provisions by repeal of Ohio General Code Section 8624-20, and the addition of Ohio Revised Code Section 1707.43 (Ohio General Code Section 8624-48a), making contracts in violation of the Act voidable by the purchaser, instead of valid.

¹¹ The purpose of blue sky legislation is "... to give a basis for judgment of the securities offered the purchasing public; assure credit where it is deserved and confidence to investment and trading; prevent deception and save credulity and ignorance from imposition, as far as this can be done by the approved reputation of the seller of the securities and authoritative information." *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 551, 37 Sup. Ct. 217, 221 (1917).

¹² Authors vary on the categorization. The classification used herein is substantially the same as that in Smith, *State "Blue-Sky" Laws and the Federal Securities Acts*, 34 MICH. L. REV. 1135 (1936). But see also BALLANTINE, CORPORATIONS § 365 (1946), and citations collected in Loss, *op. cit. supra* note 2, at 20.

¹³ *E.g.*, New York (Martin Act), Delaware, Maryland and New Jersey.

¹⁴ *E.g.*, Connecticut, Maine, Pennsylvania and Rhode Island.

¹⁵ *E.g.*, New Mexico, Tennessee and Wyoming.

¹⁶ *E.g.*, Illinois, Kansas, Minnesota and Wisconsin.

¹⁷ See §§ 1707.02 to 1707.09 and 1707.14 to 1707.19 (8624-3 to 8624-10 and 8624-17 to 8624-22).

B. *Scope*

With such a three-pronged attack, the scope of the act is necessarily broad. Although a "... strict construction of the provisions of this act . . . of course is required when dealing with criminal prosecution,"¹⁸ much leeway is in fact given in order to carry out the legislative intent of preventing fraud and eliminating loopholes in the law.¹⁹ Further broadening its coverage, the act requires that *all* securities except those specifically exempted must qualify,²⁰ and the burden of proving an exemption is placed upon the person claiming its benefit.²¹ This procedure is constitutional.²²

The term "security" is defined in very general terms, in the Act.²³ As the committee writing this section stated: "[It] is believed that this definition includes, in terms, practically all forms of security familiar to the financial world and, by general definition, facilitates determining the status of a newly devised or unspecified evidence of an instrument in or charge upon assets or earnings."²⁴ Bond investment companies and the sale of domestic real estate are excluded,²⁵ but instruments in a profit-sharing plan which serve the same general function as securities have been included.²⁶

The term "sale" has also been given a broad definition,²⁷ including contracts of sale, exchanges, options, solicitations and subscriptions. But advertisements offering non-registered stock for sale elsewhere are permitted in Ohio where they appear in periodicals published outside Ohio.²⁸ This is a matter of practical convenience, especially since the act is directed at sales within the state. Nor are offers occurring by operation of law deemed to be sales within the meaning of the Act.²⁹ And where a prosecution arising under the act depends upon the existence of a "sale," there must be a selling intent.³⁰

¹⁸ *Groby v. State*, 109 Ohio St. 543, 550, 143 N.E. 126, 128 (1924).

¹⁹ *Ibid.*

²⁰ § 1707.09 (8624-10).

²¹ § 1707.44, 1707.45 (8624-25).

²² *Catterlin v. State*, 16 Ohio L. Abs. 410 (App.), *app. dis'm* 128 Ohio St. 110, 190 N.E. 578 (1934).

²³ "... any certificate or instrument which represents title to or interest in, or is secured by any lien or charge upon, the capital, assets, profits, property or credit of any person . . . or of any public or governmental body, subdivision or agency . . ." § 1707.01 (8624-2). Such comprehensive language should be given comprehensive treatment. See *Ross v. Couden*, 22 Ohio App. 330, 154 N.E. 527 (1926), construing previous definition in Ohio General Code Section 6373-1 (now repealed).

²⁴ 1 Ohio Bar, No. 42, p. 23.

²⁵ § 1707.01(2) (8624-2(2)). But note the comprehensive coverage given to sales of foreign real estate in Section 1707.33 (8624-47).

²⁶ 1939 OPS. ATT'Y GEN. [Ohio] No. 721.

²⁷ § 1707.01(3) (8624-2(3)).

²⁸ 1935 OPS. ATT'Y GEN. [Ohio] No. 4850.

Although "purchase" is not specifically defined in the act itself, it has been held that it is the counterpart of "sale" as defined. So a purchaser is any person to whom a sale is made.³¹

II. ADMINISTRATOR—DIVISION OF SECURITIES

A. Organization

The Division of Securities³² is the administrative department entrusted with the administration and enforcement of the Ohio Act.³³ It is one of six divisions under the Department of Commerce. At its head, with a pleasure appointment by the Governor, is the Chief of Division, in whose name all rulings and pronouncements are made.

Under the Ohio organization, all private capital groups are under the supervision of the division. Within the division itself, there are three main subdivisions, entrusted with administering respectively, the Securities Act, the Credit Union Act,³⁴ and the Small Loan³⁵ and Pawnbrokers Acts.³⁶ If the issuer is an insurance company,³⁷ the superintendent of insurance is substituted for the division.³⁸ Each of these subdivisions is more or less separate, and is concerned mainly with the enforcement of the act or acts under its care.

The enforcement arm for the Securities Act is the attorney-inspector.³⁹ His duty is to investigate and report on complaints concerning alleged violations of the Act. Should a violation be discovered, the Division (which can act through the Chief of Division or the Director of Commerce)⁴⁰ may suspend registration of the securities,⁴¹ or suspend or revoke the dealer's license.⁴² And in criminal prosecutions,⁴³ it is also the attorney-inspector's duty to represent the Division.

²⁹ *Portage Rubber Co. v. Firestone*, 3 Ohio L. Abs. 45 (App. 1924).

³⁰ See *Snypp v. State*, 21 Ohio L. Abs. 324, 327 (App.), *app. dis'm*, 131 Ohio St. 216, 2 N.E.2d 269 (1936). For another phase of the same prosecution, see *Snypp v. State of Ohio*, 70 F.2d 535 (6th Cir.), *cert. denied*, 293 U.S. 563, 55 Sup. Ct. 74 (1934).

³¹ *Indem. Ins. Co. v. Kircher*, 47 Ohio App. 140, 191 N.E. 374 (1934).

³² Hereafter referred to as "the Division."

³³ § 1707.01(1) (8624-2(1)).

³⁴ §§ 1733.01 to 1733.19 (9676 to 9694).

³⁵ §§ 1321.01 to 1321.19 (8624-50 to 8624-72).

³⁶ §§ 4727.01 to 4727.16 (6337 to 6346).

³⁷ Of the kind named in Sections 3907.01 *et seq.* (9339 *et seq.*).

³⁸ § 1707.32 (8624-37).

³⁹ This position is created by Section 1707.36 (8624-44).

⁴⁰ § 1707.01(1) (8624-2(1)).

⁴¹ § 1707.13 (8624-16).

⁴² § 1707.19 (8624-22).

⁴³ Pursuant to Sections 1707.44, 1707.45 (8624-25).

The Division is given a wide power of investigation and examination into proposed or past violations of the Act. This investigative procedure can be set in motion merely "when the division believes it to be in the best interests of the public and necessary for the protection of investors."⁴⁴ Under this power, it may proceed against violators without waiting for a complaint to be filed. This is an extensive grant of power, which can be utilized when more formalized regulations do not afford adequate protection.

Formal action by the Division in exercising its rule-making powers and in issuing its other orders pursuant to adjudications is subject to the provisions of the Ohio Administrative Procedure Act.⁴⁵ The latter act provides for an appeal to a common pleas court by an adversely affected person where rule-making is concerned,⁴⁶ or by a party where a license is denied, suspended or revoked, or other contested order is issued.⁴⁷ The Division's primary sanctions under the Act are thus all subject to judicial review. The Administrative Procedure Act also sets definite procedures for the promulgation of rules⁴⁸ and for the necessity and conduct of hearings on all agency adjudications.⁴⁹

B. *Approach*

Since the Act goes beyond mere disclosure⁵⁰ to actual affirmative regulation of securities and dealers, the Division tries to eliminate some of the risks for a prospective investor. The regulatory provisions are themselves quite strict, demonstrating the legislature's primary purpose of protecting investors as much as possible without interfering too much with those whose business involves securities. The protection offered is mainly negative, in that only minimum representative safeguards are set up and enforced; the Division is forbidden to endorse affirmatively or give a value judgment on any security.⁵¹

In deciding questions of qualification, registration and the sale of securities, however, the Division does indirectly examine into the merits of the security. Since the many selling schemes attempted vary widely and no definite protective pattern can effectively be established, each case must be decided separately. By maintaining a certain degree of flexibility in its

⁴⁴ § 1707.23 (8624-28).

⁴⁵ §§ 119.01 *et seq.* (154-61 *et seq.*).

⁴⁶ § 119.11 (154-72).

⁴⁷ § 119.12 (154-73).

⁴⁸ §§ 119.03 to 119.05, and 111.15 (154-64 to 154-66 and 161-1).

⁴⁹ §§ 119.06 to 119.10 and 119.13 (154-67 to 154-71 and 154-74).

⁵⁰ Disclosure is the philosophy of federal regulation of securities. See *e.g.*, LOSS, SECURITIES REGULATION 76-82 (1951).

⁵¹ Regulation G-3.

application, the Division can adjust its administrative policy to current economic conditions.⁵²

In addition to preventing fraudulent and deceptive schemes and practices, which is the central theme of any blue sky law, Ohio goes further in protecting its investors by granting the Division power to prohibit sales of securities (and practices of dealers)⁵³ which are "grossly unfair."⁵⁴ By the use of this flexible phrase, issues which technically comply with the provisions of the Act and do not involve fraud may nevertheless be prohibited if the Division feels the terms are not in the best interest of the public.⁵⁵

Using "grossly unfair" as a lever, the Division is able to keep a tight check on securities offered to Ohio investors. It can keep the terms of an issue fair, eliminate semi-hidden intracompany agreements and schemes which indirectly reduce the value of the securities, and keep out issues of financially insecure companies which may shortly sour on an investor. By its use, the Division is also able to determine what a fair maximum sale price should be. In the earlier days of the present Act, the Division adopted a rule of thumb which prohibited the price of a security from exceeding two times its proportionate share of the book value of the issuer's assets, assuming an immediate liquidation. This was used as a rather rough yardstick, and, depending on the type of business, previous record of the company and other pertinent factors, was applied fairly loosely. More recently, money now being easier to obtain, the Division has reduced the ratio to about 1:1.⁵⁶

Such an all-inclusive phrase allows the Division much leeway in preventing undesirable sales of securities. Thus, the Division has excluded non-voting common stock,⁵⁷ all but excluded preferred stock without default

⁵² *I.e.*, to balance the relative interests between investors and issuers when money is scarce in depression periods, as compared to boom times when it is readily available. Different problems are manifested and require separate solutions. See Nida, *The Ohio Division of Securities and the Ohio Securities Act*, 13 OHIO ST. L.J. 427, 433 (1952).

⁵³ See § 1707.19 (8624-22) and Regulation DS-19.

⁵⁴ §§ 1707.09(k) (2) and 1707.13 (8624-10(k) (2) and 8624-16). Note that under this latter section, even though the securities, or transactions in which they are involved, are either exempt or registered by description, the Division may suspend all rights to buy, sell or deal in these securities, if their disposal is found to be on grossly unfair terms. This permits the Division to cut through exemptions, etc., in appropriate instances, although the power is not often used.

⁵⁵ Regarding the Division's broad discretion in applying this term, see 1923 OPS. ATT'Y GEN. [Ohio] No. 934.

⁵⁶ This is the initial test applied to a new issue by the Division. If the security fails to meet it, a sort of presumption of gross unfairness arises which can be overcome by other favorable factors. If the security does meet this standard, it will be excluded only if other factors themselves are grossly unfair.

⁵⁷ Administrative Ruling 19.

voting rights,⁵⁸ required companies to sell all of an issue at the same price to any purchaser buying at a given time⁵⁹ and required promoters to pay the same price for securities as the public does.⁶⁰ Its application for the Division would seem to be limited only if its decision is arbitrary and wanton.⁶¹

III. REGULATION OF SECURITIES — REGISTRATION

The main regulatory features of the Act are found in its provisions for registration of securities and transactions.⁶² In deciding to include these provisions in the Ohio Act, the drafting committee stated⁶³ that issuers were familiar with such regulations, and by allowing exemptions for many securities and merely requiring the filing of information and permitting sale without prior approval for others, much work for the Division would be eliminated while the interests of the investor would still be adequately protected — a sort of calculated-risk theory. By requiring all other securities to be approved before sale to the investing public, more protection could be afforded investors than mere fraud laws could accomplish. It was felt that the fraud type of blue sky law was aimed at punishing violators *after* the offense had occurred. Registration, however, was thought to *prevent* many such abuses of investors, although the two functions may sometimes overlap. Either the issuer or a licensed dealer may effect registration.

Securities are divided into three classes: those that are exempt from registration, those that require registration by description and those which are in neither of the two above categories but which must be qualified. Classifications are based on the relatively deceptive nature of the security itself, or the propensity toward its deceptive sale.⁶⁴ It should be noted however, that regardless of the classification (including exemptions) and the degree of regulation applied, the provisions prohibiting fraudulent and deceptive sales apply.⁶⁵

A. Exemptions

The exemption provisions of the Act provide that certain types of securities may be sold⁶⁶ and transactions involving certain types of securities

⁵⁸ Administrative Ruling 17.

⁵⁹ Administrative Ruling 20.

⁶⁰ Administrative Ruling 21.

⁶¹ See *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 554, 37 Sup. Ct. 217, 222 (1917).

⁶² §§ 1707.02 to 1707.09 (8624-3 to 8624-10).

⁶³ 1 Ohio Bar, No. 42, p. 8.

⁶⁴ See generally 1 Ohio Bar, No. 42, pp. 7-9; 1 Ohio Bar, the unnumbered supplement entitled, *Report of the Committee on Judicial Administration and Legal Reform at the Mid-Winter Meeting, Cleveland, January 24, 25, and 26, 1929*, p. 13; 36 OHIO JUR. 479.

⁶⁵ §§ 1707.13 and 1707.23 (8624-16 and 8624-28). See also 1 Ohio Bar, No. 42, p. 31.

may be consummated⁶⁷ without any required affirmative action. Securities are exempted if by their inherent nature it appears probable they will not be issued on a deceptive basis. The issuer may proceed to sell the specified kinds of securities without filing any choice or application with the division. But if an exemption is challenged by the Division, the seller must prove the benefit of the exempting section by a preponderance of the evidence.⁶⁸

1. *Exemptions of Securities*

An examination of the exemptions granted to certain types of securities helps in determining the motivations behind each. Government and municipal,⁶⁹ banks⁷⁰ and equipment trust⁷¹ securities appear to be exempted because of the relative stability of the issuer or collateral; regulated public utility⁷² and insurance company securities⁷³ are because of prior governmental supervision; commercial paper,⁷⁴ seasoned securities without default⁷⁵ and non-profit company securities⁷⁶ are exempted because business useage has proved regulation to be neither expedient nor necessary; interim certificates of exempted securities⁷⁷ are exempted because of the speed necessary in many commercial transactions; and securities which certain stock exchanges have listed⁷⁸ are exempted because approval has already been given by a reliable organization. These exemptions indicate that, aside from fraud,⁷⁹ the investor needs less protection where securities 1) have a relatively sound backing, 2) are otherwise supervised or 3) are normally not deceptively sold. They also recognize that commercial practicality dictates an absence of regulation in certain areas.

2. *Exemptions of Transactions*

Transactions are exempted if 1) the securities involved are not susceptible to regulation and are outside the scope of most blue sky laws, 2) the

⁶⁹ § 1707.02 (8624-3).

⁶⁷ §§ 1707.03 and 1707.04 (8624-4 and 8624-4a).

⁶⁸ *Catterlin v. State*, 16 Ohio L. Abs. 410 (App.), *app. dis'm*, 128 Ohio St. 110, 190 N.E. 578 (1934); *Sellers v. State*, 18 Ohio L. Abs. 328 (App. 1934).

⁶⁹ § 1707.02 (1) (8624-3(1)).

⁷⁰ § 1707.02 (2) (8624-3(2)).

⁷¹ § 1707.02 (5) (8624-3(5)).

⁷² *Ibid.*

⁷³ § 1707.02 (7) (8624-3(7)).

⁷⁴ § 1707.02 (6) (8624-3(6)).

⁷⁵ § 1707.02 (9) (8624-3(9)).

⁷⁶ § 1707.02 (8) (8624-3(8)).

⁷⁷ § 1707.02 (3) (8624-3(3)).

⁷⁸ § 1707.02 (4) (8624-3(4)); Regulation A-4.

⁷⁹ Prohibitions against fraud apply to sales of exempt securities.

transaction is usually not deceptively consummated, 3) the transaction is quite limited in scope, or 4) the purchaser is one not easily deceived.⁸⁰ A rational basis for exempting the enumerated transactions can be found in each case, but the reasonableness of some is open to question.

Sales by a fiduciary,⁸¹ a pledgee,⁸² or a corporation (of its own subscribed stock when payment is delinquent),⁸³ isolated sales by the owner⁸⁴ and single sales of securities under a chattel mortgage or conditional sale⁸⁵ are exempted because the isolated nature of the sale dictates that no supervision or regulation is required. Sales to an issuer, dealer, corporation, bank or insurance company⁸⁶ are exempted because such a purchaser is considered able to protect himself. The initial sale (to not more than five shareholders) of either voting shares by the issuer⁸⁷ or of participation shares in Ohio oil and gas wells⁸⁸ are exempted from registration because of the necessity of allowing small, close corporations the opportunity of rapid organization and operation and because of the absence of general public concern. The delivery or exercise of conversion or purchase rights to exempt securities,⁸⁹ deposits under voting trusts and delivery on surrender of interims,⁹⁰ share dividends and preorganization subscriptions without commissions⁹¹ and reorganization exchanges⁹² are exempted because they are internal transactions which do not concern the general public. Sales by banks at not over two per-cent profit to the seller⁹³ are exempted, probably because it is not expedient to regulate sales by such conservative institutions at such a small profit. And sales over an Ohio stock exchange⁹⁴ or by a licensed dealer of issued and outstanding securities⁹⁵ need not be registered because the security is already regulated.⁹⁶

In considering these transaction exemptions, it is important to remember that they preclude the necessity of any action by the seller *only if* the

⁸⁰ The transaction only is exempt — not the security. So subsequent sales must also fit within an exemption, or appropriate action taken.

⁸¹ § 1707.03(2) (8624-4(2)).

⁸² § 1707.03(4) (8624-4(4)).

⁸³ § 1707.03(5) (8624-4(5)).

⁸⁴ § 1707.03(1) (8624-4(1)).

⁸⁵ § 1707.03(7) (8624-4(7)).

⁸⁶ § 1707.03(3) (8624-4(3)). But note exception to exemption of securities purchased outside of, or transported into, Ohio within one year of sale.

⁸⁷ § 1707.03(13) (8624-4(13)). See Regulation E-2.

⁸⁸ § 1707.03(14) (8624-4(14)).

⁸⁹ § 1707.03(8) (8624-4(8)).

⁹⁰ *Ibid.*

⁹¹ § 1707.03(10) (8624-4(10)).

⁹² §§ 1707.03(11) and 1707.04(11) and 8624-4a).

⁹³ § 1707.03(9) (8624-4(9)).

security meets the requirements of a particular exemption at the time of its sale. And since *all* securities must be qualified before sale unless an exemption (or registration by description) *applies*.⁹⁷ The same is also true of security exemptions.⁹⁸ It is immaterial whether the exemption applied to sales of this security prior⁹⁹ or subsequent¹⁰⁰ to the present sale — exemptions presently claimed must be established on existing facts.

The Ohio exemptions are not unusual, being found to a varying extent in many blue sky laws, especially those of the midwestern states.¹⁰¹ They are basically sound in directing regulation at those securities needing it most, while not unduly hindering commercial transactions. And it should be remembered that the anti-fraud provisions apply to all securities transactions, the Act regulating exempt securities to that extent.

B. *Registration by Description*

Registration by description is required for securities which, although not exempt, do not have to submit to the approval of the Division if they are able to prove their quality in designated ways. Proof is accomplished by filing a description with the Division prior to sale, showing that the securities fall within one of the listed categories.¹⁰² Sale without further regulation is then permitted, under the theory that if the required facts do exist, the securities are deemed to be relatively free from deception.¹⁰³

1. *Registration of Securities*

Securities which need only be registered by description include those of a going concern which has proved its earning ability over a prescribed period,¹⁰⁴ because the issuer's earning capacity tends to prove its stability; securities backed by interests in land mortgages,¹⁰⁵ land trusts¹⁰⁶ or steam-

⁹⁴ § 1707.03(1) (8624-4(1)).

⁹⁵ § 1707.03(12) (8624-4(12)). This exemption does not apply where part of an underwriter's unsold allotment is involved.

⁹⁶ Either in acquiring trading privileges on the exchange or in its initial sale by an issuer, it was subjected to some sort of regulation or scrutiny, unless the security itself is exempt.

⁹⁷ § 1707.09 (8624-10).

⁹⁸ See *State v. Stockman*, 21 Ohio App. 475, 479, 153 N.E. 250, 251 (1926).

⁹⁹ 1927 OPS. ATT'Y GEN. [Ohio] No. 991.

¹⁰⁰ *State v. Stockman*, 21 Ohio App. 475, 153 N.E. 250 (1926).

¹⁰¹ Compare Ohio's with the listing in 1 CCH BLUE SKY LAW REP. 55 1191-2181. See also 87 A.L.R. 42.

¹⁰² § 1707.08 (8624-8).

¹⁰³ 1 Ohio Bar, No. 42, p. 44.

¹⁰⁴ § 1707.05(1) (8624-5(1)).

¹⁰⁵ § 1707.05(2) (8624-5(2)).

¹⁰⁶ § 1707.05(3) (8624-5(3)).

ships,¹⁰⁷ which do not exceed two-thirds of the fair value of the interest, and collateral trust certificates which do not exceed the value of certain types of collateral,¹⁰⁸ because of the relatively sound value of the collateral backing the security.

The provision including securities of an issuer who has demonstrated certain earning ability allows small, going concerns to acquire new capital with little red-tape. The other provisions permit the sale of securities backed by what is considered to be sufficient collateral, without actually passing on the relative merits of each security's individual backing. The collateral securities described are typical ones, normally bonds.

2. *Registration of Transactions*

Transactions which must be registered by description consist of sales by domestic corporations of their own securities at a cost of not more than three per cent,¹⁰⁹ since the issuer itself receives most of the proceeds, eliminating large outside profits; sales by issuers having no more than fifteen shareholders¹¹⁰ or by partnerships, syndicates, etc., of not over ten members,¹¹¹ because of the relatively small nature of the transaction and consequent lack of danger to the general public; a sale by a corporation to its existing security holders,¹¹² because the transaction is internal and not within the proper scope of regulation.

However, a particular method of selling cannot be chosen solely for the purpose of avoiding the Act's other provisions. It should be observed that many of the securities and transactions eligible for registration by description are similar to exemptions, but different enough to require some regulation. The absence of much regulation for sales by small issuers or to existing shareholders seems reasonable, but the provisions for issuers who receive at least ninety-seven per cent of the sale price does not seem to benefit investors greatly, except insofar as it may indirectly tend to eliminate watered stock.

The information required in the description is quite simple.¹¹³ The securities must be briefly described, the amount to be issued and the selling price given, and the facts leading to compliance with one of the categories stated. Once filed the securities may be sold. However, the se-

¹⁰⁷ § 1707.05(4) (8624-5(4)).

¹⁰⁸ § 1707.05(5) (8624-5(5)).

¹⁰⁹ § 1707.06(1) (8624-6(1)). Another requirement is that "no part of the securities to be sold is issued directly or indirectly in payment or exchange for intangible property or for property not located in this state." See also Regulations R-6A and E-1.

¹¹⁰ § 1707.06(2) (8624-6(2)).

¹¹¹ § 1707.06(3) (8624-6(3)).

¹¹² § 1707.06(4) (8624-6(4)).

curities in this group are subject to further scrutiny, and the issuer must file semi-annual reports.¹¹⁴ Registration may subsequently be revoked if certain fraudulent or deceptive conditions are found to exist.¹¹⁵

C. *Qualification*

If a security by itself, or as the subject matter of a transaction, is neither exempt nor eligible for registration by description, it must qualify with the Division before it can be sold in Ohio.¹¹⁶ Qualification is accomplished by filing an application with the Division which requires more detailed information concerning the issuer and the financial dealings surrounding the securities.¹¹⁷ Where the securities have previously been registered with the Securities and Exchange Commission, materials and exhibits from that registration may be incorporated by reference.¹¹⁸ Foreign issuers must file an irrevocable, written consent to substituted service in all cases of fraud arising from a sale of these securities.¹¹⁹ And if the Division feels it is in the best interests of the public, it may require that the securities or proceeds be held in escrow for as long as is necessary.¹²⁰

Where the issuer is "of good business repute," securities may be sold without qualification if the division gives its prior consent and if they are subsequently qualified within thirty days.¹²¹ This allows established companies to float new issues quickly and thus take advantage of a favorable market, without the delay of prior qualification and investigation. If on subsequent filing, the Division refuses to qualify the security, the issuer or dealer must withdraw the securities from the market and buy back those already sold by refunding the purchase price.

The Division will refuse to qualify securities if it finds that the business of the issuer is fraudulently conducted, or that sales are fraudulent, deceptive or on grossly unfair terms.¹²² Since fraud is often difficult to

¹¹³ See § 1707.08 (8624-8).

¹¹⁴ Regulation Q-2. This applies to "qualified" securities as well.

¹¹⁵ See § 1707.13 (8624-16).

¹¹⁶ § 1707.09 (8624-10).

¹¹⁷ Presently this is done on form U (Uniform Qualification Form). Note that under Section 1707.09(h) (8624-10(h)) the Division can require any other information it deems necessary.

¹¹⁸ Regulation Q-4.

¹¹⁹ § 1707.11 (8624-13).

¹²⁰ Regulation Q-1. See also § 1707.09(k) (8624-10(k)).

¹²¹ § 1707.10 (8624-14). The sale must "... not deceive or tend to deceive the public."

¹²² If the sale is to be by an underwriter, the issuer must receive at least 85% of the total sales price. § 1707.09(j) (8624-10(j)). This is also true of securities registered by description. Regulation R-5A. And breach of a contract for more than 15% of the sales price does not give rise to a cause of action. *Anchor Life & Acc. Ins. Co. v. Taylor*, 29 Ohio App. 428, 163 N.E. 631 (1928).

prove, the prohibition against sale on grossly unfair terms is most important here.¹²³ With this provision, the Division is able to exclude securities which it feels do not give investors a "fair shake," although no actual fraud may be involved. Since "grossly unfair" is so flexible a term, decisions of the Division in such instances are difficult to upset on appeal.

Power is also granted to suspend a security or the right to sell it by dealers or issuers if the Division finds (1) the issuer's business is fraudulent or (2) its sale is or will be fraudulent, deceptive or on grossly unfair terms.¹²⁴ This is true whether the security is registered, qualified or exempt. Following a hearing, the suspension must be either confirmed or revoked.

It appears that the overall aim of the regulatory provisions of the Act is to permit established issuers to function with a minimum of interference. New and financially unstable companies and issues and the more speculative securities are subjected to greater restrictions. The degree of regulation seems to be directly proportionate to the likelihood that a security may be deceptively sold.

IV. REGULATION OF SELLERS—LICENSING

Ohio's protection of investors is further extended by the Act's broker-dealer licensing requirements.¹²⁵ These requirements attempt to "... prevent deception and save credulity and ignorance from imposition, as far as this can be done by the approved reputation of the seller of the securities and authoritative information."¹²⁶

To grant a license, the Division must be convinced "... that the applicant is of good business repute."¹²⁷ The application form requires fairly detailed information upon which this judgment may be based.¹²⁸ With such a prerequisite, the Division is able to maintain a high standard in this occupation and to eliminate persons whose dealings might be suspect. A written consent to substituted service must also be filed by foreign applications.¹²⁹ And there is a special section dealing with fraudulent actions by a broker.¹³⁰

All brokers of securities are required to secure a license. All sales and the *business* of buying, selling and dealing must be carried on through licensed dealers, unless the securities involved are the subject matter of a transaction either exempt or registered by description. Since casual in-

¹²³ See Regulation Q-3, regarding investment trust securities.

¹²⁴ § 1707.13 (8624-16).

¹²⁵ § 1707.14 (8624-17). Sellers of warehouse receipts for intoxicating liquor must also obtain a license. §1707.34 (8624-49).

¹²⁶ Hall v. Geiger-Jones Co., 242 U.S. 539, 551, 37 Sup. Ct. 217, 221 (1917).

¹²⁷ § 1707.15 (8624-18).

¹²⁸ *Ibid.*; Form 18; Regulation DS-2.

¹²⁹ § 1707.15 (8624-18).

¹³⁰ § 2911.05 (13108).

vestors must normally deal through a broker and since the broker has been subjected to the examination of the Division, investors are assured of dealing with a person whose character and business dealings have been subjected to scrutiny.¹³¹

A dealer's solvency is assured by requiring applicants to prove a net worth of at least \$10,000, after eliminating questionable assets.¹³² This may be lowered to \$5000 for good cause, or a security bond may be posted in lieu of the requirement. When debts exceed 1500% of net worth, or net worth dips below \$10,000, customers' funds must be segregated according to detailed provisions.¹³³ Failure to comply is considered a "grossly unfair practice," which can lead to suspension of the dealer's license.¹³⁴

A person dealing in securities as a principal must consummate his transactions through a licensed dealer or acquire a license himself.¹³⁵ This provision is designed to protect the investor, since although he may *buy* directly without going to a broker, he must *sell* through one, unless the securities are in transactions exempt or subject to registration by description. Direct sales may be made of the seller's own commercial paper or of securities of a non-profit company.¹³⁶ The reasoning appears to be that it is difficult to defraud a *seller*, and that these transactions are excepted since they are deemed to be of such a nature that the restriction of acting through a dealer need not be imposed. In all other situations, the transaction must be consummated through a licensed dealer, whose honesty is investigated.

The purpose of licensing is to prevent fraud in sales and to assure trustworthy and solvent dealers. Like registration, licensing does not insure an advantageous transaction. Instead, a framework of honesty is established, within which transactions may be carried on with a minimum risk of fraud and deception. But there is no affirmative confidential relationship or position of trust toward purchasers imposed upon dealers.¹³⁷

A dealer licensed under the Act may employ salesmen. They also are required to be "of good business repute" and must be licensed.¹³⁸ Every salesman is required to be in the employ of a particular dealer, and when such connection is severed, the salesman's license is automatically voided.

¹³¹ Receipt of a license places a burden of care on a seller, upon which the public may rely. *Ross v. Couden*, 22 Ohio App. 330, 154 N.E. 527 (1926).

¹³² Regulation DS-4.

¹³³ Regulation DS-5.

¹³⁴ § 1707.19 (8624-22).

¹³⁵ § 1707.14 (8624-17). And see Regulation DS-1.

¹³⁶ § 1707.14(2)(a) (8624-17(2)(a)). But the final determination of whether or not a corporation is non-profit rests with the Division, and foreign decisions on the subject are not binding. 1925 OPS. ATT'Y GEN. [Ohio] No. 2387.

¹³⁷ *Shibley v. Shultz Bros. & Co.*, 16 Ohio L. Abs. 454 (App. 1934).

¹³⁸ § 1707.16 (8624-19).

At what point a salesman becomes a dealer, and thereby requires a dealer's license, is a question of fact, to be decided by a jury.¹³⁹ Clericals and other employees of a dealer who may exercise occasional selling functions are deemed not to be salesmen where selling is incidental to their main work.¹⁴⁰ This exception is not applicable if the dealer himself is not licensed, and participation in sales under these conditions makes the employees amenable to the Act.¹⁴¹

Licenses are subject to revocation or suspension, or may be refused for insolvency, fraud or other unethical business practices or violations of the Act.¹⁴² Original or renewal refusal and suspension may be effected by the Division without a hearing,¹⁴³ but upon request a hearing must be held within fifteen days.¹⁴⁴ And a right of judicial review is provided.¹⁴⁵ Revocation must be preceded by notice and hearing.¹⁴⁶ In view of the fact that renewal refusals and suspensions are predicated upon the same grounds, the requirement of yearly renewal seems to be more of a revenue than regulatory measure.¹⁴⁷

Where an unlicensed dealer has made a contract to sell securities, if he cannot show how it can be performed without violating the Act, it is unenforceable.¹⁴⁸ Actual sales without license are considered violations, unless otherwise proved by a preponderance of evidence.¹⁴⁹ But the sale itself must be made within the state to constitute a violation of the licensing provisions,¹⁵⁰ whereas fraud perpetrated anywhere may violate other sections of the Act.¹⁵¹

V. POWERS OF THE DIVISION

The Division has been granted sweeping investigative and corrective powers by the Ohio legislature. If an issuer has violated the act in any

¹³⁹ 1924 Ops. ATT'Y GEN. [Ohio] No. 2087.

¹⁴⁰ § 1707.01 (6) (8624-2(6)).

¹⁴¹ See *Snypp v. State*, 21 Ohio L. Abs. 324, 326 (App.), *app. dis'm*, 131 Ohio St. 216, 2 N.E.2d 269 (1936).

¹⁴² § 1707.19 (8624-22).

¹⁴³ *Ibid.* See also § 119.06 (154-67). But see end of § 1707.14 (8624-17), regarding refusals.

¹⁴⁴ §§ 119.06 and 119.07 (154-67 and 154-68).

¹⁴⁵ § 1707.22 (8624-24).

¹⁴⁶ § 1707.19 (8624-22). The hearing must conform to the requirements of the Ohio Administrative Procedure Act.

¹⁴⁷ Note § 1707.15 (8624-18). requiring only an abbreviated information statement for renewals. Also note the substantial renewal fees required by § 1707.17 (8624-21)

¹⁴⁸ *Cochran v. Hurth*, 29 Ohio App. 305, 163 N.E. 560 (1927).

¹⁴⁹ *Catterlin v. State*, 16 Ohio L. Abs. 410 (App.), *app. dis'm*, 128 Ohio St. 110, 190 N.E. 578 (1934).

¹⁵⁰ § 1707.14 (8624-17).

way, is or has been acting fraudulently or is insolvent, or if the security is being disposed of on fraudulent, deceptive or grossly unfair terms, the Division may summarily suspend registration or qualification and the right of all dealers (or the issuer) to deal in the security.¹⁵² Similarly, it may suspend, without hearing,¹⁵³ the license of any dealer or salesman dealing fraudulently or violating other provisions of the Act, or who "is not of good business repute."¹⁵⁴ Prior to final action on suspension, hearings must be held, as required by the Act or the Ohio Administrative Procedure Act, and a right of appeal is given to any aggrieved party.¹⁵⁵ Of chief importance here is the Division's power to take immediate action, without the delay of hearings when such action appears necessary. Investor protection is of paramount importance.

Broad investigative powers have been given the Division¹⁵⁶ since it must base suspension orders on findings, as stated above. Investigations are easily begun, since it need only appear that a violation, fraudulent act or deceptive scheme was, is, or will be occurring, or merely that the Division "believes it to be in the best interests of the public and necessary for the protection of investors."¹⁵⁷ This standard allows the division to set its investigative machinery into operation at the first suspicion of misconduct.

Once the above determination has been made, the Division may require any person to file statements of any facts or circumstances concerning the issuance or sale of securities within Ohio by such persons, and "such other data and information as it may deem relevant or material thereto."¹⁵⁸ It may examine any seller, dealer, salesman, issuer or person connected therewith under oath, and any records, books or documents deemed material.¹⁵⁹ Any dealer may be required to furnish a copy of prospectuses, circulars or advertisements,¹⁶⁰ and to furnish a notice of intention to sell all securities neither exempt nor in exempt transactions.¹⁶¹ The Division is given power to subpoena witnesses and to compel production of documentary evidence as required,¹⁶² and proceedings may be brought in any com-

¹⁵¹ *Indem. Ins. Co. v. Kircher*, 47 Ohio App. 140, 191 N.E. 374 (1934).

¹⁵² § 1707.13 (8624-16). This is true even if the security is exempt.

¹⁵³ But note Administrative Procedure Act requirements.

¹⁵⁴ § 1707.19 (8624-22). Such a broad definition is not an unreasonable classification. Cf. *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 37 Sup. Ct. 217 (1917).

¹⁵⁵ § 1707.22 (8624-24).

¹⁵⁶ § 1707.23 (8624-28).

¹⁵⁷ *Ibid.*

¹⁵⁸ § 1707.23 (a) (8624-28(a)).

¹⁵⁹ § 1707.23 (c) (8624-28(c)).

¹⁶⁰ § 1707.23 (f) (8624-28(f)).

¹⁶¹ § 1707.23 (g) (8624-28(g)).

¹⁶² § 1707.23 (c) (8624-28(c)).

mon pleas court to enforce compliance.¹⁶³ Failure to comply with a court order puts the recalcitrant in contempt.

A question arose as to whether a person required to furnish such information to the Division, subject to contempt proceedings if he fails to do so, can effectively assert the privilege against self-incrimination granted by Art. I, Sec. 10 of the Ohio Constitution.¹⁶⁴ The precise issue was decided in *Adkins v. State*.¹⁶⁵ There the defendant, a dealer, furnished certain incriminating information to the Division pursuant to a hearing. When later prosecuted for violating the Act, the defendant objected to the admission in evidence of a transcript of this testimony as irrelevant. On appeal from his conviction, he contended for the first time that this privilege had been violated, since he was *required* to testify under the provisions of section 8624-28 of the Ohio General Code (now Section 1707.23 Ohio Revised Code).

In affirming his conviction, the court of appeals stated that the possibilities of loss of a dealer's license or of contempt proceedings for refusal to testify were insufficient in themselves to constitute enough compulsion to violate the constitution. Implied but inarticulated is the reasoning that the defendant may have waived his privilege by failing properly to invoke it at the hearing.

However, in *Mouser v. Pub. Utilities Comm'n*,¹⁶⁶ the Ohio Supreme Court made it clear that, where the defendant timely asserts this privilege, he cannot be convicted of contempt for refusing to answer. In that case, the defendant refused to give information which the Public Utilities Commission was authorized to require, under a statute¹⁶⁷ almost identical to Section 1707.23 Ohio Revised Code. The court confirmed the defendant's right to refuse to answer on the basis of self-incrimination, but affirmed his contempt conviction since the same statute contained a provision granting immunity from any prosecution based upon this testimony.

It is interesting to note that the final report of the committee drafting the present Ohio Securities Act contained a similar immunity provision.¹⁶⁸ However, the Act was passed without it. Perhaps the legislature decided that in this situation it would be better to permit the privilege to be invoked wherever applicable, but to prosecute *all* violators without allowing an opportunity for immunity.

¹⁶³ § 1707.24 (8624-29).

¹⁶⁴ The federal privilege probably does not apply. *Twining v. New Jersey*, 211 U.S. 78, 29 Sup. Ct. 14 (1908). See *Mouser v. Pub. Utilities Comm'n*, 124 Ohio St. 425, 429, 179 N.E. 133, 134 (1931).

¹⁶⁵ 15 Ohio L. Abs. 603 (App. 1933).

¹⁶⁶ 124 Ohio St. 425, 179 N.E. 333 (1931).

¹⁶⁷ § 4903.02 (614-6).

¹⁶⁸ 1 Ohio Bar, No. 42, p. 84, § 31.

Information acquired from these investigations can be used to furnish the basis for suspension of a dealer's or salesman's license,¹⁶⁹ or to initiate criminal proceedings by turning incriminating evidence over to the appropriate prosecuting attorney.¹⁷⁰ There would seem to be no valid reason why these investigative powers could not also be used to obtain the information necessary to suspend registration, qualification or the dealing in a particular security, although use of this section is specifically authorized only in subsequent hearings on such suspension orders.¹⁷¹ Probably the language was deemed broad enough to make a specific reference to this purpose unnecessary.

Where a person fails to furnish information or documents required by the Division, or violates an order of a court, the court may enjoin his issuing or selling securities in Ohio.¹⁷² Where such person is an issuer, the court may enjoin the sale of *any* of his securities and the Division may revoke the qualification or revoke or suspend the registration.¹⁷³ Thus refusal to furnish required information can result not only in prosecution for contempt, but in an abolition of the right to engage in the securities business in Ohio.

Injunctions may also be issued where no order of the Division is involved, if it appears to the Division that some violation of the Act was, is or will be occurring.¹⁷⁴ Violation of this injunction puts the violator in contempt of court, whereas his actions without such an injunction might not have subjected him to criminal penalties, even though contrary to the Act.

Complaints to the Division must be made for the purpose of invoking proceedings for the suspension or revocation of licenses or registration, and the Division may require verification upon oath by the complainant.¹⁷⁵ It is the duty of the attorney-inspector¹⁷⁶ to investigate these complaints and decide whether or not a violation has occurred. Since many detailed fact situations are involved, much discretion in instituting proceedings necessarily rests in this office. In any event, the complainant must be notified of the disposition of his complaint.¹⁷⁷

Where unintentional or minor violations occur, the Division may be

¹⁶⁹ § 1707.23 (d) (8624-28 (d)).

¹⁷⁰ § 1707.23 (e) (8624-28 (e)).

¹⁷¹ § 1707.13 (8624-16).

¹⁷² § 1707.25 (8624-30).

¹⁷³ *Ibid.*

¹⁷⁴ § 1707.26 (8624-31).

¹⁷⁵ Regulation C-1.

¹⁷⁶ See § 1707.36 (8624-44).

¹⁷⁷ Regulation C-1.

reluctant to take formal action, and a word to the violator will usually clear up the difficulty. The mere fact that the Division knows of a present or prospective violation is usually a sufficient deterrent to its occurrence or recurrence, in view of the criminal sanctions applicable. This undoubtedly helps to account for the paucity of cases arising under the present Act. And where securities are sold without first complying with the Act, they may later be qualified upon payment of a small fee, as long as no fraud or prejudice did or will result.¹⁷⁸

Where a person has been defrauded through a securities transaction carried on in violation of the Act, the Division has the power to apply to a court and have a receiver appointed for the defrauding party.¹⁷⁹ This receiver assumes custody of all proceeds resulting from the fraud and of any property with which such proceeds have been mingled. The person defrauded is thereby aided in recovering his losses, even if he cannot trace the exact proceeds.

VI. LIABILITIES

A. *Civil*

The extent of civil liability under the Act is somewhat indefinite. Section 1707.40 of the Ohio Revised Code (Ohio General Code Section 8624-43) specifically saves all common law liabilities, except as limited or extended by three other named sections.¹⁸⁰ The main difficulty comes in determining the scope of these three sections and whether or not the liability and procedure provided in each is exclusive, given a deceptive act of the type defined therein. An additional problem is determining what are the relative advantages of a statutory and a common law action when a purchaser has an election.

Many of the Ohio cases on civil liability arising under the Act are based on interpretations of sections now repealed, and are therefore valuable only for their reasoning. At present there is no section conferring a right of action based merely on a fraudulent sale.¹⁸¹ Hence, unless the conduct of the seller can be fitted into one of the three categories giving rise to a statutory cause of action, the buyer's suit must be at common law.

1. *Liability of Advisers*

The statutory remedy presenting the least problem is afforded by a section concerning the civil liability of an adviser.¹⁸² This makes liable one who, "with intent to secure financial gain," advises a person to purchase securities and receives a commission or reward without disclosing his

¹⁷⁸ § 1707.39 (8624-41). The seller may still be prosecuted for a violation, however.

¹⁷⁹ § 1707.27 (8624-32).

¹⁸⁰ §§ 1707.41, 1707.42 and 1707.43 (8624-35, 8624-36 and 8624-48a).

agency or interest in the purchase. He is liable to the purchaser "for the amount of his damage thereby," if the purchaser tenders back the securities and sues within one year. This is essentially an anti-touting provision.

2. *Liability for Written Misrepresentations*

Ohio Revised Code Section 1707.41 (Ohio General Code Section 8624-35) provides for suit by a person deceived "by a written or printed circular, prospectus or advertisement." This is "in addition to the liability now imposed by law," and affords an alternative action to the common law remedy for deceit.¹⁸³ The purchaser must rely on the circular, prospectus or advertisement in making the purchase, and is entitled to recover "for the loss or damage sustained by reason of the falsity of any material statement contained therein," unless the person otherwise liable can establish either that, 1) he had no knowledge of the publication prior to the sale, or 2) he had "just and reasonable grounds to believe such statement to be true." But these defenses are available only where such person has used reasonable diligence to discover the fact of publication or falsity of any statement.

Liability under this section is imposed upon any person who offers a security for sale or receives the profits accruing from such sale under the conditions above described. In this respect, it enlarges common law liability, since there need be no principal-agent relationship shown; mere receipt of the proceeds is sufficient. The section also provides that where a corporation is liable, each director is also liable unless he can avail himself of one of the two defenses. But he is given a right of contribution from other directors who are liable. And where a board of directors approves the statement of one director to be furnished to a purchaser, it becomes the statement of the corporation.¹⁸⁴

¹⁸³ Ohio has passed the Uniform Sales Act, which may be helpful, especially §§ 1315.70 and 1315.74 (8449 and 8453). See also *Citizens Bank of Ashville v. Cameron & Co.*, 40 F. Supp. 1002 (D.C. Ohio 1941), *aff'd*, 134 F.2d 888 (6th Cir. 1943), which indicates that any fraud is actionable.

¹⁸² § 1707.42 (8624-36). Note also Regulation DS-8, limiting advice to be given customers by a licensed dealer.

¹⁸³ *Citizens Banking & Savings Co. v. Spitzer, Rorick & Co.*, 65 Ohio App. 309, 29 N.E.2d 892 (1938). There a suit based on alleged fraudulent statements was allowed apart from this section. Although the court stated that the plaintiff was suing on a statutory cause of action, it appears they referred only to a portion of Ohio General Code Section 6373-3(d) (old dealer's bonding provision) which provided for liability against the bonding company. In another portion of this section, service on the consensual agent was provided where there had been a "fraudulent" disposal. The court went on to say that the action was limited to the *form* of action specified by this consent jurisdiction, and required proof of "actual fraud." The conclusion seems to be that the action was based on the common law remedy for fraud. Note also that this section was expressly held not to be construed in *pari materia* with Section 1707.41 (6373-18 (later 8624-35)).

¹⁸⁴ *Berry v. Pugh*, 6 Ohio L. Abs. 217 (App. 1928).

The scope of common law liability is somewhat reduced by defenses available in suits under this section. The principal of an agent selling securities by means of a fraudulent prospectus can avoid liability by showing that he reasonably did not know of the prospectus. It might appear from the words of the section that *any* reliance on such false statements, no matter how unreasonable or foolish, is sufficient. Although this is arguable, it has been held in a common law suit for fraudulent representations contained in a prospectus that the purchaser has an obligation to read the prospectus "understandingly and not negligently."¹⁸⁵ Presumably this applies to actions under this section also. Nor does a purchaser have to prove that the seller intended that he rely on the prospectus; such intent is assumed.

In suits for common law fraud, opinions as to future events contained in a prospectus are not actionable, since there must be a misrepresentation of a material fact.¹⁸⁶ It is conceivable that the legislature, by establishing liability under this section for false "material statements" intended to include more than mere statements of fact.¹⁸⁷

The choice of whether to base a suit on the provisions of this section or upon common law grounds belongs to the individual plaintiff, depending on which of the above factors are most promising to his cause of action. Of course where there are oral misrepresentations or other fraudulent acts committed in the sale, the buyer's only remedy is a suit based on the common law. The two-year statute of limitations provided for actions against directors brought under this section is probably irrelevant, in view of the general two-year statute of limitations on *any* action arising from a sale in violation of any provisions of the act.¹⁸⁸ Class actions are probably not possible, since each plaintiff, although suing on the same misrepresentation, was individually defrauded.¹⁸⁹

The amount of damages recoverable in an action based on this section is probably the same as that recoverable in a common law action. The common law measure seems to be based on the buyer's "loss-of-bargain,"¹⁹⁰ whereby he can recover the difference between the value of the securities as represented and the actual value at the time of sale.¹⁹¹ Recovery of speculative profits or the maturity value of bonds¹⁹² is not permitted.¹⁹³ Since the statute provides recovery for "loss or damage sustained," a measure similar to

¹⁸⁵ *Citizens Banking & Savings Co. v. Spitzer, Rorick & Co.*, 65 Ohio App. 309, 29 N.E.2d 892 (1938).

¹⁸⁶ *Id.* at 318, 29 N.E.2d at 897.

¹⁸⁷ See LOSS, SECURITIES REGULATION 980 (1951).

¹⁸⁸ § 1707.43 (8624-48a).

¹⁸⁹ *Aetna Casualty & Surety Co. v. Lanz*, 18 Ohio L. Abs. 121 (App. 1934).

¹⁹⁰ PROSSER, TORTS § 90 (1941).

¹⁹¹ *Gray v. Gordon*, 96 Ohio St. 490, 117 N.E. 891 (1917); *Citizens Banking & Savings Co. v. Spitzer, Rorick & Co.*, 65 Ohio App. 309, 29 N.E.2d 892 (1938).

the common law one is probably applicable. Where there is no provable loss incurred, the person defrauded may find he can recover no damages, but this is not an unjust result since he may still rescind the sale and obtain restitution.¹⁹⁴

3. *Liability for Violations of the Act*

A third statutory remedy is provided in situations where there has been a violation of any provision of the Act, "unless the court shall determine that the violation did not materially affect the protection contemplated by the violated provision."¹⁹⁵ This remedy is further limited by the provision¹⁹⁶ that there shall be no civil liability for non-compliance with orders of refusal, suspension and revocation of licenses, orders issued pursuant to a fraud investigation or other rules or regulations of the Division. Sales or contracts for sale made in violation of any provision of the Act are made voidable at the election of the purchaser.¹⁹⁷

Liability under this section is imposed upon the seller and "every person who shall have participated in or aided the seller in any way in making such a sale or contract of sale." They are jointly and severally liable to the purchaser in an action at law, upon tender of the contract or securities, for the full purchase price and all taxable court costs and interest.¹⁹⁸ In order to claim the benefit of this section, however, the purchaser must not refuse or fail to accept within thirty days an offer, made in writing by the seller (within two weeks of the date of the sale or contract), to take back the securities and return the purchase price.

It is clear that a person buying securities from a seller who has violated the Act may recover in the manner and to the degree specified above. A question arises when the seller's actions may also provide the basis for a common law action for deceit, apart from the statutory remedy, *e.g.* where false information is filed with the Division pursuant to a qualification¹⁹⁹

¹⁹² The so-called New York rule of *Hotaling v. A.B. Leach & Co.*, 247 N.Y. 84, 159 N.E. 870 (1928), adopted by the dissent in the *Spitzer, Rorick* case, *supra* note 191.

¹⁹³ *Citizens Banking & Savings Co. v. Spitzer, Rorick & Co.*, 65 Ohio App. 309, 29 N.E.2d 892 (1938).

¹⁹⁴ *Ibid.* For common law rights in general, see PROSSER, TORTS § 90 (1941).

¹⁹⁵ § 1707.43 (8624-48a).

¹⁹⁶ § 1707.40 (8624-43).

¹⁹⁷ This changes the holding in *Warren People's Market Co. v. Corbett & Sons*, 114 Ohio St. 126, 151 N.E. 51 (1926), that such sales or contracts of sale were valid, the violator being subject to the prescribed penalties. See Note, 15 Ohio Op. 414 (1939).

¹⁹⁸ Note award by lower court in *Citizens Banking & Savings Co. v. Spitzer, Rorick & Co.*, 65 Ohio App. 309, 29 N.E.2d 892 (1938). See also LOSS, SECURITIES REGULATION 965 (1951).

¹⁹⁹ Or if seller falsely states facts pursuant to a registration by description, where in fact the securities are ineligible.

and the prospective purchaser examines²⁰⁰ and relies on it in making his purchase.²⁰¹ Are the buyer's rights limited to suit under this section, or can he disregard the Act and sue for deceit? A purchaser would want to sue on a common law theory if he had failed to accept timely a proper tender, thus forfeiting his right to "claim or have the benefit of this section."²⁰² Or he might wish to recover loss-of-bargain damages rather than the out-of-pocket recovery provided by the Act.

The language of the section itself would not seem to preclude a common law action. Hence the question is probably reduced to an examination of the legislative intent in inserting such a provision. The argument that it was not intended to be the exclusive remedy is certainly not inconsistent with the purpose of the Act as a whole—the protection of investors. It is quite conceivable that it was merely intended to provide the purchaser with a more accessible remedy and eliminate his having to prove all the requirements of actual fraud.²⁰³ The contrary argument is that this section was intended to "limit"²⁰⁴ the common law right of action in the manner stated, and has substituted this statutory cause of action. This issue has not been litigated, and, in view of the relatively unimportant differences between the two actions, presents perhaps a rather minor question.

A more important question is the effect to be given the two-year statute of limitations prescribed by this section. Besides limiting actions brought under this section, it states that "no other action for any recovery based upon or arising out of a sale or contract for sale made in violation of *any* of the provisions of the Ohio Securities Act, *whether based upon contract or tort, and whether legal or equitable in nature*, shall be brought after two years from the date of such sale or contract for sale" (italics supplied). In view of the comprehensive language of this limitation, it is doubtful that it could successfully be argued that it was meant to apply only to those suits based on a statutory cause of action.

Other related questions include the applicability of Ohio's tolling,²⁰⁵

²⁰⁰ As he has a right to do. . § 1707.12 (8624-12). See also §§ 1707.30 and 1707.31 (8624-33 and 8624-34).

²⁰¹ See *Citizens Banking & Savings Co. v. Spitzer, Rorick & Co.*, 65 Ohio App. 309, 29 N.E.2d 892 (1938).

²⁰² This language tends to indicate that this section is not the exclusive remedy, but rather extends an alternative benefit.

²⁰³ The section was not added to the Act until 1939. A reasonable inference is that the legislature decided that it was usually too difficult for deceived purchasers to recover for common law deceit, and therefore added an alternative remedy which could be used or not, as the purchaser desired. But remember that this action may still be subject to defeat if the court determines the violation did not materially affect the protection contemplated. This appears to be a limitation on any such action.

²⁰⁴ § 1707.40 (8624-43).

²⁰⁵ § 2305.15 (11228).

disability²⁰⁶ and survival²⁰⁷ statutes. If, as is probable, this statute of limitations applies to both common law and statutory actions,²⁰⁸ the tolling and disability statutes would undoubtedly be held inapplicable, but there would seem to be no valid reason to prevent the application of the survival statute.

B. *Criminal*

The penal section of the Act provides maximum penalties of five years imprisonment and/or \$5000 fine for each violation.²⁰⁹ These are of course in addition to denial, suspension and revocation of licenses or registration. But "a strict construction of the provisions of this act . . . of course is required when dealing with a criminal prosecution."²¹⁰ A three-year statute of limitations is provided for criminal prosecutions.²¹¹

Any person selling securities or causing the same to be sold²¹² without a license, where by the provisions of the Act, a license is required, is guilty of a violation. No element of intent need be proved for this violation—merely the fact of a sale as defined. A violation also exists where one "knowingly" makes or causes to be made any false statement or representation concerning a relevant and material fact in order to (a) comply with the provisions of registration, (b) secure qualification, (c) procure the licensing of a dealer or salesman or (d) sell securities within Ohio. It is a violation where a sale is "knowingly and intentionally" made of securities: (a) not exempt, registered, or qualified, or in a transaction exempt or registered, (b) for which registration or qualification fees have not been paid, (c) where registration, qualification or the right to sell has been revoked or suspended or (d) with a statement that the Division endorses them. The term "knowingly" as used in this section does not permit good faith or advice of counsel as a defense, since it means with knowledge of the essential facts, lack of knowledge of the legal consequences being immaterial.²¹³

Where an issuer is insolvent, any officer, director, trustee or dealer who sells its securities knowing of the insolvency violates this section unless he

²⁰⁶ § 2305.16 (11229).

²⁰⁷ § 2305.21 (11235).

²⁰⁸ In the *Spitzer, Rorick* case, *supra* note 201, counsel's argument that the four-year fraud statute of limitations applied, was rejected in favor of another six-year time limitation for all statutory causes of action (§ 2305.07 (11222)). There was no statute of limitations comparable to this one present in the Act at that time, however.

²⁰⁹ §§ 1707.44, 1707.45 (8624-25).

²¹⁰ *Groby v. State*, 109 Ohio St. 543, 550, 143 N.E. 126, 128 (1924).

²¹¹ § 1707.28 (8624-27).

²¹² A sale by an authorized agent may cause his principal to be liable if he "causes" the sale. *State v. Weger*, 25 Ohio L. Abs. 49 (App.), *app. dis'm*, 133 Ohio St. 23, 10 N.E.2d 634 (1937).

²¹³ *Catterlin v. State*, 16 Ohio L. Abs. 410 (App.), *app. dis'm*, 128 Ohio St. 110, 190 N.E. 578 (1934).

discloses such insolvency to the purchaser. Anyone who sells securities of a known insolvent issuer "with intent to deceive" is also a violator. Other violations occur where a seller, with intent to aid in the sale of securities, "knowingly" makes representations unauthorized by the issuer or at material variance with the statements filed by the issuer. Finally, when a person selling securities within Ohio "knowingly engages in any act or practice declared illegal or defined as fraudulent or prohibited anywhere in this Act," it is a violation.

In prosecutions under this section, a defendant is deemed to have knowledge of any matter of fact he should have acquired by reasonable diligence exercised prior to the alleged violation.²¹⁴ Exemptions must be established by the claimant by a preponderance of the evidence.²¹⁵ And where a defendant is found guilty of selling in violation of the Act, *each* violation is a separate offense and can subject the violator to independent penalties. For example, in *State v. Weger*,²¹⁶ the defendant's sale of two unregistered notes without a license resulted in a judgment on four different counts — two for selling without a license, and two for selling unregistered securities. And the four sentences he received were to run consecutively.

VII. CONCLUSION

An overall evaluation of the Act is rather difficult. If absence of prosecutions indicates the successful functioning of a blue sky law, Ohio's has been working well for the last two decades, since most cases arose under the old Act or in the early thirties when the new Act was being sounded out. In spite of the numerous exemptions, etc., the Act's coverage is relatively comprehensive. Civil liability, even taken at the minimum possible extent, is still quite liberal. The fraud provisions seem to plug up any glaring holes left by exemptions, while the licensing provisions exclude professional swindlers. And with the large collection of weapons present in the Division's arsenal, a potential violator will think twice before operating in Ohio.

²¹⁴ § 1707.29 (8624-26).

²¹⁵ *Catterlin v. State*, 16 Ohio L. Abs. 410 (App.), *app. dis'm*, 128 Ohio St. 110, 190 N.E. 578 (1934).

²¹⁶ 25 Ohio L. Abs. 49 (App.), *app. dis'm*, 133 Ohio St. 23, 10 N.E.2d 634 (1937).