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Bill Analysis
Legislative Service Commission

S.B. 7

125th General Assembly
(As Introduced)

Sens. Coughlin, Harris, Goodman, Amstutz, Mumper, Jacobson, DiDonato

BILL SUMMARY

- Modifies the application of the Securities Law to include certain oral, written, or electronic agreements, understandings, or opportunities.
- Modifies registration of securities requirements, including: (1) requiring that a registration application be verified or sworn to by a natural person and contain specified information about the person, (2) requiring the Division of Securities to refuse a registration under specified circumstances, and (3) permitting the Division to refuse registration under specified other circumstances.
- Makes a clarification concerning the designation of the Secretary of State to receive service of process under the Securities Law.
- Provides that administrative enforcement actions are in addition to other remedies authorized by the Securities Law and modifies civil liability, including providing restitution authority.
- Increases statutes of limitations for bringing actions against directors of corporations for described unlawful activities, for bringing actions against an investment adviser or an investment adviser representative for a violation of the Securities Law, and for bringing actions involving the sale or contract for sale of securities in violation of the Securities Law.
- Prohibits specified acts in connection with the preparation, compilation, review, or audit of financial statements.
- Establishes a criminal violation for making false representations in certain notice filings with the Division of Securities and establishes the criminal violation of aggravated theft of \$1 million or more.

- Modifies the Corporation Law with respect to the timing of special meetings of shareholders held in connection with tender offer, control share acquisition bids.
- Increases criminal penalties under the Criminal Theft Law for theft of \$100,000 or more from any person and theft of \$25,000 or more from an elderly or disabled person.

CONTENT AND OPERATION

SECURITIES LAW

Application of the Securities Law--definition of securities

Currently, for purposes of the Securities Law, "security" means "any certificate or instrument that 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." The bill expands that definition to include certain oral, written, or electronic agreements, understandings, or opportunities. Thus, under the bill, for purposes of the Securities Law, "security" means any certificate or instrument, *or any oral, written, or electronic agreement, understanding, or opportunity*, that 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. (R.C. 1707.01(B).)

Registration of securities by description and by qualification

Current law

Generally, continuing law specifies that securities may be sold in Ohio if the securities are registered by description, by qualification, or by coordination (R.C. 1707.07, not in the bill). Current law specifies the conditions and requirements for registration of securities by description and by qualification.

If securities are to be registered by *description*, existing law specifies that the registration (1) must be filed with the Division of Securities by one of the following: the issuer, a majority of the incorporators of the issuer, or an Ohio licensed securities dealer, (2) must be on forms prescribed by the Division, (3) must set forth specified information about the issuer, securities, and transactions involving the securities, and (4) must be verified by the oath of the person filing it or any person having knowledge of the facts. Current law also specifies that registration by description is completed when it is filed with a filing fee of \$50 "in

the form of cash, check, or United States postal money order," and is delivered or mailed "by certified mail with postage prepaid, to the [D]ivision." (R.C. 1707.08.)

Under existing law, an application for registration of securities by *qualification* (1) must be filed with the Division of Securities, (2) must be made in writing and signed by the issuer or an Ohio licensed securities dealer desiring to sell them in Ohio, (3) must be on forms prescribed by the Division of Securities, (4) must set forth specified information about the issuer, securities, and transactions involving the securities, and (5) must be sworn to by any person having knowledge of the facts stated in the application. Current law also requires that any exhibits, statements, and documents required to be provided with the application for registration by qualification, except "certified public documents," be verified by oath of the applicant, issuer, or person having knowledge of the facts. (R.C. 1707.09.)

Operation of the bill

The bill replaces the requirement that an application for registration by description be verified by oath by the *person* filing it or any person having knowledge of the facts in the application with a requirement that the *individual* filing it or any individual having knowledge of the facts verify by oath the information in the application. It also replaces the requirement that an application by qualification be sworn to by any person having knowledge of the facts in the application with a requirement that those facts be sworn to by any *individual* having knowledge of those facts. This appears to mean that a natural person having knowledge of the facts in the application must swear to them on an application for registration by qualification, and a natural person either filing the application or having knowledge of the facts must verify the application for registration by description. Similarly, it requires that all exhibits, statements, and documents required to be provided with an application by qualification be verified by the applicant, issuer (existing law), or any individual (added by the bill) having knowledge of the facts. (R.C. 1707.08(B) and 1707.09(A)(2) and (D).)

In addition, the bill specifies that the individual who executes an application for registration by description or by qualification on behalf of the applicant must state the individual's relationship to the applicant and certify all of the following (R.C. 1707.08(C) and 1707.09(A)(3)):

- (1) The individual has executed the application on behalf of the applicant.
- (2) The individual is fully authorized to execute and file the application on behalf of the applicant.
- (3) The individual is familiar with the applicant's application.

(4) To the best of the individual's knowledge, information, and belief, the statements made in the application are true, and the documents submitted with the application are true copies of the original documents.

The bill eliminates the specified methods of payment of the \$50 filing fee and specifications about when a registration by *description* is effective. Instead, the bill specifies that a registration by description is effective seven business days after the Division of Securities receives the description on applicable forms, together with a filing fee of \$50, if no proceeding is pending under continuing law authorizing the Division to suspend the registration of securities or no proceeding is pending under provisions of the bill discussed below under "**Refusal of registration of securities by the Division.**" However, the bill also allows the Division to permit an earlier effective date by rule or by issuing a certificate of acknowledgement for the registration by description. (R.C. 1707.08(D).)

Refusal of registration of securities by the Division

The bill requires the Division of Securities to refuse any registration by description, by qualification, or by coordination if the issuer is in the development stage and either has no specific business plan or purpose or has indicated that its business is to engage in a merger or acquisition with an unidentified company or companies, or other entities or persons (R.C. 1707.131(B)). However, under the bill, the Division *may* refuse any registration by description, by qualification, or by coordination if either of the following applies (R.C. 1707.131(C)):

(1) The issuer does not disclose in the final offering circular, prospectus, or form U-7 of the North American Securities Administrators Association that any future transaction with an officer, director, 5% shareholder, manager, trustee, or general partner will be on terms no less favorable to the issuer than could be obtained from an independent third party;

(2) The issuer does not disclose in the final offering circular, prospectus, or form U-7 of the North American Securities Administrators Association that (a) any outstanding loan from the issuer to an officer, director, 5% shareholder, manager, trustee, or general partner is required to be repaid within six months of the offering, except for a loan or extension of credit made by a bank, or (b) any future loan from the issuer to an officer, director, 5% shareholder, manager, trustee, or general partner will be for a bona fide business purpose and approved by a majority of the disinterested directors, managers, trustees, or general partners, or will be a type of transaction involving a director or executive officer of the issuer that is permitted by section 13(k) of the "Securities Exchange Act of 1934" (see **COMMENT** 1, below). For purposes of this provision, the bill defines "5% shareholder" as a beneficial owner of 5% or more of the issuer's outstanding securities (R.C. 1707.131(A)).

Service of process

Generally, continuing law requires every entity not organized under the laws of Ohio, not licensed as a foreign corporation under Ohio law, or not having its principal place of business in Ohio to execute and submit to the Division of Securities an irrevocable consent to service of process when making filings for exemption from securities registration, making applications for securities registration, or making investment company notice filings. Among other requirements, continuing law requires that the irrevocable consent to service of process designate the Secretary of State as agent to receive service of process or pleadings. (R.C. 1707.11(A) and (B)(1).)

The bill clarifies that even if an application, form, or other material filed with or submitted to the Division of Securities purports to appoint a person other than the Secretary of State as agent for service of process, the application, form, or other material nonetheless is considered to appoint the Secretary of State as agent for service of process (R.C. 1707.11(C)).

Administrative and civil liability

Administrative enforcement actions

Continuing law authorizes the Division of Securities to take certain enforcement actions against persons that have engaged in or may engage in specified actions, including fraudulent or deceptive practices. These enforcement actions include information filing requirements with the Division; examining records, books, and accounts of securities-related persons; requiring attendance of witnesses at hearings and production of documents; suspending or revoking an Ohio license of described securities-related persons; and initiating contempt or criminal proceedings. (R.C. 1707.23.)

The bill adds that the remedies discussed in the preceding paragraph are cumulative and concurrent with any other remedy provided under the Securities Law, and the exercise of one remedy does not preclude or require the exercise of any other remedy (R.C. 1707.23(J)).

Restitution authority

The bill also authorizes restitution to be sought on behalf of investors in certain situations. Specifically, the bill provides that if the Attorney General, (1) by referral from the Division of Securities, or (2) as a result of complaints or otherwise, has reasonable cause to believe that a person has violated the Securities Law, the Attorney General may bring a class action under Civil Rule 23 seeking an order granting restitution to persons damaged by a violation of the Securities Law. (Civil Rule 23 is a Supreme Court rule governing procedures for most class

action lawsuits brought in any court of law or equity in Ohio.) In addition, the bill specifies that the Attorney General's exercise of authority pursuant to this provision does not require or preclude the exercise of any other authority or remedy in accordance with the Securities Law. (R.C. 1707.231.)

In addition, under existing law, no new civil liability, other than certain common law liabilities for fraud or deception, is created under the Securities Law, including civil liability for noncompliance with orders, rules, regulations, or requirements of the Division of Securities. As a conforming provision, the bill provides that this limitation is subject to the bill's provisions authorizing the Attorney General to seek restitution for persons that have suffered damages as a result of a violation of the Securities Law. (R.C. 1707.40.)

Statute of limitations for actions against directors

Continuing law establishes the conditions upon which a person, including a director of a corporation, profiting from a sale of securities is liable to a person purchasing securities who relied, to the person's detriment, upon a written prospectus, circular, or advertisement containing a false material statement or omitting a material fact. Under current law, an action must be brought against a director pursuant to this authority within two years after the purchaser knew or had reason to know of the unlawful action of the director or person profiting from the sale of the securities or within four years after the purchase of the securities, whichever period is shorter. The bill extends the four-year period to five years. (R.C. 1707.41(D).)

Statute of limitations for actions against investment advisers or investment adviser representatives

Securities Law not affected by the bill specifies that an investment adviser or investment adviser representative is liable in a court of competent jurisdiction for damages resulting from a violation of the Securities Law. Existing law provides, however, that an action for damages cannot be brought more than four years after the rendering of investment advice or two years after discovery of facts constituting the violation, whichever is the shorter period. The bill lengthens the four-year period to five years. (R.C. 1707.42(B).)

Statute of limitations for actions involving the sale of securities

Continuing law specifies the conditions under which a person making a sale or contract for sale of securities and any person aiding or participating in the sale for the seller, which sale is in violation of the Securities Law, is liable to a purchaser for all costs associated with the sale. One condition specified by current law is that the action for recovery of the purchase price be brought within two years after the purchaser knew or had reason to know of the unlawful actions or no

more than four years after the date of the sale or contract for sale, whichever is shorter. Again, the bill extends the four-year period to five years. (R.C. 1707.43(B).)

Criminal violations of the Securities Law

There are numerous prohibitions under the Securities Law that are subject to penalties, which penalties include a fine and criminal penalty dependent upon the value of funds or securities involved in the offense or the loss to the victim (sec. 1707.99, not in the bill). For example, under continuing law, a person is prohibited from knowingly making, or causing to be made, a false representation concerning a material or relevant fact in any oral statement or in a prospectus, circular, description, application, or written statement for purposes of submitting to the Division of Securities a notice filing indicating registration with the Securities and Exchange Commission (SEC) as an investment company under the federal "Investment Company Act of 1940." This notice filing is one of the requirements of a person registered with the SEC selling nonexempt securities or acting as an investment adviser in Ohio.

The bill adds that a person is prohibited from knowingly making or causing to be made, a false representation concerning a material or relevant fact in any oral statement or in a prospectus, circular, description, application, or written statement for purposes of submitting to the Division of Securities a notice filing showing that securities are exempt from registration with the Division because the offer or sale is made in reliance on the exemption provided in Rule 506 of Regulation D of the "Securities Act of 1933" (which generally deals with exemptions from registration requirements for limited offers or sales of securities to no more than 35 purchasers) and is in accordance with Rules 501 to 503 of that regulation (which generally address exemptions from registrations) (R.C. 1707.44(B)(6)).

The bill also adds a prohibition against any person knowingly influencing, coercing, manipulating, or misleading any person engaged in the preparation, compilation, review, or audit of financial statements to be used in the purchase or sale of securities for the purpose of rendering the financial statements materially misleading. (R.C. 1707.44(N).)

Technical changes

The bill proposes re-lettering of divisions in several sections to facilitate understandability of the bill's proposed changes and makes a number of other nonsubstantive adjustments to existing law.

CRIMINAL LAW

Criminal Theft Law

The Criminal Theft Statute prohibits a person, with purpose to deprive the owner of property or services, from obtaining or exerting control over either the property or services of the owner without the owner's or authorized person's consent or beyond the scope of that consent or by deception, threat, or intimidation. The criminal sanction for a violation of these provisions and the name of the offense depends upon the value or type of property or services stolen.

Under current law, it is a third degree felony, and the offense is "aggravated theft" if the value of the property or services involved in the offense is \$100,000 or more. If the victim of the offense is an elderly person or disabled adult, the offense is "theft from an elderly person or disabled adult," and the penalty depends upon the value of the property or services involved in the offense. If that value is \$25,000 or more, it is a second degree felony. (R.C. 2913.02.)

The bill increases some of these penalties. Aggravated theft is a *second* degree felony. In addition, under the bill, if the value of the property or services stolen is \$1 million or more, it is "aggravated theft of \$1 million or more," which is a first degree felony. The penalty for "theft from an elderly person or disabled adult" involving property or services of \$25,000 or more is increased to a *first* degree felony. (R.C. 2913.02(B)(2) and (B)(3).)

CORPORATION LAW

Control share acquisitions--special meetings of shareholders

Continuing law specifies certain requirements that apply when a person proposes to make a control share acquisition of a public corporation. (Generally, continuing law defines a "control share acquisition" to mean an acquisition in which there is gained, indirectly, alone or with others, the ability to exercise voting power within a particular voting category ranging from one-fifth to a majority of the voting power (sec. 1701.01(Z) not in bill).) One of the requirements with a control share acquisition bid is that the public corporation, the shares of which are the subject of the bid, must call a special meeting of the shareholders for the purpose of voting on the proposed control share acquisition. (R.C. 1701.831(C).)

Current law specifies the date within which the special meeting must be held after a described "acquiring person statement" is received by the public corporation (generally, either 50 days or no sooner than 30 days depending upon the circumstances). And a special meeting must be held no later than certain other special meetings are held under specified provisions of the Corporation Law. (R.C. 1701.831(C).)



The bill modifies the time in which a special meeting must be held seemingly to track with federal law requiring that certain tender offers be open at least ten business days, which tender offers contain changes to a previous tender offer. Thus, the bill specifies that if, in connection with a tender offer (which is a type of control share acquisition bid), (1) an acquiring person increases or decreases (a) the percentage of the class of securities being sought, (b) the consideration offered, or (c) the security dealer's soliciting fee, and (2) the acquiring person is required to hold open the tender offer for at least ten business days from the date that the notice of such change is first published, sent, or given to shareholders pursuant to Securities and Exchange Commission Rule 14e-1(b) (see **COMMENT 2**, below), then the directors of the issuing public corporation may reschedule the special meeting of shareholders to a date that is no later than the date established by the acquiring person as the closing date of the changed tender offer. (R.C. 1701.831(C)(2).)

COMMENT

1. This federal law generally prohibits an issuer of securities making extensions of credit to directors or executive officers of the issuer, subject to express exceptions. These exceptions include described consumer credit, open end credit, charge cards, home improvement or manufactured home loans, and extensions of credit by securities brokers or dealers to employees of the broker or dealer to make securities transactions that (1) are permitted by other federal law, (2) are not used to purchase stock of "that issuer," and (3) meet other requirements including that the extension of credit is made in the ordinary course of "consumer credit business" of the issuer, is of a type generally made available to the public by the issuer, and made on terms not more favorable to the employee than other loans made by that issuer to the public.

2. Generally, this ten-day requirement pursuant to a regulation by the Securities and Exchange Commission is "designed to prevent fraudulent, deceptive or manipulative acts or practices within the meaning of [the Securities Exchange Act of 1934]" (17 C.F.R. § 240.14e-1).

HISTORY

ACTION	DATE	JOURNAL ENTRY
Introduced	01-23-03	p. 65

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