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## REVISIONS TO OHIO SECURITIES LAWS NEEDED

by

DAVID E. WEISS\*

The Ohio Division of Securities (the "Division") has reestablished several advisory committees in conjunction with its annual conference in Columbus, Ohio. These advisory committees are intended to facilitate a dialogue among the Division, the practicing bar and the securities industry. Currently, there are five advisory committees: Registration, Exemptions, Takeovers, Enforcement and Licensing. The purpose of this article is to discuss several proposed revisions to Ohio's securities laws which were addressed during the Registration Advisory Committee meeting held at the Division's annual conference in October 1989 and to recommend prompt action to amend those provisions of Ohio's securities laws to effectuate these revisions.

Several of the issues discussed by the Registration Advisory Committee concerned registration by description. In general, registration by description is a simplified registration process which can be utilized for certain securities or transactions as an alternative to the more comprehensive registration by qualification or registration by coordination under Ohio securities laws. Sections 1707.08 and 1707.06 of the Ohio Revised Code (the "Code") and Section 1301:6-3-06 of the Ohio Administrative Code (the "Administrative Code") are the primary provisions governing the transactions which may be registered by description.

Section 1707.08 of the Code establishes a "short form" registration procedure for the four types of transactions or offerings set forth in Section 1707.06(A) of the Code. The first offering described in Section 1707.06(A)(1) is an offering of securities by a corporation for consideration other than intangible property or property located outside the state of Ohio provided the commissions and expenses (including legal and accounting fees) in connection with the offering do not exceed three percent of the amount of securities sold. The second and third types of offerings described in Sections 1707.06(A)(2) and 1707.06(A)(3) are those by corporations and partnerships, respectively, to no more than thirty-five purchasers provided certain other conditions are met. The final offering described in Section 1707.06(A)(4) is an offering by a corporation made only to current security holders.

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If an offering qualifies for registration by description, there are several significant benefits. First, as compared to other types of registrations, registering securities by description is relatively simple. A registration by description, in general, can be accomplished by the filing of the proper registration form and the appropriate exhibits with the Division. If the amount of the offering does not exceed \$250,000, no offering circular is required under Section 1301:6-3-06 of the Administrative Code. Second, Section 1707.06(B) of the Code provides that an issuer engaging in the sale of securities registered by description will not be deemed to be a dealer and thus the issuer is not required to register as a dealer pursuant to Section 1707.14 of the Code. Finally, registration by description can be accomplished quickly. Section 1707.08 provides that a registration by description is complete when the appropriate form and filing fee have been delivered or mailed by certified mail to the Division.

The Registration Advisory Committee has recommended several revisions to the Code and Administrative Code in connection with registration by description. These revisions generally are intended to facilitate the coordination of registration by description and Regulation D as promulgated by the Securities and Exchange Commission pursuant to the Securities Act of 1933.

#### OFFERING CIRCULAR DELIVERY REQUIREMENT

As previously mentioned, Section 1301:6-3-06(G) of the Administrative Code requires that an offering circular be prepared if an offering is registered by description and the aggregate amount of the offering exceeds \$250,000. Under Rule 504 of Regulation D, the limitation on the manner of the offering (i.e. the prohibition on general solicitation) and the limitation on resale (i.e. the creation of "restricted" stock) do not apply if the securities generally are offered in states which provide for the registration of the securities and which require the delivery of a disclosure document prior to a sale. Section 1301:6-3-06(G) of the Administrative Code states that "[a]n offering circular is required for any registration by description . . . where the aggregate amount of the offering exceeds two hundred fifty thousand dollars . . ." However, this Section does not specifically state that the offering circular must be delivered or when such delivery must occur. Although presumably a delivery requirement was intended, this Section does not expressly provide for delivery of the offering circular and thus leaves open the question of whether registration by description meets the registration provision under Rule 504. Because of this discrepancy, the Registration Advisory Committee recommended that this Section of the Administrative code be revised to

require the delivery of the offering circular whenever the use of an offering circular is mandated. Informally, the Division has expressed its agreement with this recommended revision.

### EXCLUSION OF ACCREDITED INVESTORS

As discussed above, registration by description is available for offerings described in Sections 1707.06(A)(2) and 1707.06(A)(3) of the Code which are offerings by corporations and partnerships, respectively, when the securities are sold to no more than thirty-five purchasers and certain other conditions have been met. Both of these Sections provide that any person who purchases at least \$100,000 of securities is excluded from this thirty-five purchaser limitation. The Registration Advisory Committee discussed an amendment to these Sections in order to coordinate registration by description and Regulation D. Specifically, the Registration Advisory Committee recommended that the \$100,000 purchaser exception be replaced with an exception for all persons who are "accredited investors" as defined in Rule 501 of Regulation D. If this amendment is adopted, Sections 1707.06(A)(2) and 1707.06(A)(3) would parallel Rules 505 and 506 of Regulation D which permit offerings to an unlimited number of accredited investors and no more than thirty-five unaccredited investors. The Division, informally, has indicated that it supports this proposed amendment.

### REVISION OF SECTION 1707.06(A)(1)

As already indicated, an offering of securities pursuant to Section 1707.06(A)(1) may be registered by description. Section 1707.06(A)(1) of the Code describes an offering by a corporation of its securities "when 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, and when the total commission, . . . [and] expense . . . in connection with the sale of such securities does not exceed three percent of the initial offering price thereof." The Division has taken the position that this three percent limitation is calculated based upon the amount of securities actually sold rather than the amount offered for sale. This position is consistent with other provisions of the Code and Administrative Code dealing with limitations on commissions and expenses, for example, Section 1301:6-3-03(B) of the Administrative Code. (It should be noted for comparison, however, that the requirement of an offering circular pursuant to Section 1301:6-3-06(G) of the Administrative Code is based upon the amount of securities offered rather than the amount sold.) Although Sections 1707.06(A)(2) and 1707.06(A)(3) also place limitations on expenses incurred in connection with offerings described in those Sections, legal fees and accounting fees are expressly excluded from this expense limitation.

Many securities offerings which might be registered under Section 1707.06(A)(1) will necessitate the use of an offering circular either because it is required by law (for example when the offering exceeds \$250,000 and an offering circular is required under Section 1301:6-3-06(G) of the Administrative Code) or because it is necessary as protection against potential liability under the anti-fraud provisions of state and federal securities laws. However, for offerings that require the expense of an offering circular, particularly those small offerings which are exempt from registration under Rule 504 of Regulation D, the three percent limit on legal and accounting expenses makes registration under Section 1707.06(A)(1) virtually impossible. In addition, practitioners find themselves in the dilemma of the necessity of an offering circular prior to the commencement of an offering (based upon the amount of the securities offered pursuant to Section 1301:6-3-06(G) of the Administrative Code) but the uncertainty as to whether the issuer can comply with the three percent expense limitation which cannot be determined until the offering has terminated and the amount of the securities actually sold is established. Consequently, the Registration Advisory Committee recommended that the limitation on offering expenses be increased or alternatively, that legal and accounting fees be excluded, in order to make this registration provision more practical.

The Division, however, has been reluctant to endorse a modification of Section 1707.06(A)(1). The Division has indicated that its reluctance is due to the fact that Section 1707.06(A)(1) has no limitation on the number of purchasers as do Sections 1707.06(A)(2) and 1707.06(A)(3). Therefore, because a registration by description becomes effective upon the filing or mailing of the appropriate registration form, the Division is concerned that a public offering registered under Section 1707.06(A)(1) can occur before the Division has an opportunity to subject the offering to the proper level of merit review. Ohio, like other merit review states, reviews the substantive terms of offerings to determine whether the securities are being offered on grossly unfair terms. The Division recently has experienced an increased number of offerings, particularly those originating from outside of Ohio, which it believes were on grossly unfair terms and which were registered under Section 1707.06(A)(1).

While the Division has a legitimate concern about inadequate merit review, this concern has been expressed primarily in the context of offerings registered under Section 1707.06(A)(1). The Division has stated that its concern is lessened with respect to offerings registered under Sections 1707.06(A)(2) and 1707.06(A)(3) because these Sections limit the number of purchasers to thirty-five. As a result, one possible amendment which would address the Division's concern is to place a purchaser limit on offerings registered pursuant to Section 1707.06(A)(1). However, a pur-

chaser limit would be inconsistent with the coordination of registrations under Section 1707.06(A)(1) with Rule 504 which does not limit the number of purchasers. A purchaser limit also would be contrary to the underlying premise of Section 1707.06(A)(1) of the Code which is to establish the parameters on offerings that do not limit the number of purchasers but that nevertheless are appropriate for registration by description.

A compromise to the conflicting interests in connection with a proposed amendment to Section 1707.06(A)(1) may be found in reviewing one of the goals of registration by description which is to facilitate the raising of capital through small offerings. Therefore, a compromise amendment may be to exclude legal and accounting fees from the expense limitation, increase the expense limitation to seven percent, and restrict the availability of Section 1707.06(A)(1) to offerings which do not exceed \$1,000,000. This proposed revision is consistent with the aggregate offering limitation contained in Rule 504 of Regulation D. Furthermore, the imposition of an aggregate offering limitation and the retention of an expense limitation, particularly with respect to commissions, will discourage public offerings. The exclusion of legal fees and accounting fees from the expense limitation also is consistent with many other provisions of Ohio securities laws, for example, Sections 1707.03(O)(5), 1707.03(Q)(2), 1707.06(A)(2) and 1707.06(A)(3). This revision and increased enforcement reviews of registrations under Section 1707.06(A)(1) will address the Division's concern while also making registrations under this Section more practical for practitioners and the securities industry.

### CONCLUSION

Practitioners and the securities industry should be pleased at the reestablishment of Division advisory committees. In general, the advisory committees should be encouraged by the receptiveness of the Division to revise Ohio securities laws in order to facilitate the raising of capital through small offerings. The changes recommended by the Registration Advisory Committee are appropriate and necessary to ensure that Ohio stays abreast of the current developments in securities law. However, cooperation and leadership will be needed to ensure that these changes are effectuated promptly. Furthermore, the amendment suggested above or some other revision to Section 1707.06(A)(1) should be endorsed by the Division in order to make this Section more meaningful to the practicing bar and the securities industry.

