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**LIABILITIES AND REMEDIES  
FOR SECURITIES VIOLATIONS UNDER OHIO LAW**

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*The material in this outline is not intended to provide legal advice as to any of the subjects mentioned but is presented for general information only. Readers should consult knowledgeable legal counsel as to any legal questions they may have.*

## I. THE BASIC APPLICABILITY OF OHIO SECURITIES LAWS

The Ohio Securities Act, R.C. 1707 (the “Act”), applies to the “sale” “in Ohio” of securities.” The Act is administered and enforced by the Ohio Division of Securities (“Division”). Administrative rules promulgated by the Division are contained in Ohio Administrative Code (“O.A.C.”) Chapter 1301.

A. “Sale.” R.C. 1707.01(C)(1) states:

“Sale” has the full meaning of “sale” as applied by or accepted in courts of law or equity, and includes every disposition, or attempt to dispose, of a security or of an interest in a security. “Sale” also includes a contract to sell, an exchange, an attempt to sell, an option of sale, a solicitation of a sale, a solicitation of an offer to buy, a subscription, or an offer to sell, directly or indirectly, by agent, circular, pamphlet, advertisement, or otherwise.

B. “In Ohio.”

1. *Howard v. Rowley & Brown Petroleum Corp.*, No. 78-AP-113 (Franklin Cty., August 15, 1978): held the Act applied where the offeror resided in Ohio and the offeree resided in Mississippi.
2. *Martin v. Steubner*, 485 F. Supp. 88 (S.D. Ohio 1979): held Act applied where the offeror resided in Minnesota and the offeree resided in Ohio.
3. *Bernie v. Waterfront Ltd. Dividend Housing Ass’n*, 614 F. Supp. 651 S.D. Ohio 1985): held *in personam* jurisdiction over nonresident defendants who had sold securities to an Ohio resident.

C. The Definition of “Security” Under R.C. 1707.01(B).

1. Statutory definition. R.C. 1707.01(B) states:

"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. It includes shares of stock, certificates for shares of stock, an uncertificated security, membership interests in limited liability companies, voting-trust certificates, warrants and options to purchase securities, subscription rights, interim receipts, interim certificates, promissory notes, all forms of commercial paper, evidences of indebtedness, bonds, debentures, land trust certificates, fee certificates, leasehold certificates, syndicate certificates, endowment certificates,

interests in or under profit-sharing or participation agreements, interests in or under oil, gas, or mining leases, preorganization or reorganization subscriptions, preorganization certificates, reorganization certificates, interests in any trust or pretended trust, any investment contract, any life settlement interest, any instrument evidencing a promise or an agreement to pay money, warehouse receipts for intoxicating liquor, and the currency of any government other than those of the United States and Canada, but sections 1707.01 to 1707.45 of the Revised Code do not apply to the sale of real estate.

*Note:* R.C. 1707.01(B) was amended effective September 16, 2003, to make clear that an opportunity need not be in writing in order to be a “security” under Ohio law, and thereby reverse the Ohio Supreme Court’s decision in *Gutmann v. Feldman*, 97 Ohio St. 3d 473 (2002).

2. Particular Items.

- a. Corporate instruments: stock (including subscription rights), debentures, options, warrants.
- b. Membership interests in LLCs.
- c. “Investment contract.” Under Ohio law, an investment contract exists when: (1) an offeree furnishes initial value to an offeror; (2) a portion of the initial value is subjected to the risks of the enterprise; (3) the furnishing of the initial value is induced by the offeror’s promises or representations that give rise to a reasonable understanding that a valuable benefit or some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise; and (4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise. *State v. George*, 50 Ohio App. 2d 297, 302-303 (10<sup>th</sup> Dist. Ct. App. 1975).
- d. Promissory notes. In addition to the broad first sentence, the statutory definition also includes promissory notes and evidences of indebtedness. For a prosecution of violations of the Ohio Securities Act in connection with the sale of promissory notes, *State v. Taubman*, 78 Ohio App. 3d 834 (1992).
- e. Partnership interests.
  - i. An interest in a limited partnership is a security. *See, e.g., Hater v. Gradison Division of McDonald and Company Securities*, 101 Ohio App.3d 99 (1995).

- ii. An interest in a general partnership typically is not a security. *See, e.g., Brannon v. Rinzler*, 77 Ohio App. 3d 749 (1991).
- iii. However, developing jurisprudence holds that a general partnership may be a security where: (1) an agreement among the parties leaves so little power in the hands of the partner that the arrangement in fact distributes power as would a limited partnership; or (2) the partner is so inexperienced and unknowledgable in business affairs that he or she is incapable of intelligently exercising his partnership powers; or (3) the partner is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership powers.
  - (a) Federal: *SEC v. Telecom Marketing, Inc.*, 888 F. Supp. 1160 (N.D. Ga. 1995); *Koch v. Hankins*, 928 F.2d 1471 (9<sup>th</sup> Cir. 1991); *Williamson v. Tucker*, 645 F.2d 404 (5<sup>th</sup> Cir.), *cert. denied*, 454 U.S. 897 (1981).
  - (b) Ohio: Division administrative orders *Joseph P. Medsker*, No. 94-194; *Continental Wireless Television Company*, No. 94-208; the *Unisco Corporation*, No. 94-017.
- f. Franchises. If an investment opportunity constitutes a “franchise,” it is subject to the Ohio Business Purchaser’s Protection Act, R.C. 1334, not the Ohio Securities Act. *Peltier v. Spaghetti Tree, Inc.*, 6 Ohio St. 3d 194 (1983).

## II. THE GENERAL CONSEQUENCES OF APPLICABILITY OF THE OHIO SECURITIES ACT

- A. Each security sold must be registered, properly exempted from regulation, or the subject of a notice filing.
- B. Each person selling securities must be licensed or properly exempted from licensure.
  - 1. Dealer

- a. In general, a “dealer” is a person who engages in the business of selling securities. R.C. 1707.01(E)(1). There are exceptions to this general rule, *see* R.C. 1707.01(E)(a) – (f). A commonly relied upon exception is for issuers of securities, R.C. 1707.01(E)(1)(a), which excepts:
 

Any issuer, including any officer, director, employee, or trustee of, or member or manager of, or partner in, or any general partner of, any issuer, that sells, offers for sale, or does any act in furtherance of the sale of a security that represents an economic interest in that issuer, provided no commission, fee, or other similar remuneration is paid to or received by the issuer for the sale.
  - b. In general, “dealers” must be licensed by the Division. R.C. 1707.14(A)(1). There are some exceptions to this general rule, *see* R.C. 1707.14(A)(1)(a)-(d).
2. Salesperson.
- a. A salesperson is a natural person, other than a dealer, who is employed, authorized or appointed by a dealer to sell securities. R.C. 1707.01(F).
  - b. Every salesperson must be licensed by the Division and may be employed only by the licensed dealer specified in his or her license. R.C. 1707.16.
- C. Persons giving advice regarding securities for compensation must be licensed by the Division or registered with the Securities and Exchange Commission (“SEC”).
- 1. An “investment adviser” is a person who is in the business of, for compensation, providing advice regarding securities. R.C. 1707.01(X). In general, an investment adviser operating in Ohio must be licensed by the Division, or registered with the SEC. R.C. 1707.141. An investment adviser registered with the SEC must make a “notice filing” with the Division. *Id.*
  - 2. An “investment adviser representative” is a natural person who is employed by an investment adviser firm and regularly meets with a certain minimum number of clients. R.C. 1707.01(II). In general, an investment adviser representative must be licensed by the Division. R.C. 1707.161.
- D. Anti-fraud standards apply to all securities transactions, and to the giving of advice regarding securities for compensation. R.C. 1707.44.

### III. THE BASICS OF OHIO SECURITIES REGISTRATION AND EXEMPTION

#### A. Registration.

1. R.C. 1707.06: registration by description -- a short form registration process where there are limited selling efforts, limited number of purchasers, or limited sales commissions (an “offering circular” is required if offering is greater than \$250,000).
  - a. 6(A)(1): limited selling efforts.
    - i. unlimited number of investors
    - ii. selling commission and other remuneration cannot exceed 3%
    - iii. securities must be issued for cash or tangible property located in Ohio
    - iv. available only for corporations
    - v. Form 6(A)(1) filing; \$50 filing fee
  - b. 6(A)(2): limited purchasers, limited commissions.
    - i. not more than 35 purchasers plus certain other “insiders” and “high worth” investors
    - ii. commissions cannot exceed 10%
    - iii. sales for the sole account of issuer and in good faith
    - iv. available only for corporations
    - v. Form 6(A)(2) filing; \$50 filing fee
  - c. 6(A)(3): same as 6(A)(2) for partnership, limited partnership, partnership association, limited liability company, syndicate, pool, trust, trust fund or other unincorporated association. Use Form 6(A)(3) (\$50 filing fee).
  - d. 6(A)(4): rights offering by a corporation to existing securities holders. Use Form 6(A)(4) with a \$50 filing fee.
2. R.C. 1707.09: registration by qualification -- a comprehensive filing for sales that are not eligible for registration by description.

- a. 1707.09(J) requires that at least 85% of the offering proceeds must go to the issuer.
  - b. The Division must find that the business of the issuer is not fraudulently conducted, that the securities will not be offered or disposed of on grossly unfair terms, and that the plan of issuance and sale will not tend to, or in fact, defraud or deceive purchasers.
  - c. Issuers may file Form 9 or Form U-1 with a \$100.00 filing fee and a qualification fee of from \$100.00 to \$1,000.00.
3. R.C. 1707.091: registration by coordination -- a streamlined procedure for offerings that are also being registered with the SEC under the 1933 Act.
- a. Division merit guidelines apply under R.C. 1707.01(Q) and 1707.13.
  - b. Issuers may file the Form U-1 with a \$100 filing fee and a registration fee of from \$100 to \$1,000.
4. Because of the statutory requirement that registered offerings in Ohio not be on “grossly unfair terms,” registered offerings are subject to the Division’s merit regulations.
- a. Most merit standards are contained in the Division’s merit guidelines, available at:  
[http://www.securities.state.oh.us/Rules/Existing\\_Guidelines.aspx](http://www.securities.state.oh.us/Rules/Existing_Guidelines.aspx).
  - b. The prohibition on “blank check” offerings, and the limitations on transactions with affiliates and loans to insiders are codified in R.C. 1707.131.

B. Exempt Securities.

1. R.C. 1707.02 exempts securities issued by the following issuers:
  - a. Government issuers, including the United States, state and local agencies and any government that has diplomatic relations with the United States. R.C. 1707.02(B).
  - b. Banks. R.C. 1707.01(O) and 1707.02(C).
  - c. Public Utilities. R.C. 1707.01(M) and 1707.02(F).
  - d. Insurance Companies. R.C. 1707.02(H).

- e. Non-profit issuers and Ohio cooperatives, but the provision does not exempt notes, bonds, debentures, evidences of indebtedness or agreements or promises to pay money. R.C. 1707.02(I).
  - f. “Blue Chip” issuers whose securities are not in default. R.C. 1707.02(J).
2. Exchange exemption: R.C. 1707.02(E)(1).
- a. Securities listed on the American Stock Exchange (“AMEX”), the New York Stock Exchange (“NYSE”) and the NASDAQ National Market System (“NMS”) are exempt. The exemption also covers securities equal in seniority to listed securities.
  - b. Securities listed, or equal in seniority to listed securities, on exchanges that the SEC has determined to have similar listing standards to the AMEX, NYSE and NMS under SEC Rule 146(b) are also exempt.
  - c. The Division by rule has exempted securities listed on, or securities equal in seniority to listed securities on Tier 1 of the Philadelphia Stock Exchange, Tier 1 of the Pacific Stock Exchange and the Chicago Board of Options Exchange. O.A.C. 1301:6-3-02(A).
3. Commercial Paper and Promissory Notes: R.C. 1707.02(G).
- a. Private offerings and commercial paper and promissory notes are exempt.
  - b. “Private offering” has been defined in O.A.C. 1301:6-3-02(D)(1) to include sales to officers, directors or general partners, persons who control management of the issuer, or sales to ten in a twelve month period that the issuer believes are purchasing for investment.
4. All securities exemptions under R.C. 1707.02 and O.A.C. 1301:6-3-02 are self-executing, meaning no filing with the Division is required to perfect the exemption. Use of an offering document is not required, but all sales of exempt securities are subject to the fraud prohibitions of R.C. 1707.44. The burden of proof in any action is on the party claiming the benefit of the exemption under R.C. 1707.45.

C. Exempt Transactions.

1. R.C. 1707.03 and O.A.C. 1301:6-3-03(E) exempt the following transactions:
  - a. Sales by bona fide owners. R.C. 1707.03(B).
  - b. Sales by persons acting in a fiduciary capacity. R.C. 1707.03(C).
  - c. Sales to institutional investors, issuers and dealers. R.C. 1707.01(S) and 1707.03(D).
  - d. Sales by pledgees. R.C. 1707.03(E).
  - e. Sales at public auction due to default. R.C. 1707.02(F).
  - f. Sale of options or warrants on securities that are properly registered or exempted. R.C. 1707.03(G).
  - g. Sale of mortgages, other than oil, gas and mining interests, to a single purchaser. R.C. 1707.03(H).
  - h. Exercise of subscription rights, conversion rights and certain exempt options and warrants. R.C. 1707.03(I).
  - i. Dividends, exchanges and distribution by corporations with its security holders. R.C. 1707.03(K).
  - j. Reorganizations under the federal Bankruptcy Act. R.C. 1707.01(L).
  - k. Secondary sales through licensed dealers not involving an issuer or an underwriter. R.C. 1707.03(M) and (N).
  - l. Sales of equity securities by corporations or limited liability companies to ten or fewer persons in a private offering. R.C. 1707.03(O).
  - m. Sale of oil and gas interest in a single well to not more than five natural persons. R.C. 1707.03(P).
  - n. Offerings exempt under section 4(2) of the Securities Act of 1933. R.C. 1707.03(Q).
  - o. Sale of a money order or travelers' check by a person licensed under section 1109.60 or Chapter 1315 of the Revised Code. R.C. 1707.03(R).

- p. Preliminary sales, or indications of interest, by a licensed securities dealer. R.C. 1707.03(S).
  - q. Unsolicited trade by a licensed securities dealer R.C. 1707.03(T).
  - r. Mergers and other reorganizations. R.C. 1707.03(U).
  - s. Offerings exempt under Rule 505 of Regulation D. R.C. 1707.03(W).
  - t. Public offerings to accredited investors as defined in Rule 501 of Regulation D. R.C. 1707.03(X).
  - u. Sales by banks of retail repurchase agreements and mortgage-backed securities. O.A.C. 1301:6-3-03(E)(1) and (2).
  - v. Sales of direct or fractional interests of GNMA-backed or GNMA pass-through securities. O.A.C. 1301:6-3-03(E)(3).
  - w. Sales of direct or fractional interests in certain certificates of deposit or pools of certificates of deposit. O.A.C. 1301:6-3-03(E)(4).
  - x. Sales pursuant to employee benefit plans that have been qualified under sections 401 to 425 of the Internal Revenue Code, are exempt under Rule 701 or are registered with the SEC. O.A.C. 1301:6-3-03(E)(5).
  - y. The sale of rights, options or warrants to purchase “exchange-listed” securities. O.A.C. 1301:6-3-03(E)(6).
  - z. Guarantees, letters of credit or other credit enhancements for securities exempt under R.C. 1707.02(B). O.A.C. 1301:6-3-03(E)(7).
  - aa. Notices on the Internet not directed to Ohio residents. O.A.C. 1301:6-3-03(E)(9).
  - bb. Sales of securities by issuers formed to provide professional services as defined in R.C. 1785.01(A). O.A.C. 1301:6-3-03(E)(8).
2. Only issuers claiming the exemptions from registration pursuant to R.C. 1707.03(Q), (W), and (Y) are required to make a filing with the Division to perfect the exemptions. All of the other exempt transactions under R.C. 1707.03 and O.A.C. 1301:6-3-03(E) are self-executing. Except for sales

under R.C. 1707.03(W), there are no specific requirements that an offering circular or private placement memorandum be used. However, all sales are subject to the fraud prohibitions of R.C. 1707.44. The burden of proof is on the party claiming the benefit of an exempt transaction under R.C. 1707.45.

3. Summary of filing requirements for exempt transactions under R.C. 1707.03(Q), (W) and (Y).

a. R.C. 1707.03(Q): Private offerings pursuant to section (4)2 of the Securities Act of 1933.

- i. The offering must be one “not involving a public offering” as required by section 4(2) of the Securities Act of 1933. This necessarily prohibits advertising and general solicitation, and requires investment intent.
- ii. Commissions are limited to a maximum of 10% and may be paid only to securities dealers or salespersons licensed by the Division.
- iii. A Form 3-Q must be filed with the Division within sixty days of the date of sale. O.A.C. 1301:6-3-03(B)(6) defines the date of sale as the later of the date that: (i) a purchaser signs a subscription agreement or loses control of the purchase funds, whichever is earlier, or (ii) the first date of disbursement of proceeds of the sale of security from an escrow account. The filing fees are \$100 for the first filing of the calendar year and \$50 for each subsequent filing. Out-of-state issuers must file an irrevocable consent to service on Form 11 or Form U-2 pursuant to R.C. 1707.11.

b. R.C. 1707.03(W): Private offerings pursuant to SEC Rule 505.

- i. The offering must comply with the conditions of SEC Rule 505 which among other things:
  - (a) limits the offering amount to \$5,000,000
  - (b) prohibits advertising and general solicitation
  - (c) limits the number of purchasers to 35 non-“accredited” investors (an unlimited number of “accredited” investors is permitted)

- (d) requires the delivery of a disclosure document to non-“accredited” investors
    - (e) requires investment intent
  - ii. Aggregate commissions are limited to 12% and may be paid only to dealers or salesmen licensed by the Division.
  - iii. A Form 3-W must be filed with the Division at least five business days prior to the first use of an offering document or the first sale in Ohio. The filing fee is \$100. Out-of-state issuers also must file an irrevocable consent to service on Form 11 or Form U-2.
  - iv. “Bad Boy” provision: R.C. 1707.03(W)(2)(a) disqualifies any issuer or broker-dealer which would be prohibited from filing under Regulation A under the Securities Act of 1933 from using the exemption under R.C. 1707.03(W). Among the disqualifying actions would be convictions for fraud or securities law violations, administrative actions for securities law violations issued by state agencies, regulatory agencies or the SEC or civil actions enjoining the issuer or dealer from engaging in the offer or sale of securities or continued violations of any securities law.
- c. R.C. 1707.03(Y): Offerings only to accredited investors.
  - i. Under certain conditions, an issuer may make a “general announcement” of an offering to a group of “accredited” investors.
  - ii. Procedural requirements include:
    - (a) A notice filing on Form 3-Y with the Division, including all offering materials, a description of the issuer and a copy of the general announcement. The general announcement must be limited to a brief description of the issuer’s business, description of the securities, including the price and aggregate offering amount, and the issuer’s address and telephone number. All offering materials must clearly indicate that the offering is limited to accredited investors.
    - (b) A filing fee of \$100.

- (c) A consent to service for out-of-state issuers.
- (d) Resales must be limited to other accredited investors or the securities must be registered.
- (e) Issuers who have been subject to past enforcement actions may be disqualified from the exemption.
- (f) There is no limit on commissions, but commissions or other remuneration may be paid only to licensed securities dealers.
- (g) Sales may be made by the issuer without a securities dealers license provided no commissions or other compensation are paid.

D. Covered Securities / Notice Filings.

1. R.C. 1707.03(X): Private offerings pursuant to SEC Rule 506.

- a. The offering must comply with the conditions of SEC Rule 506, which among other things:
  - i. prohibits advertising and general solicitation
  - ii. limits the number of purchasers to 35 non-“accredited” investors (an unlimited number of “accredited” investors is permitted)
    - (a) “Accredited investor” is defined in SEC Rule 501. An individual is an “accredited investor” if he or she:
      - (i) is a director, executive officer or general partner of the issuer;
      - (ii) has an individual net worth, or joint net worth with spouse, in excess off \$1,000,000; or
      - (iii) had an individual income in excess of \$200,000 in each of the two most recent years, or joint income with spouse in excess of \$300,000 in each of the two most recent years, and a reasonable expectation of

reaching the same income level in the current year.

- iii. requires that non-“accredited” investors be “sophisticated” (either alone or with a purchaser representative)
  - iv. requires the delivery of a disclosure document to all investors if the offering involves non-“accredited” investors
  - v. requires investment intent
- b. A Form D, along with a \$100 filing fee, must be filed with the Division within fifteen days of sale. Out-of-state issuers must file an irrevocable consent to service on Form 11 or Form U-2.
2. Investment companies registered with the SEC must file the following items with the Division:
- a. A copy of the issuer’s federal registration statement, a Form U-1 or Form NF. R.C. 1707.092(A)(1)(a).
  - b. A filing fee of \$100 and an additional fee off 1/10 of 1% of the securities to be sold in Ohio with a minimum fee of \$100 and a maximum fee of \$1,000. R.C. 1707.092(A)(1)(b).
  - c. A consent to service on Form 11 or Form U-2. R.C. 1707.11.
  - d. A copy of the final prospectus. R.C. 1707.092(A)(1)(c).

#### **IV. LIABILITIES AND REMEDIES FOR THE SALE OF UNREGISTERED SECURITIES**

##### **A. Generally.**

- 1. R.C. 1707.43 makes each sale made in violation of the Ohio Securities Act voidable at the election of the purchaser unless it is shown that the violation did not materially affect the protection contemplated by the violated provision.
- 2. Ohio courts have imposed virtual strict liability for the sale of unregistered securities by almost always granting rescission on violations of R.C. 1707.44(C)(1). *See, e.g., Pencheff v. Adams*, 5 Ohio St. 3d 153 (1983). Liability has been imposed even where the purchaser approached the issuer and negotiated the terms of the investment. *Callahan v. Class One, Inc.*, 58 Ohio St. 3d 76 (1991).

3. Under R.C. 1707.43 there is joint and several liability for any person who aided or participated in making the sale. Liability has been extended to officers for signing stock certificates and subscription documents. *Miller v. Griffith*, 92 Ohio Law Abs. 488 (Columbiana Cty. Com. Pl. 1961). Third parties have been found liable for promoting, soliciting and giving investment advice about an issuer's securities. *Reidel v. Acutote of Colorado*, 773 F. Supp. 1055 (S.D. Ohio 1991).
4. Liability under R.C. 1707.43 is limited to a recovery of the purchase price plus court costs. There are no provisions for punitive damages or pre-judgment interest in R.C. 1707.43. While R.C. 1707.43 requires that securities be tendered to the seller(s), some courts have permitted damages up to the full purchase price plus court costs. *Roger v. Lehman Brothers Kuhn Loeb, Inc.*, 621 F. Supp. 114 (S.D. Ohio 1985). Purchasers also have recovered the full purchase price of securities without an offset for any income or potential tax benefits from the investment. *See, e.g., Crater v. International Resources, Inc.*, 92 Ohio App. 3d. 18 (9<sup>th</sup> Dist. Ct. App. 1993).

B. Covered Securities.

1. R.C. 1707.43 does not appear to impose any civil liability for the failure of an issuer to make a notice filing for an offering of covered securities. If an issuer relying on SEC Rule 506, or an investment company, fails to make a notice filing section 18 of the Securities Act of 1933 indicates that such failure may be corrected by "promptly" submitting the required forms and fees. In response to the National Securities Markets Improvement Act of 1996, the Division's rules for filing under R.C. 1707.391 by issuers relying on SEC Rule 506, or by investment companies, were amended to permit filings promptly after the failure to file is discovered. A corrective filing under R.C. 1707.391 and O.A.C. 1301:6-3-391(E) or (F) appears to eliminate any potential liability under R.C. 1707.43 for the failure to make a notice filing.
2. Failure to comply with the material terms of SEC Rule 506 may lead to liability under R.C. 1707.43. *Mark v. FSC Securities Corp.*, 870 F. 2d. 331 (6<sup>th</sup> Cir. 1989).

C. Defenses.

1. R.C. 1707.43 provides that no purchaser is entitled to relief if they have failed to accept a written offer to repurchase the securities. The written repurchase offer must be made more than two weeks after the sale and the offer must be open at least thirty days. The offer does not have to include the payment of interest.

*Note:* A rescission offer under R.C. 1707.43 does not necessarily stop the Division from bringing an enforcement action under R.C. 1707.13, 1707.19 or 1707.23.

2. R.C. 1707.43 includes a statute of limitations of two years from when the plaintiff knew, or had reason to know of the violation, or five years from the date of sale. *Hild v Woodcrest Assn.*, 59 Ohio Misc. 13 (2<sup>nd</sup> Dist. Ct. App. 1977). *Eastman v. Benchmark Minerals*, 34 Ohio App. 3d 255 (10<sup>th</sup> Dist. Ct. App. 1988).
3. A purchaser may not be entitled to rescission if it is shown that the violation did not materially affect the protection contemplated under the Act. While most courts have not accepted a materiality defense when violations of R.C. 1707.44(C)(1) are alleged, a court did refuse to grant rescission when Form 3-Qs were filed with the Division fourteen to sixteen days late. *Obenauf v. Cidco Investment Services, Inc.*, 54 Ohio App. 3d 131 (8<sup>th</sup> Dist. Ct. App. 1990). However, in a decision three years later, the same court granted rescission to investors in a private offering when the Form 3-Q was filed two days late and stamped “completed” by the Division. *Sherman v. River Oaks Office Plaza, Ltd.*, 91 Ohio App. 3d. 450 (8<sup>th</sup> Dist. Ct. App. 1993).
4. Courts may recognize a defense of *in pari delicto* in an action under R.C. 1707.43. A court noted that the defense may be available when the purchaser’s wife represented the securities dealer that sold the limited partnership interest. *Mark v. FSC Securities Corp.*, 870 F. 2d 331. (6<sup>th</sup> Cir. 1989). In a bankruptcy case, legal counsel for a securities dealer was able to use *in pari delicto* to defend a legal malpractice action brought by the trustee for the securities dealer. *In Re Dublin Securities, Inc.*, 133 F. 3d 377 (6<sup>th</sup> Cir. 1997). However, in another bankruptcy case, an issuer was not permitted to use the *in pari delicto* defense when there was not evidence the purchaser had engaged in fraudulent conduct. *In Re Bell & Beckwith*, 89 Bankr. 632 (Bankr. N.D. Ohio 1988).
5. Although an offering is registered by the Division, liability may be attached if conditions subsequent to the registration are not satisfied. A bankruptcy court held that R.C. 1707.43 would support a cause of action where the issuer failed to comply with escrow conditions imposed as part of a registration by qualification. However, unless the registration is suspended by the Division under R.C. 1707.13, the issuer and any securities dealers would not have the burden of proof under R.C. 1707.45. *In Re Bell & Beckwith*, 89 Bankr. 632 (Bankr. N.D. Ohio 1988).
6. R.C. 1707.431(A) provides that any attorney, accountant or engineer shall not be deemed to have effected, participated in, or aided the seller in

making sales in violation of the Act if his performance is incidental to the practice of his profession. *Leeth v. Decorator's Mfg., Inc.* 67 Ohio App. 2d 29 (10<sup>th</sup> Dist. Ct. App. 1979).

7. R.C. 1707.431(B) provides that any person, other than an investment adviser or investment adviser representative, who brings an issuer together with any potential investor without receiving, directly or indirectly, a commission, fee or other remuneration based on the sale of any security is not deemed to have participated in the sale of a security. Remuneration received for reasonable out-of-pocket costs shall not be deemed a commission, fee or other remuneration.
8. Corrective Filings Under The Ohio Securities Act.
  - a. R.C. 1707.39 allows an issuer or any interested party to apply to the Division to qualify any securities sold in violation of R.C. 1707.01 to 1707.45. The Division must make a finding that no person has been defeated, prejudiced or damaged by the violation or will be defrauded, prejudiced or damaged by such qualification. Upon qualification of the securities under R.C. 1707.39, the Division is stopped from commencing criminal proceedings under R.C. 1707.23(E) or administrative actions under R.C. 1707.13. To complete the qualification, the following procedures must be completed:
    - i. A Form 39 and exhibits must be filed with the Division. The required exhibits include financial statements that may be either audited or attested to by the issuer.
    - ii. A filing fee of \$100 must be paid along with a qualification fee of 1/5 of one per cent of the aggregate price at which securities have been sold with a \$100 minimum and a \$2,000 maximum. The Division may also require additional fees for an examination either in Ohio or out of state.
    - iii. The Division will require that each purchaser sign an Explanatory Statement/Non-Prejudice Statement. The statement details the purchaser's rights under R.C 1707.43 and requires the purchaser to indicate whether he desires a return to his investment, he is satisfied with his purchase, or an explanation of why he does not elect to waive any rights under R.C. 1707.43. If an investor elects to rescind the transaction, the Division will require proof that such rescission has been made prior to granting the registration.

- iv. Any other information given to the purchasers should be filed with the Division and cleared prior to distribution.
  - v. The Division may require commissions, discounts, finder's fees or other compensation paid to unlicensed individuals be repaid. The Division may also require escrow of outstanding securities issued at less than the public offering price or for consideration other than cash, prior to making a finding that no purchaser was defrauded, damaged or prejudiced.
- b. Excusable Neglect. R.C. 1707.391 provides that an issuer or securities dealer may apply to the Division for a corrective filing when securities have been sold in reliance upon R.C. 1707.03(Q), 1707.03(W), 1707.03(X), 1707.03(Y) or 1707.08 and such reliance was due to the failure to timely or properly file the required forms. Investment companies that have failed to timely file a renewal of their coordination or qualification registration may also file a Form 391. Upon a finding of excusable neglect by the Division, the applications are deemed timely and properly filed. Filings under R.C. 1707.391 may be made only to correct late filings, filings where the wrong form was submitted to the Division, or not properly filed as defined in O.A.C. 1301:6-3-391(A)(2). Any other violations may be corrected only pursuant to R.C. 1707.39.
- i. Filing Requirements: The applicant must submit a Form 391 and the form, which should have been timely and properly filed with all required exhibits. The filing fee is double the statutory filing fee of the underlying registration or exemption, excluding any fees already submitted. An irrevocable consent to service on either Form 11 or Form U-2 is required for all out-of-state applicants pursuant to R.C. 1707.11.
  - ii. Sworn Statements: O.A.C. 1301:6-3-391(D) also requires the issuer or its counsel to file two sworn statements stating that no investor was prejudiced by the failure to timely or properly file and the reason the form was not timely or properly filed.
  - iii. Excusable Neglect: O.A.C. 1301:6-3-391 presumes excusable neglect if the Form 391 is filed within six months of the earliest sale made in reliance upon R.C. 1707.03(Q), 1707.03(W) and 1707.03(Y). The presumption is limited to one month from the earliest sale for filings under R.C. 1707.06 and 1707.08.

- iv. Effectiveness: The Form 391 is effective fourteen days after filing with the Division, unless the applicant is notified that the Division has not found excusable neglect.
- v. Division Procedure: O.A.C. 1301:6-3-391(E) allows the Division to notify the applicant of denial by any reasonable means including telephone, telegram, mail, personal service or other electronic means. The Division may telephone the applicant and send a confirming letter. A form notice signed by the commissioner is sent later.
- vi. Division Policy: The Division has very strictly followed the presumption of excusable neglect set forth in O.A.C. 1301:6-3-391(B). The Division denies filings that are not submitted with the specific time periods of Ohio Administrative Code 1301:6-3-391. (See *Ohio Securities Bulletin*, Issue 2, July 1986 at page 1).

**V. LIABILITIES AND REMEDIES FOR THE UNLICENSED SALE OF SECURITIES AND UNLICENSED GIVING OF INVESTMENT ADVICE**

A. Unlicensed Sale of Securities.

- 1. Liability: R.C. 1707.44(A)(1) prohibits the unlicensed sale of securities. R.C. 1707.43 provides that every sale made in violation of the Act is voidable at the election of the purchaser.
  - a. R.C. 1707.43 extends liability to “every person who has participated in or aided the seller in any way in making such sale.” Courts have construed R.C. 1707.43 liberally in the case of unlicensed sales of securities:
    - i. extended liability to a defendant who signed a sale agreement and was the only representative of the issuer with whom the plaintiff discussed the deal. *Sorenson v. Tenuta*, 62 Ohio App. 3d 696 (10<sup>th</sup> Dist. Ct. App. 1989).
    - ii. held that the fact that a putative defendant did not receive compensation did not preclude liability for the unlicensed sale of securities. *Id.*
    - iii. held that “inducing” a plaintiff to invest creates liability. *Federated Management Co. v. Coopers & Lybrand*, 137

Ohio App. 3d 366, 391 (10<sup>th</sup> Dist. Ct. App. 2000) *appeal not allowed* 90 Ohio St. 3d 1424 (2000).

- iv. held that a single unlicensed transaction is sufficient to create liability under R.C. 1707.43. *Carrousel North, Inc. v. Chelsea Moore, Co.*, 9 Ohio App. 3d 344 (1<sup>st</sup> Dist. Ct. App. 1983).
  - b. There is no intent requirement, although several affirmative defenses are available.
  - c. The plaintiff must be a “purchaser.”
2. Remedy: The primary private civil remedy available for the unlicensed sale of securities is the right to rescind the transaction pursuant to R.C. 1707.43.
- a. Formal tender of the securities is not a prerequisite to recovery. *Roger v. Lehman Brothers Kuhn Loeb, Inc.*, 621 F. Supp. 114 (S.D. Ohio 1985). Consequently, a plaintiff who no longer owns the securities purchased in an unlicensed transaction may seek rescissory damages.
  - b. The plaintiff may recover the full amount paid for the securities, and all taxable court costs.
  - c. The courts have emphasized the right to recover the full amount of the purchase price, rejecting offsets because of returns on the investment (*Crater v. International Resources, Inc.*, 92 Ohio App. 3d 18, 25 (9<sup>th</sup> Dist. Ct. App. 1993)), tax benefits (*Id.*), and dividends (*Mandalaywala v. Yajnik*, 2001 WL 118592 (10<sup>th</sup> Dist. Ct. App. 2001)).
  - d. A contract for sale made in violation in the Act’s licensing requirement “necessarily involves the violation of a statute [and] the contract itself is against public policy and will not be enforced.” *Diversified Property Corp. v. Winters National Bank and Trust*, 13 Ohio App. 2d 190, 194 (2<sup>nd</sup> Dist. Ct. App. 1967).
3. Defenses. *See supra* § IV. C.

B. Unlicensed Giving of Investment Advice.

1. Liability: R.C. 1707.44(A)(2) prohibits the unlicensed giving of investment advice. R.C. 1707.42(B) provides that whoever acts as an investment adviser or investment adviser representative in violation of the Act shall be liable for

damages resulting from the violation in an action at law in a court of competent jurisdiction.

2. Remedy: Under R.C. 1707.42(B), damages may include consideration paid for the advice, any loss due to the advice, and all court costs, less the amount of any income received from the advice.
3. Statute of Limitations. No person may bring an action under 1707.42(B) more than five years after the rendering of investment advice or two years after discovery of facts constituting the violation, whichever is the shorter period.

## **VI. LIABILITIES AND REMEDIES FOR MISREPRESENTATION OF MATERIAL FACTS, AND OMISSIONS OF MATERIAL FACTS, IN THE SALE AND PURCHASE OF SECURITIES**

### **A. Statutory Causes of Action.**

#### **1. Statutory Prohibitions.**

- a. R.C. 1707.44(G): No person in purchasing or selling securities shall knowingly engage in any act or practice that is, in this chapter, declared illegal, defined as fraudulent, or prohibited.
  - i. For purposes of the Act, “knowingly” is defined in terms of “negligently.” *State v. Warner*, 55 Ohio St. 3d 31, 56-57 (1990). Consequently, a person is liable if he or she represents facts to be different than he or she should have known them to be if he or she had exercised reasonable diligence to ascertain the facts. *Id.*
  - ii. In construing the definition of “fraud,” the Ohio Supreme Court held that “the legislature broadly drafted [the definition] to draw from *all* securities case law defining fraudulent conduct in both state and federal courts.” *In re Columbus Skyline Securities*, 74 Ohio St. 3d 495 (1996). This holding is significant because it “incorporates” state and federal securities fraud case law into the Ohio definition of fraud.
  - iii. R.C. 1707.44(G) prohibits not only affirmative misrepresentations of material facts, but also omissions of material facts where there is a duty to disclose. *State v. Warner*, 55 Ohio St. 3d 31, 54 (1990).

- b. R.C. 1707.44(B)(4): No person shall knowingly make or cause to be made any false representation concerning a material and relevant fact, in any oral statement or in any prospectus, circular, description, application, or written statement, for any of the following purposes: \*\*\* Selling any securities in this state.
  - i. The general test for materiality under Ohio law is whether a fact is likely, under the circumstances, to affect conduct of a reasonable person with reference to the transaction. *Leal v. Holtvogt*, 123 Ohio App. 3d 51, 76 (2<sup>nd</sup> Dist. Ct. App. 1998).
  - ii. In the alternative, presumably, an Ohio court could apply the test for materiality that has developed under federal securities fraud jurisprudence: a substantial likelihood that the information would have been viewed by the reasonable investor as having significantly altered the total mix of information made available. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976).
- c. R.C. 1707.44(C)(4): No person shall knowingly and intentionally sell, cause to be sold, offer for sale, or cause to be offered for sale, any security which comes under any of the following descriptions: \*\*\* The offer or sale is accompanied by a statement that the security offered or sold has been or is to be in any manner indorsed [sic] by the Division.
- d. R.C. 1707.44(D): No person who is an officer, director, or trustee of, or a dealer for, any issuer, and who knows such issuer to be insolvent in that the liabilities of the issuer exceed its assets, shall sell any securities of or for any such issuer, without disclosing the fact of the insolvency to the purchaser.
- e. R.C. 1707.44(E): No person with intent to aid in the sale of any securities on behalf of the issuer, shall knowingly make any representation not authorized by such issuer or at material variance with statements and documents filed with the division by such issuer.
- f. R.C. 1707.44(F): No person with intent to deceive, shall sell, cause to be sold, offer for sale, or cause to be offered for sale, any securities of an insolvent issuer, with knowledge that such issuer is insolvent in that the liabilities of the issuer exceed its assets, taken at their fair market value.

- g. R.C. 1707.44(J): No person, with purpose to deceive, shall make, issue, publish, or cause to be made, issued, or published any statement or advertisement as to the value of securities, or as to alleged facts affecting the value of securities, or as to the financial condition of any issuer of securities, when the person knows that such statement or advertisement is false in any material respect.
- h. R.C. 1707.44(K): No person, with purpose to deceive, shall make, record, or publish or cause to be made, recorded, or published, a report of any transaction in securities which is false in any material respect.
- i. R.C. 1707.44(N): No person knowingly shall influence, coerce, manipulate, or mislead 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.

2. Statutory Remedies.

- a. The Act does not support implied private rights of action. R.C. 1707.40.
- b. In general: R.C. 1707.43. *See supra* § IV. A., C.
- c. Statutory Private Civil Cause of Action for False Sales Materials. R.C. 1707.41 states in pertinent part:

In addition to the other liabilities imposed by law any person who, by a written or printed circular, prospectus, or advertisement, offers any security for sale, or receives the profits accruing from such sale, is liable, to any person who purchased such security relying on such circular, prospectus, or advertisement, for the loss or damage sustained by such relying person by reason of the falsity of any material statement contained therein or for the omission there from of material facts...

- i. The plain language of this excerpt makes clear that reliance, falsity and materiality are elements of this cause of action.
- ii. The plaintiff must be a purchaser, but the plaintiff need not prove common law fraud in order to recover under R.C. 1707.41. *In re Four Season Securities Laws Litigation*, 370 F. Supp. 219 (W.D. Okla. 1974).

- iii. The plaintiff may seek rescission or damages, but punitive damages are not recoverable under R.C. 1707.41. *Byrley v. Nationwide Life Insurance Co.*, 94 Ohio App. 3d 1, 20 (6<sup>th</sup> Dist. Ct. App. 1994).
- iv. The foregoing excerpt indicates that “any person who...offers any security for sale, or receives the profits accruing from such sale, is liable.” Courts have construed this category broadly:
  - (a) *Moore v. Fenex, Inc.*, 809 F.2d 297 (6<sup>th</sup> Dist. Ct. App. 1994): extending liability under R.C. 1707.41 to a securities salesperson.
  - (b) *Byrley v. Nationwide Life Insurance Co.*, 94 Ohio App. 3d 1 (6<sup>th</sup> Dist. Ct. App. 1994): reversing summary judgment in favor of a financial adviser on a R.C. 1701.41 claim.
  - (c) *Federated Management Co. v. Coopers & Lybrand*, 137 Ohio App. 3d 366, 388-9 (10<sup>th</sup> Dist. Ct. App. 2000) *appeal not allowed* 90 Ohio St. 3d 1424 (2000): holding that a national bank could be liable under R.C. 1707.41 where the bank received “referral fees” consisting of a percentage of the advisory fees earned by the financial advisor to a securities offering, and a percentage of the underwriting fees earned by the underwriter of the offering.
- v. R.C. 1707.41 also expressly provides for director liability. Case law confirms that liability will be extended to directors “who have failed to use due diligence in reviewing or preparing a publication.” *Baker v. Conlan*, 66 Ohio App. 3d 454, 460-1 (1<sup>st</sup> Dist. Ct. App. 1990).
- vi. A person can avoid liability under R.C. 1707.41 if he or she establishes that he or she had no knowledge of the publication thereof prior to the transaction complained of, or had just and reasonable grounds to believe such statement to be true or the omitted facts to be not material.

B. Common Law Causes of Action.

1. Fraud. The elements of a cause of action for actual fraud under Ohio law are: (1) a representation or, where there is a duty to disclose, concealment of a fact, (2) which is material to the transaction at hand, (3) made falsely, with knowledge of its falsity, or with such utter disregard and recklessness as to whether it is true or false that knowledge may be inferred, (4) with the intent of misleading another into relying upon it, (5) justifiable reliance upon the representation or concealment, and (6) a resulting injury proximately caused by the reliance. *Gaines v. Preterm-Cleveland, Inc.*, 33 Ohio St. 3d 54, 55 (1987).
2. Negligent Misrepresentation. Ohio law supports a cause of action for negligent misrepresentation where one who, in the course of his or her business, profession, or employment, or in any other transaction in which he or she has a pecuniary interest, supplies false information for the guidance of others in their business transactions. *Delman v. City of Cleveland Heights*, 41 Ohio St. 3d 1, 4 (1989). To be actionable, the negligent misrepresentation must result in the plaintiff's pecuniary loss caused by justifiable reliance on the information. *Leal v. Holtvogt*, 123 Ohio App. 3d 51, 62 (2<sup>nd</sup> Dist. Ct. App. 1998).
3. Negligent Nondisclosure. The Ohio Supreme Court has held that a party is under a duty to speak, and therefore liable for non-disclosure, if the party fails to exercise reasonable care to disclose a material fact which may justifiably induce another party to act or refrain from acting, and the non-disclosing party knows that the failure to disclose such information to the other party will render a prior statement or representation untrue or misleading. *Miles v. McSwegin*, 58 Ohio St. 2d 97, 100 (1979).
4. Breach of Fiduciary Duty. Under Ohio law, a fiduciary relationship is defined as a relationship in which special confidence and trust is reposed in the integrity and fidelity of another and there is a resulting position of superiority or influence, acquired by virtue of this special trust. *Ed Schory & Sons, Inc. v. Society National Bank*, 75 Ohio St. 3d 433, 442 (1996). Ohio courts have recognized that a securities salesperson is in a fiduciary relationship with his or her clients. See, e.g., *Byrley v. Nationwide Life Insurance Co.*, 94 Ohio App. 3d 1, 18 (6<sup>th</sup> Dist. Ct. App. 1994). An investment adviser is also a fiduciary. See e.g., *SEC v. Capital Gains Research Bureau*, 375 U.S. 180 (1963). A fiduciary must disclose all material information that he or she learns concerning the subject matter of the fiduciary relationship. *Silverberg v. Thomson, McKinnon Securities, Inc.*, 1985 WL 6611 (at 4) (8<sup>th</sup> Dist. Ct. App. 1985). Consequently, a fiduciary may be liable for the failure to disclose material information. See, e.g., *State v. Warner*, 55 Ohio St. 3d 31, 53-4 (1990).
5. Breach of Contract. Ohio courts have not been receptive to a plaintiff's effort to characterize a securities law claim as a breach of contract claim.

Plaintiffs attempt this characterization in order to take advantage of the fifteen-year statute of limitations on breach of contract claims. However, the courts have considered the actual nature of the case rather than the nature of the complaint. *See, e.g., Helman v. EPL Prolong, Inc.*, 2000 WL 1670683 (7<sup>th</sup> Dist. Ct. App. 2000); *Ware v. Kowars*, 2001 WL 58731 (10<sup>th</sup> Dist. Ct. App. 2001).

C. Remedies for Common Law Causes of Action.

1. Money Damages. Upon proving fraud a plaintiff is entitled to money damages in the amount of damages actually arising from the fraud. *Medical Billing, Inc. v. Medical Management Science, Inc.*, 212 F.3d 332, 338 (6<sup>th</sup> Cir. 2000). The defrauded party must choose between suing for money damages or suing for rescission. *Mid-Am Acceptance Co. v. Lightle*, 63 Ohio App. 3d 590, 599 (10<sup>th</sup> Dist. Ct. App. 1989).
2. Rescission. Rescission is intended to return the parties to the positions they were in before the contract was made. As just mentioned, a defrauded party may seek rescission or money damages but not both. If rescission is elected, the defrauded party is entitled to recover whatever the defrauded party has paid on the contract. In addition, in returning the parties to the “status quo,” it is generally necessary to award the party seeking rescission at least his or her out-of-pocket expenses. Ohio law characterizes these out-of-pocket expenses as “damages” because they represent the loss not cured by the cancellation of the contract. *Mid-Am Acceptance Co. v. Lightle*, 63 Ohio App. 3d 590, 599 (10<sup>th</sup> Dist. Ct. App. 1989).
3. Punitive Damages. Punitive damages may be awarded in a fraud case where the defrauded party shows either that the fraud is aggravated by the existence of malice or ill will, or that the wrongdoing is particularly gross or egregious. *Logsdon v. Graham Ford*, 54 Ohio St. 2d 336, 340 (1978). Such a showing may be made by evidence of intentional, willful or wanton acts, or by malice inferred from conduct and surrounding circumstances. *Emmons v. Merrill, Lynch, Pierce, Fenner & Smith*, 532 F. Supp. 480, 485 (S.D. Ohio 1982). Of course, the defrauded party must first establish the elements of the fraud cause of action. *Id.* Punitive damages will not be awarded in the absence of proof of actual damages. *Richard v. Hunter*, 151 Ohio St. 185 (1949).
4. Attorney Fees. Attorney fees may be awarded in cases involving fraud. *Liming v. Liming*, 117 Ohio App. 3d 617, 622 (4<sup>th</sup> Dist. Ct. App. 1996). However, attorney fees will be awarded in fraud cases only where punitive damages would be appropriate. *Id.* “This requires a case of gross or malicious fraud or something showing a very corrupt state of affairs.” *Id.*

In contrast, a case of “bare” fraud does not warrant punitive damages and thus does not support the award of attorney fees. *Id.*

D. Limitations Periods.

1. Statute of Limitations for Common Law Actions.

a. The limitations period for fraud, negligent misrepresentation and negligent nondisclosure is four years. R.C. 2305.09(C), (D).

i. In the case of fraud, the statute of limitations provides that the cause of action accrues when the fraud is discovered. Under this “discovery rule,” Ohio courts have construed the accrual date as the date the defrauded party actually discovered, or should have discovered, the fraud. *Investors REIT One v. Jacobs*, 46 Ohio St. 3d 176, 179 (1989).

ii. In the case of negligence, however, the statute of limitations provides that the cause of action accrues at the time the negligence occurs. Ohio courts have declined to extend the “discovery rule” to negligence actions in the absence of express statutory authority. *See e.g., Investors REIT One v. Jacobs*, 46 Ohio St. 3d 176, 179 (1989). Specifically, the “discovery rule” has been held inapplicable to negligence claims arising out of the sale of securities. *Hater v. Gradison Division of McDonald and Company Securities, Inc.*, 101 Ohio App. 3d 99 (1<sup>st</sup> Dist. Ct. App. 1995). Similarly, the discovery rule has been held inapplicable to a claim of negligent investment advice. *Kondrat v. Morris*, 118 Ohio App. 3d 198, 206-207 (8<sup>th</sup> Dist. Ct. App. 1997). As a result, the limitations period begins to run on the date the negligent act was committed, not the date the injury occurred. *Hater v. Gradison Division of McDonald and Company Securities, Inc.*, 101 Ohio App. 3d 99, 110-111 (1<sup>st</sup> Dist. Ct. App. 1995); *Kondrat v. Morris*, 118 Ohio App. 3d 198, 206-207 (8<sup>th</sup> Dist. Ct. App. 1997).

b. The limitations period for a breach of fiduciary duty claim is four years. R.C. 2305.09(D).

c. The limitations period for a breach of contract claim is fifteen years. R.C. 2305.06.

2. The Statutes of Limitations in R.C. 2305 versus the Statute of Limitations in R.C. 1707.43.

- a. On a number of occasions, courts have addressed the interaction of R.C. 2305.09's general four-year fraud statute of limitations (and its discovery rule) and the R.C. 1707.43 statute of limitations. (R.C. 1707.43 provided for a two-year/four-year statute of limitations until September 16, 2003, when it was amended to a two-year/five-year period. The following cases interpreted the two-year/four-year provision, but the reasoning of the decisions would seem applicable to the new two-year/five-year period.) Since the discovery rule contained in R.C. 2305.09 is more favorable to plaintiffs, plaintiffs often attempt to cast their cause of action in the nature of fraud. However, the plain language of R.C. 1707.43 states that its limitations period applies to "action[s] for any recovery based upon or arising out of a sale or contract for sale made in violation of the [Act]." As the following discussion demonstrates, in cases involving securities claims styled as fraud claims, courts have tended to find that R.C. 1707.43, rather than R.C. 2305.09, provides the appropriate statute of limitations.
- b. The starting point for the judicial discussions of the applicable limitations period in a securities case usually is the proposition that the court "must look to the actual nature or subject matter of the case, rather than to the form in which an action is pleaded, to determine the applicable limitations period." *Ware v. Kowars*, 2001 WL 58731 (at 9) (10<sup>th</sup> Dist. Ct. App. 2001). While it has been recognized that R.C. 1707.43 was not intended to apply to securities fraud cases based solely upon common law fraud, *Nickels v. Koehler Management Corp.*, 541 F.2d 611, 616 (6<sup>th</sup> Cir. 1976), courts have broadly construed what constitutes "based upon or arising out of a sale or contract for sale made in violation of the [Act]" for purposes of applying the R.C. 1707.43 limitations period.

### 3. Case Law.

- a. In *Hater v. Gradison Division of McDonald and Company Securities, Inc.*, 101 Ohio App. 3d 99 (1<sup>st</sup> Dist. Ct. App. 1995), the plaintiffs alleged fraud by virtue of the defendants' concealment of a number of facts regarding a limited partnership and partnership property. Plaintiffs further alleged that the fraudulent acts occurred after the sale of the limited partnership interests, and that their claim was brought as "owners" of securities, rather than as "purchasers" of securities. Accordingly, plaintiffs contended that R.C. 2305.09 provided the appropriate limitations period. The First District Court of Appeals rejected this contention, holding that the "allegations of fraud [were] inextricably interwoven with

the sale of the partnership units,” and concluded that R.C. 1707.43 provided the appropriate limitations period.

- b. In *Lynch v. Dean Witter Reynolds, Inc.*, 134 Ohio App. 3d 668 (2<sup>nd</sup> Dist. Ct. App. 1999), plaintiffs claimed that the defendant securities brokerage firm breached brokerage account contracts by failing to make required disclosures, engaging in self-dealing, acting without due diligence and improperly managing the investment accounts. Since the acts occurred after the opening of the brokerage account contracts and were allegedly unrelated to the purchase of securities, the plaintiffs reasoned that the claims should be subject to the fifteen year statute of limitations for breach of contract contained in R.C. 2305.06. However, the Second District Court of Appeals found that the allegations related to defendant’s sales practices, marketing and representations on which the plaintiffs would have relied in deciding to purchase securities, and therefore “clearly arose out of the sale or contract for sale of the securities.” The court also noted the general rule that specific statutory provisions prevail over general provisions. As a result the court concluded that R.C. 1707.43 provided the appropriate limitations period.
- c. In *Ware v. Kowars*, 2001 WL 58731 (10<sup>th</sup> Dist. Ct. App. 2001), a customer sued her stockbroker claiming that the broker engaged in unauthorized and unsuitable activities in her brokerage account. Her complaint alleged conversion, breach of contract, breach of fiduciary duty and fraud. However, the Tenth District Court of Appeals rejected the argument that the limitation periods for those theories should apply. Specifically, the court relied on *Lynch* to reject the contention that the breach of contract limitations period should apply because the appellant’s claims allegedly arose not from the sale of securities, but from mismanagement of her account after the securities were purchased. Similarly, the court relied on *Hater* to reject application of the limitation period for fraud even though the complaint sounded in fraud. The court concluded:

Although appellant has attempted to avoid the application of R.C. 1707.43 by framing her counts as common law claims for breach of contract, breach of fiduciary duty [and fraud], we must look to the actual nature or subject matter of the case, rather than the form in which an action is pleaded, to determine the applicable limitations period. ... In reviewing the allegations of appellant’s complaint, we find that appellant has alleged conduct that is

violative of the R.C. Chapter 1707's prohibition against fraud in the sale of securities. ... As such, appellant's allegations are inextricably interwoven with the sale of securities and, therefore, controlled by the limitations period contained in R.C. 1707.43.

- d. The plaintiffs were given the benefit of the R.C. 2305.09 limitations period in *Ferritto v. Alejandro*, 2000 WL 1507912 (9<sup>th</sup> Dist. Ct. App. 2000). In that case, the defendant sold both investments and insurance policies to the plaintiffs. However, the defendant purchased investments for less than the amount given to him for that purpose by the plaintiffs, and used the difference for his own personal purposes. The plaintiffs sued based on several causes of action, including common law fraud. The complaint did not contain a cause of action under R.C. 1707, but the trial court applied the R.C. 1707.43 limitations period. On appeal, the Ninth District Court of Appeals reversed, recognizing that the complaint stated a cause of action for common law fraud rather than a cause of action under the Act. The court recognized that the plaintiffs did not "seek to recover the purchase price of securities or damages in violation of [the Act], rather they [sought] damages for the defendant's false statements that securities were purchased." The court found that the false statements "were not made for the purpose of selling securities...rather [the] statements were, allegedly, made with the intent to induce the [plaintiffs] to deposit funds with [defendant] so that he could pocket his investment money," and therefore R.C. 2305.09 provided the appropriate statute of limitations.
- e. Ohio courts have recognized that the doctrine of equitable estoppel "may be employed to prohibit the inequitable use of the statute of limitations." In *Helman v. EPL Prolong, Inc.*, 2000 WL 1670683 (7<sup>th</sup> Dist. Ct. App. 2000), the Seventh District Court of Appeals relied on *Hater* and *Lynch* to find that the plaintiffs' claim of breach of contract based on the failure to deliver stock pursuant to a subscription agreement was "inextricably interwoven with a fraudulent sale of securities," and therefore subject to the R.C. 1707.43 limitations period. However, the court remanded the case for the trier of fact to determine if the defendants should be equitably estopped from asserting the R.C. 1707.43 statute of limitations as a defense, since there was some evidence that false assurances by certain defendants may have reasonably induced plaintiffs to forebear from suing.
- f. Notwithstanding the courts' tendency to apply the R.C. 1707.43 limitations period in the case of securities fraud, by its express

terms R.C. 1707.43 extends only to defrauded purchasers. *Toledo Trust Co. v. Nye*, 392 F. Supp. 484, 491 (N.D. Ohio 1975). Therefore, the cause of action of a defrauded seller is a cause of action sounding in common law fraud, and is governed by the R.C. 2305.09 limitations period. *Baker v. Pfeifer*, 940 F. Supp. 1168, 1181-1183 (S.D. Ohio 1996); *see also Plantation Housing Partners Ltd. v. Lidsey*, 1991 WL 34726 (8<sup>th</sup> Dist. Ct. App. 1991).

## **VII. LIABILITIES AND REMEDIES UNDER OTHER OHIO STATUTORY PROVISIONS**

### **A. Ohio Corrupt Activities Act.**

The Ohio Corrupt Activities Act, R.C. 2923.31 to 2923.36 (“OCAA”), prohibits persons employed by, or associated with, any enterprise from conducting or participating in the affairs of the enterprise through a pattern of corrupt activity. R.C. 2923.32(A)(1).

1. “Enterprise.” “Enterprise” includes any individual, sole proprietorship, partnership, limited partnership, corporation, trust, union, government agency, or other legal entity, or any organization, association, or group of persons associated in fact although not a legal entity. “Enterprise” includes illicit as well as licit enterprises. R.C. 2923.31(C).
2. “Pattern of Corrupt Activity.” A “pattern of corrupt activity” means two or more incidents of corrupt activity. R.C. 2923.31(E). However, the pattern of corrupt activity in a private civil suit must include at least one incident other than a violation of R.C. 1707.44(B), (C)(4), (D), (E) or (F). R.C. 2923.34(B). The definition of “corrupt activity” set forth in R.C. 2923.31(I) includes, among many other things, violations of R.C. 1707.44 (B), (C)(4), (D), (E) or (F), which are set forth below.

#### **a. Misrepresentations. R.C. 1707.44(B) states:**

No person shall knowingly make or cause to be made any false representation concerning a material and relevant fact, in any oral statement or in any prospectus, circular, description, application, or written statement, for any of the following purposes: (1) Complying with this chapter, in regard to registering securities by description; (2) Securing the qualification of any securities under this chapter; (3) Procuring the licensing of any dealer, salesperson, investment adviser, or investment adviser representative under this chapter; (4) Selling any securities in this state; (5) Advising for compensation, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities.

- b. Division Endorsement Claims. R.C. 1707.44(C)(4) states:

No person shall knowingly and intentionally sell, cause to be sold, offer for sale, or cause to be offered for sale, any security which comes under any of the following descriptions:.... The offer or sale is accompanied by a statement that the security offered or sold has been or is to be in any manner indorsed by the division.

- c. Failure to Disclose Issuer Insolvency. R.C. 1707.44(D) states:

No person who is an officer, director, or trustee of, or a dealer for, any issuer, and who knows such issuer to be insolvent in that the liabilities of the issuer exceed its assets, shall sell any securities of or for any such issuer, without disclosing the fact of the insolvency to the purchaser.

- d. Unauthorized Representation. R.C. 1707.44(E) states:

No person with intent to aid in the sale of any securities on behalf of the issuer, shall knowingly make any representation not authorized by such issuer or at material variance with statements and documents filed with the division by such issuer.

- e. Sale of Securities of Insolvent Issuer. R.C. 1707.44(F):

No person, with intent to deceive, shall sell, cause to be sold, offer for sale, or cause to be offered for sale, any securities of an insolvent issuer, with knowledge that such issuer is insolvent in that the liabilities of the issuer exceed its assets, taken at their fair market value.

3. Parties and Relief Afforded. The OCAA provides a private civil cause of action in favor of any person who is injured or threatened with injury by a violation of the OCAA. R.C. 2923.34(B). Relief may be sought from any person whose conduct violated or allegedly violated the OCAA, or conspired or allegedly conspired to violate the OCAA. R.C. 2923.34(B). A court may also grant injunctive or other equitable relief. R.C. 2923.34(C), (E). A successful plaintiff may also recover attorney fees. R.C. 2923.34(G). A plaintiff in a private civil OCAA case may recover treble damages if violations are proved by clear and convincing evidence. R.C. 2923.34(F).
4. Statute of Limitations. The OCAA provides a liberal five-year statute of limitations for civil claims. R.C. 2923.34(K). If the violations involved

are part of an ongoing state prosecution that time period is extended until two years after termination of the state prosecution.

B. Ohio Business Opportunity Purchasers Protection Act.

The Ohio Business Opportunity Purchasers Protection Act, R.C. Chapter 1334 ("OBOPPA"), regulates "business opportunity plans," which include sales and distribution arrangements, including relationships commonly known as franchises.

1. "Business Opportunity Plan." R.C. 1334.01 (D).

A "business opportunity plan" is an agreement in which a purchaser obtains the right to offer, sell or distribute goods or services under all of the following conditions:

- a. The goods or services are supplied by the seller, a third person with whom the purchaser is required or advised to do business by the seller, or an affiliated person.
- b. The purchaser is required to make an initial payment greater than five hundred dollars, but less than fifty thousand dollars, to the seller or an affiliated person to begin or maintain the business opportunity plan.
- c. The seller makes any of the following representations:
  - i. That the purchaser will be provided with retail outlets or accounts, or assistance in establishing retail outlets or accounts, for the sale or distribution of the goods or services;
  - ii. That the purchaser will be provided locations, or assistance in finding locations, for vending machines, electronic games, rack displays, or any other equipment or display for use in the sale or distribution of the goods or services;
  - iii. That the purchaser can earn a profit in excess of the initial payment;
  - iv. That there is a market for the goods or services;
  - v. That there is a buy-back arrangement.

2. Disclosure Requirements. While the OBOPPA does not require registration with the state for the sale of a business opportunity plan, the

seller must provide a potential buyer with a disclosure document with specific legends, risk factors and attachments. R.C. 1334.02.

3. **Cancellation Rights.** Buyers must be given a right to cancel the purchase of a business opportunity plan until midnight of the fifth business day after the signing of the purchase agreement. R.C. 1334.05. The five-day cancellation period does not begin until the seller provides the purchaser with copies of all executed documents, written notice of the right of cancellation in the language and format required by the statute, the seller's address, and the date of the agreement and the last day on which the purchaser may cancel. R.C. 1334.06. The cancellation must be in writing and may be delivered by mail, telegram or personal delivery. R.C. 1334.05.
4. **Surety Bond or Trust Account May be Required.** If the seller represents that the buyer's initial payment or promissory note is secured in any manner or if there is a buyback agreement, the seller must obtain a surety bond or establish a trust account. R.C. 1334.04.
5. **Exemption for "Securities."** The sale of a registered security, as "security" is defined in R.C. 1707.01(B), is specifically excluded from the statutory requirements for the sale of business plans. R.C. 1334.12(E). In addition, the Ohio Supreme Court has held that the sale of a business opportunity plan or franchise is a distinctly different activity from the sale of a security, and therefore is not within the purview of the OSA. *Peltier v. Spaghetti Tree, Inc.*, 6 Ohio St.3d 194 (1983). However, since elements of an investment contract may be similar to a business opportunity plan, a purchaser could allege violations of both R.C. 1334 and 1707, although a court would grant relief under only one statutory provision. *See* § II.C., *supra*. Such alternative pleading also may be prudent in order to preserve the causes of action under the limitations periods of both statutes.
6. **Parties and Relief Afforded.**
  - a. **Rescission and Treble or Statutory Damages.** For violations of the OBOPPA where the buyer has been damaged, the buyer may rescind the transaction and recover three times the amount of actual damages or ten thousand dollars, whichever is greater, or other appropriate relief in a class action. R.C. 1334.09(A).
  - b. **Attorney Fees.** A court may also award reasonable attorney fees to the buyer, or to the seller if the buyer brought an action that is groundless and in bad faith. R.C. 1334.09(B).
  - c. **Injunctive and/or Class Action by Ohio Attorney General.** In addition to the buyer's remedies, the Ohio Attorney General is

authorized to obtain a declaratory judgment that an act or practice violates the OBOPPA and to bring an action to obtain a temporary restraining order, a preliminary injunction or a permanent injunction. R.C. 1334.08(A)(1) and (2). Unlike the Division, the Ohio Attorney General may commence a class action on behalf of buyers damaged by violation of the OBOPPA. R.C. 1334.08(A)(3).

7. Statute of Limitations. The OBOPPA provides a five-year statute of limitations for civil claims. R.C. 1334.10(C).

C. Ohio Consumer Sales Practices Act.

The Ohio Consumer Sales Practices Act, R.C. Chapter 1345 ("OCSPA"), prohibits the commission of unfair, deceptive, or unconscionable acts or practices by a supplier in connection with a consumer transaction. R.C. 1345.02(A), 1345.03(A).

1. "Consumer transaction." Subject to certain exceptions, "consumer transaction" means a sale, lease, assignment, award by chance, or other transfer of an item or goods, a service, a franchise, or an intangible, to an individual for purposes that are primarily personal, family, or household, or solicitation to supply any of the foregoing. R.C. 1345.01(A). "Consumer transaction" does not include transactions between persons, defined in R.C. 4905.03 (public utilities) and R.C. 5725.01 (certain financial institutions and insurance companies), and their customers; transactions between certified public accountants or public accountants and their clients; transactions between attorneys, physicians, or dentists and their clients or patients; and transactions between veterinarians and their patients that pertain to medical treatment but not ancillary services. *Id.*
2. "Supplier." The prohibitions extend to a "supplier," which is defined as a seller, lessor, assignor, franchisor, or other person engaged in the business of effecting or soliciting consumer transactions, whether or not he or she deals directly with the consumer. R.C. 1345.01(C).
3. Sale of Unregistered Securities as Consumer Transaction. While the Uniform Consumer Sales Practices Act expressly excludes securities from the definition of "consumer transaction," Ohio law does not, suggesting that securities may be within the purview of the OCSPA.
  - a. *State ex rel. Celebrezze v. Erie Shores Resort & Marina, Inc.*, 1989 WL 572075 (Ashtabula Cty. Com. Pl. 1989). The court found that the giving of a "Certificate of Beneficial Interest" in connection with a consumer transaction constituted the sale of an unregistered security in violation of the OSA, "and thus an unfair or deceptive

act or practice prohibited by the Ohio Consumer Sales Practices Act."

- b. *State ex rel. Celebrezze v. Venture Out Resorts, Inc.*, 1988 WL 877630 (Holmes Cty. Com. Pl. 1988). The court found that the distribution of a "Certificate for one \$5,000 Municipal Securities Bond" and a "Certificate of Beneficial Interest" in violation of the OSA's securities registration requirements in connection with a consumer transaction constituted an unfair or deceptive act or practice prohibited by OCSPA.
4. **Unlicensed Sale of Securities as Consumer Transaction.** There are also decisions holding that unlicensed activities constitute unfair and deceptive acts and practices, although there are not any decisions specifically holding that the unlicensed sale of securities or unlicensed giving of investment advice constitute unfair and deceptive acts or practices. *See, e.g., Slotkin v. Toth*, 1999 WL 1421654 (Cuyahoga Cty. Com. Pl. 1999) (failure to secure food handlers and liquor licenses); *State ex rel. Celebrezze v. Auto Adoption Leasing*, 1990 WL 677014 (Montgomery Cty. Com. Pl. 1990) (failure to secure motor vehicle leasing dealer's license); *State ex rel. Brown v. Martz Tri-County Landscaping*, No. CV-81-1152 (Butler Cty. Com. Pl. May 29, 1982) (failure to secure nursery license).
5. **Parties and Relief Afforded.**
  - a. **Rescission or Damages.** The primary private civil remedy available under the OCSPA is the right to rescission or damages. R.C. 1345.09(A). However, the plaintiff may choose between rescission or treble damages if the act is one declared to be deceptive or unconscionable in the OCSPA or the rules adopted by the Ohio Attorney General under the OCSPA, or the act is one determined by an Ohio court to violate the OCSPA and is committed after the decision containing the determination is made available for public inspection by the Ohio Attorney General. R.C. 1345.09(B). Ohio Revised Code Section 1345.05(A)(3) requires the Ohio Attorney General to make available for public inspection all judgments determining that specific acts or practices violate the OCSPA. The Ohio Attorney General maintains this information in the "Index of Significant Consumer Protection Litigation."
  - b. **Attorney Fees.** A court may award attorney fees to the prevailing party. R.C. 1345.09(F).
  - c. **Injunctive and Damages Action by Ohio Attorney General.** In addition to the consumer's remedies, the Ohio Attorney General is

authorized to obtain a declaratory judgment that an act or practice violates the OCSPA and to bring an action to obtain a temporary restraining order, a preliminary injunction or a permanent injunction. R.C. 1345.07.

6. Statute of Limitations. Claims under the OCSPA must be filed within two years of the violation. R.C. 1345.10(C). If the violation is the subject of a proceeding by the Ohio Attorney General, the limitations period is extended until one year after the termination of that proceeding. *Id.*

D. Ohio Telephone Solicitation Sales Act.

1. Requirements and Prohibited Activities. The Ohio Telephone Solicitation Sales Act, R.C. Chapter 4719 (“OTSSA”), prohibits a person from acting as a telephone solicitor without first obtaining a certificate of registration or registration renewal from the Ohio Attorney General. R.C. 4719.02(A). The person must also obtain a surety bond, submit to the Ohio Attorney General proposed representations concerning gifts, awards or prizes, and disclose certain information during a solicitation call. R.C. 4719.04, 4719.05, and 4719.06. No verbal agreement made as a result of a solicitation call is valid or legally binding unless the telephone solicitor receives from the purchaser a signed, written confirmation that discloses in full the terms of the agreement, and complies with other statutory requirements. R.C. 4719.07. Misrepresentations are prohibited, as are efforts to cause or attempt to cause a purchaser to waive any right granted by the OTSSA. R.C. 4719.08 and 4719.09.
2. Telephone Solicitation Not Limited to Solicitor Initiated Calls. The OTSSA also can be triggered in the case of a notification or advertisement other than by telephone if either the notification or advertisement is followed by a telephone call from a telephone solicitor or salesperson, or the notification or advertisement invites a response by telephone and during the course of that response a telephone solicitor or salesperson attempts to make or makes a sale of goods or services. R.C. 4719.01(A)(2) and (7).
3. Exemption for Licensed Securities Salesperson - Potential Liability for Unlicensed Activities. R.C. 4719.01(B)(4) provides an exemption from the substantive requirements of the OTSSA for: “A licensed securities, commodities, or investment broker, dealer, investment advisor, or associated person when making a telephone solicitation within the scope of the person's license. As used in division (B)(4) of this section, ‘licensed securities, commodities, or investment broker, dealer, investment advisor, or associated person’ means a person subject to licensure or registration as such by the SEC; the National Association of Securities Dealers or other self-regulatory organization, as defined by 15 U.S.C.A. 78c; by the

division of securities under Chapter 1707. of the Revised Code; or by an official or agency of any other state of the United States.”

This provision’s emphasis on “licensed,” and “within the scope of the person’s license” supports an argument that the benefit of the exemption is available only to properly licensed salespersons. This reading is supported by R.C. 4719.18(B), which states that the OTSSA is “remedial in nature and shall be liberally construed by the courts of this state.” 4719.18(B). Thus telemarketing activities by unlicensed persons would be subject to OTSSA.

4. **Parties and Remedies.** A purchaser injured by a violation of the OTSSA may bring a civil action against the telephone solicitor or salesperson that committed the violation for damages (and attorney fees), and may also apply to the court for an order enjoining the violation. R.C. 4719.15(A). If a court awards damages, the court shall award damages in an amount that is not less than the amount that the purchaser paid to the telephone solicitor or salesperson, and shall order the telephone solicitor or salesperson to pay reasonable attorney fees and court costs to the purchaser. R.C. 4719.15(B). The court may award the purchaser punitive or exemplary damages upon the purchaser's showing that the telephone solicitor or salesperson knowingly committed an act or practice that violated the OTSSA. R.C. 4719.15(C). Certain violations of the OTSSA also constitute violations of the OCSPA, meaning that the plaintiff may be able to recover treble damages and attorney fees under the OCSPA. R.C. 4719.14.
5. **Statute of Limitations.** Claims must be brought within two years after the date of the telephone solicitation upon which the action is based. R.C. 4719.15(D).

E. **Ohio Pyramid Sales Plans Statute.**

The Ohio Pyramid Sales Plans Statute, R.C. 1333.91 to 1333.95, (“OPSPS”) prohibits any person from proposing, planning, preparing or operating a pyramid sales plan or program. R.C. 1333.92.

1. **Pyramid Sales Plan or Program.”** R.C. 1333.91. A “pyramid sales plan or program” means:

Any scheme, whether or not for the disposal or distribution of property, whereby a person pays a consideration for the chance or opportunity to receive compensation, regardless of whether he also receives other rights or property, under either of the following circumstances:

- a. For introducing one or more persons into participation in the plan or program;
  - b. When another participant has introduced a person into participation in the plan or program.
2. Prohibited Conduct and Remedies. Any contract made in violation of the OPSPS is void, and any person who has paid consideration for the chance or opportunity to participate in a pyramid sales plan or program may recover, in a civil action, the amount of the consideration paid, together with reasonable attorney fees, from any participant who has received compensation either for introducing the person into participation in a pyramid sales plan or program, or when another participant has introduced the person into participation in a pyramid sales plan or program. R.C. 1333.93. Violations of the OPSPS also may be violations of the OCSPA. R.C. 1333.95. In addition, the Ohio Attorney General may pursue injunctive relief under the OPSPS. R.C. 1333.94.

## VIII. SECONDARY LIABILITY FOR SECURITIES VIOLATIONS.

### A. No Statutory Control Person Liability.

Unlike the federal securities laws (15 U.S.C. 77o, 15 U.S.C. 78t) and some state securities laws, the Act does not contain a provision establishing control person liability. However, the direct liability under the Act is far-reaching. R.C. 1707.43 provides joint and several liability for “every person who has participated in or aided the seller in any way in making such sale or contract for sale.” Similarly, R.C. 1707.41, the provision establishing civil liability for the use of false advertising, contemplates direct liability of officers and directors.

### B. Director and Officer Liability for Corporate Fraud.

In general, a defendant may be held liable for fraud notwithstanding the fact that the defendant did not himself make the fraudulent statement or omission. *Baker v. Pfeifer*, 940 F. Supp. 1168, 1184 (S.D. Ohio 1996).

Ohio law recognizes that corporate officers may be liable in their individual capacities for acts of fraud, *Mkparu v. Ohio Heart Care, Inc.*, 138 Ohio App. 3d 7, 13 (5<sup>th</sup> Dist. Ct. App. 1999), and this personal liability may attach even though the corporation is also liable. *Centennial Insurance Co. of New York v. Vic Tanny International of Toledo, Inc.*, 46 Ohio App. 2d 137, 141 (6<sup>th</sup> Dist. Ct. App. 1975). *See also Baker v. Pfeifer*, 940 F. Supp. 1168, 1184 (S.D. Ohio 1996). In order for a corporate officer to be personally liable for fraud, “it must be shown that he knew the statement was false, that he intended it to be acted upon by the parties seeking redress, and that it was acted upon to the injury of the party.” *Centennial*

*Insurance Co. of New York v. Vic Tanny International of Toledo, Inc.*, 46 Ohio App. 2d 137, 141 (6<sup>th</sup> Dist. Ct. App. 1975); *Baker v. Pfeifer*, 940 F. Supp. 1168, 1184-5 (S.D. Ohio 1996); *Mkparu v. Ohio Heart Care, Inc.*, 138 Ohio App. 3d 7, 13 (5<sup>th</sup> Dist. Ct. App. 1999).

C. Agency Law and Respondeat Superior.

Traditional agency law holds brokerage firms liable for the illegal acts of their brokers in the sale of securities. *Byrley v. Nationwide Life Insurance Co.*, 94 Ohio App. 3d 1, 15 (6<sup>th</sup> Dist Ct. App. 1994). The doctrine of *respondeat superior* is available to hold an employer liable where an employee is liable for a tort committed in the scope of employment. *See, e.g., Tucker v. Kroger Co.*, 133 Ohio App. 3d 140 (10<sup>th</sup> Dist. Ct. App. 1999). When the tort is intentional, the behavior giving rise to the tort must be calculated to facilitate or promote the business for which the person was employed. *Id.* at 147 (citation omitted). An employer is not liable for independent self-serving acts of an employee that in no way facilitate or promote the employer's business. *Id.*

D. Aiding and Abetting.

There is a split of authority as to whether Ohio law supports a private civil action for aiding and abetting.

In an April 2000 decision, the Tenth District Court of Appeals held: "Ohio does not recognize a claim for aiding and abetting common law fraud." *Federated Management Co. v. Coopers & Lybrand*, 137 Ohio App. 3d 366, 381 (10<sup>th</sup> Dist. Ct. App. 2000) *appeal not allowed* 90 Ohio St. 3d 1424 (2000). The appellate court reasoned that "one who engages in any way in fraudulent behavior is liable for fraud itself, not as an aider and abettor to fraud." *Id.*

However, in July 2000, the United States Sixth Circuit Court of Appeals held that Ohio law does recognize a claim for civil aiding and abetting. *Aetna Casualty and Surety Co. v. Leahey Construction Co.*, 219 F.3d 519, 532-4 (6<sup>th</sup> Cir. 2000). The federal court found support for its holding in Ohio state court recognition of Restatement (Second) of Torts § 876(b), which provides in pertinent part: "For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he ... knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself..." *Id.* at 533. The court stated that the aiding and abetting cause of action requires two elements: (1) knowledge that the primary party's conduct is a breach of duty and (2) substantial assistance or encouragement to the primary party in carrying out the tortious act. *Id.* Further, the court took the position that the knowledge element is satisfied where the aider and abettor has a general awareness of its role in the other's tortious conduct. *Id.* at 534 (citations omitted).

E. Civil Conspiracy.

Under Ohio law, a civil conspiracy is a “malicious combination of two or more persons to injure another in person or property, in a way not competent for one alone, resulting in actual damages.” *Kenty v. Transamerica Premium Insurance Co.*, 72 Ohio St. 3d 415, 419 (1995) quoting *LeFort v. Century 21-Maitland Realty Co.*, 32 Ohio St. 3d 121, 126 (1987). Civil conspiracy and aiding and abetting are similar, but distinct causes of action. The prime distinction between civil conspiracies and aiding-abetting is that a conspiracy involves an agreement to participate in a wrongful activity. Aiding-abetting focuses on whether a defendant knowingly gave 'substantial assistance' to someone who performed wrongful conduct, not on whether the defendant agreed to join in the wrongful conduct. *Aetna Casualty and Surety Co. v. Leahey Construction Co.*, 219 F.3d 519, 534 (6<sup>th</sup> Cir. 2000) (citation omitted). The elements of a civil conspiracy cause of action are: (1) a malicious combination; (2) two or more persons; (3) injury to person or property; and (4) existence of an unlawful act independent from the actual conspiracy. *Aetna Casualty and Surety Co. v. Leahey Construction Co.*, 219 F.3d 519, 534 (6<sup>th</sup> Cir. 2000) quoting *Universal Coach, Inc. v. New York City Transit Authority, Inc.*, 90 Ohio App. 3d 284 (8<sup>th</sup> Dist. Ct. App. 1993).

## **IX. DIVISION ENFORCEMENT.**

- A. The Division has broad investigative authority, including the power to conduct investigatory examinations, order the filing of information, issue subpoenas for testimony or documents, and conduct deposition-type proceedings. R.C. 1707.23.
- B. The Division may bring administrative or civil enforcement action, or refer matters to county prosecutors for criminal prosecution. R.C. 1707.23.
  - 1. The Division’s administrative enforcement authority includes:
    - a. actions to cease and desist (R.C. 1707.23(H));
    - b. actions to deny, suspend or revoke licenses (R.C. 1707.19(A)); and
    - c. actions to suspend securities offerings (R.C. 1707.13).
  - 2. The Division’s civil enforcement authority includes:
    - a. contempt proceedings (R.C. 1707.24);
    - b. injunctive proceedings (R.C. 1707.25, 1707.26);

- c. seeking court-ordered restitution or rescission from a court that has granted injunctive relief pursuant to R.C. 1707.26 (R.C. 1707.261); and
  - d. seeking court appointment of a receiver (R.C. 1707.27).
- C. The statute of limitations on Division enforcement actions is five years. R.C. 1707.28.