ORIGINAL

IN THE SUPREME COURT OF OHIO
CASE NO. 12-0216

STATE OF OHIO,	:	On Appeal from the Summit County Court of Appeals, Ninth District
Plaintiff-Appellee,	:	
v.	:	Case No. CA-24894
DAVID WILLAN,	:	
Defendant-Appellant.	:	

AMICUS CURIAE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.'S MEMORANDUM IN SUPPORT OF JURISDICTION FOR CROSS-APPEAL

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IDENTITY AND INTEREST OF AMICUS CURIAE

The North American Securities Administrators Association, Inc. ("NASAA") is the non-profit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. NASAA has 67 members, including the securities regulators in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Formed in 1919, NASAA is the oldest international organization devoted to protecting investors from fraud and abuse in connection with the offer and sale of securities.

The members of NASAA include the state agencies that are responsible for regulating securities transactions under state securities statutes, commonly referred to as "Blue Sky" laws. Their fundamental mission is protecting investors, and their principal activities include registering certain securities; licensing the firms and agents who offer and sell securities and offer investment advice; preventing securities fraud; and, where appropriate, pursuing enforcement actions for violations of Blue Sky laws. State securities regulators also educate the public about investment fraud and advocate for the adoption of strong, fair, and uniform securities laws and regulations at both the state and federal level.

NASAA supports the work of its members by coordinating multi-state enforcement actions, conducting training programs, publishing investor education materials, and presenting the views of its members in testimony before Congress on matters of securities regulation. Another core function of the NASAA is to represent the membership's position, as amicus curiae, in significant cases involving the interpretation of securities laws and the rights of investors.

NASAA is particularly interested in the instant case because the Ninth District Court of Appeals' erroneous interpretations of the Ohio Securities Act will severely weaken investor

protection in Ohio. NASAA is also concerned that the damaging impacts of the decision may spread to other states, as bad actors in other states use the decision as a road map to circumvent the securities laws and as a shield to avoid punishment for defrauding investors.

STATEMENT OF THE CASE AND FACTS

For purposes of this amicus brief, the relevant background facts and procedural history are sufficiently set forth in the Court of Appeals' decision and incorporated into the Appellee's Memorandum in Support of Jurisdiction.

THIS CASE IS OF PUBLIC AND GREAT GENERAL INTEREST

Section 2(B)(2)(e), Article IV of the Ohio Constitution provides that "[t]he supreme court shall have appellate jurisdiction ... [i]n cases of public or great general interest," and this case easily satisfies that standard. If left to stand, the Court of Appeals' decision threatens to severely frustrate the ability of the Ohio Division of Securities and criminal prosecutors to bring charges under the Ohio Securities Act (the "Act") for securities fraud, for making material false representations in the registration of securities, and for selling securities without a license. In doing so, the Court of Appeals' holdings severely jeopardize investor protection in the State of Ohio by significantly weakening the deterrent effect of the Act. Furthermore, the Court of Appeals' decision will place Ohio well outside the mainstream of Blue Sky jurisprudence, potentially inviting other courts to erode similar investor protections nationwide.

Securities Fraud

The Court of Appeals' decision is of public and great general interest. By requiring the state to prove that investors relied upon the misrepresentations made by the Defendant or that the investment plan was "illegitimate," the Court of Appeals has construed the definition of fraud very narrowly. This ruling contradicts the well-established precedent of this Court that the Act

should be broadly construed for the protection of investors, *Bronaugh v. R. & E. Dredging Co.*, 16 Ohio St.2d 35, 40-41, 242 N.E.2d 572 (1968), and that Ohio courts should look to the decisions of other state and federal courts for defining fraud in the context of the sale of securities. *In re Columbus Skyline Secs.*, 74 Ohio St.3d 495, 660 N.E.2d 427 (1996).

The Court of Appeals decision is at odds with Blue Sky decisions in other states. Those decisions do not require a finding of reliance to support a fraud conviction, but rather a finding that the Defendant misrepresented or omitted a fact that was "material." *See* 12A Joseph C. Long, *Blue Sky Law*, Section 10:45 (2011).

With its extremely narrow interpretation of what constitutes "fraud," the Court of Appeals ignored the fundamental purpose of the state securities laws, thereby leaving Ohio investors more vulnerable to predatory practices. If regulators are required to prove that investors relied upon a false statement, the regulators will be precluded from taking action against miscreants except in those instances where the fraudsters have successfully persuaded investors to part with their money.

NASAA is concerned that the erroneous interpretation of the Court of Appeals will be exported to other jurisdictions. NASAA knows of no other state that requires a showing of reliance as an element of securities fraud, but the decision of the Court of Appeals will undoubtedly be cited by defendants in other states who seek a similarly narrow application of the securities laws.

Registering Securities

The Court of Appeals' decision is also of public and great general interest because it would aid unscrupulous issuers in avoiding punishment for making false representations to regulators. Despite overwhelming evidence, including the Defendant's confession and the expert

testimony of a former Division of Securities attorney, the Court of Appeals overturned the Defendant's convictions by taking an unprecedented, narrow view on what constitutes a material misrepresentation in a securities registration. As the Defendant acknowledged, "the State's evidence demonstrated that the purpose of the [false] statements in the circular was to sell the securities." *State v. Willan,* 9th Dist. No. 24894, 2011-Ohio-6603, 2011 WL 6749842, ¶ 61. Nonetheless, the Court of Appeals accepted the Defendant's implausible argument that the State did not prove that the same false statements were material to registration and made for the purpose of registering the securities for sale.

Like its holding with respect to securities fraud, this narrow construction of R.C. §1707.44(B)(1) is at odds with this Court's holding that the provisions of the Act were drafted broadly in order to effectuate the Act's purpose of "prevent[ing] those persons willing to market worthless or unnecessarily risky securities from soliciting the purchasing public without first subjecting themselves and their securities to reasonable licensing and registration requirements designed to protect the public." *Bronaugh,* 16 Ohio St.2d at 40-41, 242 N.E.2d 572.

NASAA urges this Court to prevent Ohio from becoming a potential safe haven for those seeking to commit fraud with the aid of misleading sales materials. Moreover, NASAA is also particularly concerned that the Court of Appeals' holding could be used to potentially invite other state courts to erode investor protections by adopting similarly narrow definitions of materiality with respect to securities registration. As explained below, R.C. §1707.44(B)(1) is comparable to a provision in the Uniform Securities Act that has been adopted by many states and prohibits material false statements in the registration process. It is in the public and general interest that this Court prevent a potential nationwide erosion of investor protections by accepting review to clarify that Ohio stands with the overwhelming majority of state and federal

jurisdictions by holding that a statement made for the purposes of registering a securities offering is material if a reasonable investor would consider it important in deciding whether to invest.

Unlicensed Sale of Securities

Finally, the Court of Appeals' decision is also of public and great general interest because it narrowly construes the definition of a securities "dealer" in R.C. §1707.01(E)(1). In doing so, the Court of Appeals' holding conflicts with this Court's practice of interpreting the Act broadly to protect the investing public through reasonable licensing requirements. *Bronaugh* at 40-41.

Ohio's licensing and registration regulations play an integral part in fighting securities fraud in the state by ensuring a basic standard of competency and disclosure about those engaged in the business. NASAA is concerned that if the Court of Appeals' decision is not overturned, unscrupulous and incompetent salespersons will be able to evade registration and supervision, leaving the investing public vulnerable to fraud, abusive sales practices, and substandard investments services.

ARGUMENT IN SUPPORT OF PROPOSITIONS OF LAW

I. Proposition of Law No. I: A False Representation Is Made In Violation Of R.C. §1707.44(G) If There Is A Substantial Likelihood That A Reasonable Investor Would Have Viewed The Misrepresented Fact As Important In Deciding Whether To Invest.

If for no other reason, one sentence by the Court of Appeals should compel this Court to review the decision. With no further discussion, the Court of Appeals overturned the Defendant's conviction for securities fraud because, "the State failed to prove that anyone invested with his companies due to fraudulent misrepresentations or that the investment plan for the businesses involved anything other than a legitimate investment strategy." *Willan,* 9th Dist. No. 24894, 2011-Ohio-6603, 2011 WL 6749842, at ¶ 21. In this one sentence, the Court of Appeals demonstrated a misunderstanding of the law and a misapplication of the facts.

In effect, the Court of Appeals was looking for proof that investors relied on the misrepresentations such that they would not have invested had they known the truth or, in the alternative, proof that the investment opportunity was a total sham. These lines of inquiry reflect an erroneous interpretation of the law regarding securities fraud.

In *In re Columbus Skyline Securities*, 74 Ohio St.3d 495, 660 N.E.2d 427 (1996), this Court analyzed the definition of fraud in R.C. §1707.01(J) for purposes of finding fraud in the sale of securities under R.C. §1707.44(G). As this Court noted, the definition of "fraud" under the Act includes "anything recognized on or after July 22, 1929, as such in courts of law or equity." *Id.* at 497. Accordingly, Ohio courts should look to decisions of the federal courts and other state courts for purposes of determining what constitutes a "false representation" under R.C. §1707.01(J) in connection with a sale of securities.

Although reliance is an element of common law fraud, it is not an element of securities fraud. *See Wilson v. Ward*, 183 Ohio App.3d 494, 917 N.E.2d 821 (9th Dist.2009) (unlike a claim for common-law fraud, plaintiffs did not have to prove justifiable reliance under R.C. 1707.44). In the context of securities fraud, the state is not required to prove that an investor would not have invested but for the misrepresentation; instead, the state is required to prove that the misrepresentation was *material*. *See* 12A Joseph C. Long, *Blue Sky Law*, Sections 10:43-64 (2011). The United States Supreme Court has laid out the test for determining whether a fact is material to an investor, and while the case dealt with a fact that was omitted in a proxy solicitation, the test has universally been applied to affirmative representations made in connection with the sale of securities. *See* 12A Joseph C. Long, *Blue Sky Law*, Section 10:44 (2011):

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding

> how to vote.... It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available. *TSC Indust., Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S. Ct. 2126, 48 L.Ed. 2d 757 (1976).

Using this standard, it does not matter whether the business selling the securities is "legitimate" or not. (*See, e.g.*, *State v. Ismaili*, 269 Kan. 389, 7 P.3d 236 (2000), holding that misappropriation is not an element of securities fraud). Additionally, a specific "intent to deceive" is not required for securities fraud. Marc I. Steinberg, *The Emergence of State Securities Laws: Partly Sunny Skies for Investors*, 62 U.Cin.L.Rev. 395, 412-13 (1993). What matters is whether the seller disclosed all material facts to an investor so that a reasonable person in the investor's shoes could make a fully informed investment decision. Accordingly, the Court of Appeals was looking for the wrong evidence when it searched the record for proof that the investment strategy was illegitimate or that the investors relied upon the false statement regarding commissions to the extent that it determined the ultimate outcome of their investment decisions.

On February 13, 2012, the United States District Court for the Southern District of Ohio issued a decision that is instructive and persuasive for analyzing a false representation under R.C. §1707.44(G). *Stuckey v. Online Res. Corp.*, S.D. Ohio No. 2:08-CV-1188 (Feb. 13, 2012). In *Stuckey,* shareholders of a recently purchased company had the option to receive payment in cash or in stock of the purchasing company, Online Resources Corporation ("ORC"). *Id.* at ¶ 3. To incentivize shareholders to accept stock in lieu of cash, ORC agreed to file a registration

statement with the Securities and Exchange Commission. *Id.* Stuckey, on behalf of other investors, alleged that ORC made false representations about its intentions and ability to register the ORC stock, and failed to disclose material facts relating to the existence of the pending SEC review. *Id.* at ¶ 9. Stuckey alleged that ORC violated both R.C. §1707.44(B)(4) by knowingly making false representations concerning material facts in oral and written statements for purposes of selling ORC stock to the shareholders and R.C. §1707.44(G) by knowingly engaging in acts and practices that were illegal, fraudulent, or prohibited by the Act, "including making false representations of material fact, and failing to disclose material acts relating to the existence of the pending SEC review." *Id.* at ¶ 68.

In *Stuckey*, ORC asked the court to grant summary judgment with respect to these claims. ORC argued that a fact could not be material to an investor if the investor lacked sufficient knowledge to understand the importance of the fact. *Id.* at ¶ 69. Essentially, similar to the Court of Appeals' holding in the instant case, ORC argued that an element of a claim for misrepresentation under R.C. §1707.44(G) is subjective "actual reliance" on the misrepresentation by the investor. In doing so, ORC's argument conflated the concepts of materiality, an element of a securities fraud claim, and reliance, an element in common law fraud.

In analyzing the false representations claim under R.C. §1707.44(G), the court rebuffed ORC's argument and refused to apply the subjective element of reliance and chose instead to apply the objective materiality element as set forth in TSC Industries. *Id.* at ¶¶ 70-72. Applying this materiality definition, the *Stuckey* court denied summary judgment, explaining that a materiality "determination requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to

him, and these assessments are peculiarly ones for the trier of fact." *Id.* at ¶ 73 (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 450, 96 S. Ct. 2126, 48 L.Ed.2d 757 (1976)).

Applying the correct standard, this Court should grant the petition for review so that it may in turn reverse the Court of Appeals' decision. Defendant's conviction for securities fraud should stand because a reasonable investor would certainly want to know that a portion of the investment proceeds were being taken "off the top" to compensate an unregistered salesperson, and that the salesperson had a significant personal incentive to sell the securities to every possible investor.

II. Proposition of Law No. II: A Statement Made For The Purposes Of Registering A Securities Offering Is Material If A Reasonable Investor Would Have Considered It Important In Deciding Whether To Invest.

The Defendant was convicted of counts two and five of the indictment, which charged him with making a "false representation concerning a material and relevant fact...in any...circular, description, application, or written statement" for the purpose of registering securities. *Willan*, 9th Dist. No. 24894, 2011-Ohio-6603, 2011 WL 6749842, at ¶ 58. With respect to these charges, the Defendant admitted that, in connection with the registration of two offerings of debt securities, he filed offering circulars falsely representing that that "[n]o commissions ... will be paid" to sellers of the securities. *Id.* at ¶ 61. Nonetheless, the Court of Appeals overturned the convictions, saying that "[a]lthough the State established that the information in the circular was relevant to the sale of securities, it offered no evidence that Mr. Willan made this misstatement for the purpose of registering the securities or that it was material or relevant to the registration of the security offering." *Id.* at ¶ 63.

The conclusion reached by the Court of Appeals fails to recognize that information is material to the Ohio Division of Securities whenever it would be material to investors. The Court of Appeals apparently missed the point of the expert testimony it recited in its Opinion:

> The State presented the testimony of Sheldon Safko, formerly an attorney with the Division of Securities, who testified that the Division reviews the offering circular as part of the registration process to make sure that investors will have the information they need to make a competent decision about whether to invest. He further explained that the offering circular is 'like a road map for the investor.' The circular should include information about the company and the investment product so an investor can make an informed decision whether to invest in the company. *Id.* at ¶ 63.

The State's witness, Mr. Safko, correctly testified that the Division of Securities, in reviewing an application for securities registration, ensures that an offering circular discloses all material facts to investors. Therefore, although he did not elaborate on the registration process, the reasonable inference from Mr. Safko's testimony is that any misrepresentation in a circular that would be material to an investor would also be objectionable to the Division of Securities. This testimony is consistent with R.C. §1707.09(G)(2), which gives the Division of Securities grounds to deny an application for securities registration if the sale of the securities would "tend to defraud or deceive" purchasers.

In trying to draw a sharp distinction between false statements made for the purpose of *registering* the securities and false statements made for the purpose of *selling* securities, the Court of Appeals struggled to find guidance for determining whether a false statement is "material" to the registration process as opposed to being material to the investors' decision to invest. *Id.* at ¶¶ 61-62. The Court of Appeals ignored the "many" federal cases involving material misrepresentation in the registration of securities because those courts focused on whether the misrepresentations were material to investors' decisions to invest. *Id.* at ¶ 62. The

Court of Appeals went on to say that the focus should be on "whether Mr. Willan's misrepresentation likely would have influenced the decision of the Division of Securities to process the registration of Evergreen Investment's securities," *Id.* at ¶ 62, but the Court failed to recognize that the decision of the Division of Securities would be influenced by any misrepresentation that would be material to an investor.

The Court of Appeals' narrow construction of R.C. §1707.44(B)(1) is at odds with the purpose of the Act. The purpose of the Act "'is to prevent those persons willing to market worthless or unnecessarily risky securities from soliciting the purchasing public without first subjecting themselves and their securities to reasonable licensing and registration requirements designed to protect the public.'" *Perrysburg Twp. v. Rossford*, 149 Ohio App.3d 645, 2002-Ohio-5498, 778 N.E.2d 619, ¶ 28 (6th Dist.) (quoting *Bronaugh v. R. & E. Dredging Co.*, 16 Ohio St.2d 35, 40-41, 242 N.E.2d 572 (1968)). As this quote recognizes, the registration and sale of securities are closely connected, as registration is the precursor to conducting a sale. Thus, information that is material to the sale of securities is also material to the Ohio Division of Securities' decision on whether to approve the registration of a securities offering.

Because materiality in the context of the securities registration is directly related to whether a disclosure would be material to an investor, the same test of materiality should apply. In short, if a fact is something that a reasonable investor would consider important in deciding whether to invest, that fact is material not only to the investor but also to the regulator in reviewing an application for a securities registration.

Although Ohio has not adopted the Uniform Securities Act (2002), R.C. §1707.44(B)(1) is comparable to Section 505 of the Uniform Securities Act. Section 505 makes it unlawful to file a registration application or other document that is "false or misleading in a material

respect," and the Official Comment to Section 505 provides the following guidance for determining whether a statement is a "material" misrepresentation in a document filed with a regulator:

> The definition of "materiality" in *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) ("an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote") has generally been followed in both federal and state securities law. See 4 Louis Loss & Joel Seligman, Securities Regulation 2071-2105 (3d ed. Rev. 2000). Uniform Securities Act (2002) § 505, Official Comment.

Most states have adopted the Uniform Securities Act (2002) or its predecessor, the Uniform Securities Act of 1956, which has the identical operative language in section 404. Thus, these states would likely follow the guidance of the Official Comment and find that a misrepresentation is material in a registration application if that misrepresentation would be material to a reasonable investor under the *TSC Industries* test.

The Court of Appeals created an unnecessary and illogical rift between the securities registration requirements and the requirements governing the sale of securities. In effect, the Court's rationale leads to the conclusion that information could be material to the sale of securities, but not the Division's review of the registration materials to ensure that investors have the necessary information to make competent investment decisions about those securities.

NASAA is aware of no other state or federal jurisdiction that has interpreted a like statute in a similar fashion. Accordingly, the decision of the Court of Appeals places Ohio well outside the mainstream of Blue Sky and federal securities law jurisprudence. This Court should hold that a statement made for the purposes of registering a securities offering is material if a reasonable investor would have considered it important in deciding whether to invest. Using this standard, the Defendant's convictions for counts two and five should be upheld because a

reasonable investor would want to know that the person offering the securities will be paid a commission to close the sale.

III. Proposition of Law No. III: Under The Ohio Securities Act, The Definition Of A "Dealer" Includes An Issuer Who Pays A Commission To A Salesperson For The Sale Of Securities.

After cutting through the web of business entities and the complexity of the transactions, a simple story emerges: the Defendant paid a salesperson to sell securities on behalf of his company, Evergreen Investment. This activity brings the Defendant's company within the definition of a "dealer" in R.C. §1707.01(E)(1), which includes any person who engages, directly or indirectly, "in the business of the sale of securities for the person's own account."

R.C. §1707.01(E)(1)(a) excludes an issuer from the definition of a dealer. Under normal circumstances, then, an issuer cannot be a dealer. But the exclusion does not apply to an issuer if a "commission, fee, or other similar remuneration is paid to or received by the issuer for the sale."

The Court of Appeals misinterpreted this language regarding commissions. The Court concluded that Evergreen Investment fell within the issuer exception because "it did not receive any commission, fee, or similar remuneration for the sale." *Willan,* 9th Dist. No. 24894, 2011-Ohio-6603, 2011 WL 6749842, at ¶ 26. However, because an issuer always receives the entire proceeds from the sale and not merely a commission, the only logical reading of R.C. §1707.01(E)(1)(a) is that it refers to the payment of a commission to an *agent* of the issuer as opposed to the issuer itself. Accordingly, an issuer does not qualify for the exclusion from the dealer definition if an agent of the issuer is paid a commission, fee, or other remuneration. The company selling the securities is both an issuer and a dealer under the Act and must register with

the Division of Securities pursuant to R.C. §1707.14. The failure to register would render each sale of the security a crime under R.C. §1707.44(A)(1).

This result should not change simply because the salesperson was not paid directly by the issuer. In this case, the salesperson, Mr. Mohler, was paid the commission through Evergreen Homes, *Willan* at ¶ 21, but the evidence also showed that the proceeds from the sales flowed through Evergreen Investment to Evergreen Homes. *Id.*, at ¶ 4. The simple fact is that Mohler was paid a commission to sell the securities of Evergreen Investment, and the Defendant should not be allowed to skirt the licensing requirements by creating multiple business entities and an indirect flow of funds.

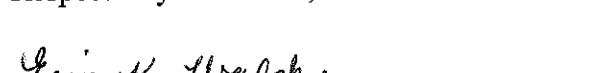
The interpretation of the Court of Appeals would render meaningless the prohibition on paying commissions to an unregistered person. An issuer could pay its agents huge commissions for selling the issuer's securities and the issuer would still qualify for an exclusion from the definition of a dealer and avoid registration. This very narrow reading of the dealer definition does not make sense and, like the other errors in the Opinion, it conflicts with this Court's practice of interpreting the Act broadly in order to effectuate the Act's purpose of "prevent[ing] those persons willing to market worthless or unnecessarily risky securities from soliciting the purchasing public without first subjecting themselves and their securities to reasonable licensing and registration requirements designed to protect the public[.]" *Bronaugh*, 16 Ohio St.2d, at 40-41, 242 N.E.2d 572.

To correct this error, this Court should grant review of the Court of Appeals' decision, and should ultimately reinstate the Defendant's conviction for 20 counts of engaging in business as an unlicensed dealer.

CONCLUSION

For the foregoing reasons, this case raises issues of public and great general interest. The Court should accept jurisdiction and review the decision of the Court of Appeals to prevent the erroneous interpretation of the Ohio Securities Act and damaging Blue Sky law jurisprudence.

Respectfully submitted,



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CERTIFICATE OF SERVICE

A copy of the foregoing Amicus Curiae North American Securities Administrators Association, Inc.'s Memorandum in Support of Jurisdiction for Cross-Appeal was served by regular U.S. mail this 5th day of March, 2012 upon:

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