



AN INTRODUCTION TO OHIO'S SECURITIES LAWS FOR STARTUPS & SMALL BUSINESSES



Department of Commerce

Division of Securities

This brochure is not intended to be, and should not be construed as legal advice. Rather, it provides a basic and simplified introduction to Ohio's securities laws. There are state and federal laws that apply to securities transactions, and violations of these laws can lead to serious civil and criminal liability. As a result, transactions in and dispositions of securities should be carried out only after consultation with competent legal counsel.

There are many legal considerations for startups and small businesses. In Ohio, the 1st Stop Business Permit Center provides Start-Up Business Kits that contain information regarding many of these legal requirements. For more information, contact the Center at 866-644-6468, or online at <https://business.ohio.gov/wps/portal/gateway/business/start>

The federal and state securities laws apply whenever a business or venture issues (or sells) ownership interest (such as stock or partnership interests), debt obligations (such as bonds or promissory notes), or otherwise seeks to raise money by promising a return to investors. This brochure aims to provide some basic information about the Ohio securities laws.

An Overview of the Ohio Securities Act

The Ohio Securities Act (the "Act") is set out in Chapter 1707 of the Ohio Revised Code. The Ohio Division of Securities (the "Division") administers and enforces the Act, which applies to all "sales" of "securities" in Ohio. The Act defines both of these terms broadly. The word "sales" includes every disposition, and every attempt to dispose of a security. The word "security" includes typical instruments like stocks, bonds, options, an promissory notes, and also includes instruments that constitute "investment contracts."

Ohio courts have held that an investment contract exists anytime that:

- (i) an offeree furnishes initial value to an offeror;
- (ii) a portion of this initial value is subjected to the risks of the enterprise;
- (iii) the furnishing of the initial value is induced by the offeror's promise or representations, which gives rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise; and
- (iv) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.¹

Simply put, the concept of "security" includes a wide range of investment opportunities.

¹ E.g., State v. George, 50 Ohio App. 2d 297 (10th Dist. 1975).

If the Act applies, there are three aspects of compliance:

- (i) the person selling the securities must be licensed with the Division or properly excepted from licensure;
- (ii) the securities being sold must be registered with the Division or properly exempted from registration; and
- (iii) anti-fraud standards apply and prohibit fraudulent tactics, including false representations and omissions, in the sale of securities. Keep in mind that similar aspects of the federal securities laws also apply. Securities professionals who are excepted from licensure and securities that are exempted from registration are nonetheless also subject to the Division's anti-fraud standards.

The Act's Licensing Requirements

The Act requires that all securities "*dealers*" and securities "*salespersons*" be licensed by the Division, or properly excepted from licensure. In general, a *dealer* is an individual or entity who is in the business of buying and selling securities for compensation. In general, a *salesperson*, commonly known as a stockbroker, is a person authorized to buy and sell securities on behalf of a dealer. Importantly, in most cases, an *issuer* of securities, including its officers, directors and employees, is excepted from the Act's licensing requirements, so long as no commission, fee, or other similar compensation is paid to or received by the issuer for the sale. As a result, a startup or small business that wishes to sell its own securities may be exempt from the Act's licensing requirements.

Competent legal counsel should be consulted to determine whether an exception to the licensing requirements exists.

The Act also requires that "*investment advisers*" be licensed under federal or Ohio law, or be properly excepted from licensure. In general, an *investment adviser* is an individual or entity that is in the business of providing advice regarding securities. In most cases, employees of an investment adviser firm, known as "*investment adviser representatives*" must also be licensed by the Division. There is no exception for issuers from the investment adviser and investment adviser representative licensing requirements, although in many cases issuers will not be required to be licensed because they are not "in the business" of providing advice. Useful flowcharts to help analyze whether someone is acting as an investment adviser are available on the Division's website at: https://www.com.ohio.gov/documents/secu_AreYouInvestmentAdviser.pdf

The Act's Registration Requirements

Perhaps the most important consideration for a start-up or small business that wishes to issue securities is the fact that all securities sold in Ohio must be registered with the Division, or properly exempted from registration.

Securities Registration

In general, there are three ways to register securities with the Division under the Act. An issuer that is registering securities with the SEC under the Securities Act of 1933 can file a registration by coordination with the Division.

An issuer that is making an offering that involves a limited number of purchasers or limited selling efforts can file a registration by description with the Division. Issuers that are not eligible for registration by coordination or registration by description pursue registration by qualification with the Division.

Exemptions From Securities Registration

Issuers of securities often first try to determine if their offering qualifies for an exemption from the securities registration requirements. The Act contains over 40 different exemptions. Please note that under ORC 1707.45, the legal burden of securities compliance in Ohio rests on the party claiming the benefit.

The exemptions commonly used by start-ups and small businesses are:

Ten or Fewer Purchasers

Section 1707.03(O) of the Act provides an exemption for the sale of equity securities by the issuer to 10 or fewer purchasers in Ohio who the issuer reasonably believes are purchasing for investment. There is no limit on the dollar amount raised. No general advertising is permitted, and sales commissions are limited to 10 percent and may be paid only to securities dealers and salespersons licensed in Ohio. No filing with the Division is required for this exemption, but the Division recommends that issuers document and memorialize their compliance with this exemption in the corporate records.

Accredited Investors

Section 1707.03(Y) provides an exemption for transactions made only to accredited investors, as that term is defined in Section 501 of Regulation D. A Form 3-Y must be filed with the Division within 15 days. Please note that the Ohio Revised Code prescribes a number of additional conditions to this exemption.

Private Placements

Section 1707.03(Q) of the Act provides an exemption for transactions not involving a public offering. The "3(Q)" exemption is available where:

- there is compliance with section 4(a)(2) of the 1933 Act;
- sales commissions are limited to 10 percent and paid only to securities dealers and salespersons licensed in Ohio;
- a Form 3-Q is filed with the Division within 60 days of the date of each sale in Ohio; and
- a filing fee of \$100 (\$50 for subsequent filings within the same calendar year) is paid to the Division. Section 1707.03(X) of the Act provides an exemption for transactions not involving a public offering that are within the "safe harbor" of federal Rule 506. In order to qualify for the "3(X)" exemption:
 - there must be compliance with federal Rule 506;
 - a Form D must be filed with the Division within 15 days of the date of sale in Ohio;
 - commissions are paid only to securities dealers and salespersons licensed in Ohio; and
 - a filing fee of \$100 must be paid to the Division.

In addition, Ohio accepts electronic filings of Form D's through the North American Securities Administrators Association's (NASAA) Electronic Filing Depository.

Private Offerings of Commercial Paper and Promissory Notes

Section 1707.02(G) of the Act provides an exemption for the sale of commercial paper and promissory notes that are not offered directly or indirectly to the public. This has limited applicability. The Ohio Administrative Code provides that there is no offering "directly or indirectly to the public" where the commercial paper or promissory notes are sold to:

- officers, directors or partner of the issuer;
- persons who control the management of the issuer; or
- not more than 10 persons in a 12-month period.

As with certain other exemptions, commissions on these sales may only be paid to securities dealers and salespersons licensed in Ohio. No filing with the Division is required for this exemption.

Compensatory Benefit Plans

Ohio Administrative Code rule 1301:6-3-03(E) (5) provides a self-executing exemption for most forms of compensatory employee benefit plans, provided certain conditions are met. O.A.C. Rule 1301:6-3-03(E)(5) exempts the sale of any security pursuant to a pension, stock, profit sharing, compensatory benefit, welfare or similar plan pursuant to Section 1707.03(V) of the Ohio Revised Code if: the security is sold pursuant to a qualified plan under sections 401 to 425 of the Internal Revenue Code;

- the sale of the security is exempt under rule 701 of the Securities Act of 1933;
- the security is effectively registered under sections 6 to 8 of the Securities Act of 1933; or
- the security is sold pursuant to a plan qualified under 501(c)(9) of the Internal Revenue Code.

This exemption applies not only to employees but also to independent contractors, consultants, or any other person that can participate in a company's compensatory benefit plan.

"Covered Securities," including Form D, Regulation A and Regulation CF

Federal law exempts some offerings from state law registration requirements. Ohio requires some notice filings of forms and documents and the payment of fees for covered securities. In addition, antifraud and broker misconduct will still violate the law. The Division published an article in the Ohio Securities Bulletin, 2016:4, entitled "The Limits of Preemption" that describes the filing and fee obligations required in Ohio for covered securities, available here (starting on page 2): https://www.com.ohio.gov/documents/secu_Bulletin2016FourthQuarter.pdf



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