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Responding to an Unforeseen Variation: Why Ohio Should Provide a Statutory Right of Rescission to All Defrauded Parties in a Stock-for-Stock Exchange

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RESPONDING TO AN *UNFORESEEN VARIATION*: WHY OHIO SHOULD PROVIDE A STATUTORY RIGHT OF RESCISSION TO ALL DEFRAUDED PARTIES IN A STOCK-FOR-STOCK EXCHANGE

I. INTRODUCTION

This problem is further complicated by wide variations in administration, not only from state to state, but sometimes from case to case in a single state.[1]

Consider two closely-held corporations in State O. They agree to enter into an agreement whereby the shareholders of the acquiring corporation, A, provide to the shareholders of the target corporation, T, stock in corporation A in exchange for all stock and control in corporation T.[2] The owners of T are considering retirement. They are seeking interest from parties looking to acquire their corporation. T expresses interest, so the two parties enter into lengthy negotiations. A ensures T that A has many lucrative contracts, is involved in substantial growth and development, and has many stockholders; indeed, A represents to T that this exchange will provide sufficient compensation to T for T's business.

However, after A and T agree to the terms of the exchange, T becomes aware that A has grossly misrepresented the value of its corporation's stock. As it turns out, A's corporation is in financial disarray. A quickly depletes the assets it obtained from T, and the once-successful business operations of T take a treacherous downward spiral due to A's misdealings. Left with nothing but worthless stock in A, the former owners of T seek rescission of the agreement pursuant to O's state securities fraud statute in state court.

Next, imagine an identical scenario in State O with two other parties, Y and Z. Z, the target corporation, becomes aware of the misrepresentations and misdealings of Y, the acquiring corporation. However, instead of pursuing its state securities fraud action in state court, Z brings federal securities claims in addition to its state securities claims. As a result, Y and Z litigate in federal court in State O. Because

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1 Alan M. Hoffman, *Blue Skying an Issue*, 13 HOW. L.J. 108, 108 (1967).

2 This hypothetical is inspired by the facts and resulting securities fraud lawsuit in *Murphy v. Stargate Defense Sys. Corp.*, 498 F.3d 386 (6th Cir. 2007). In *Murphy*, the Sixth Circuit Court of Appeals discussed, with respect to this type of stock-for-stock transaction, whether the sellers of the target company were to be considered "purchasers" entitled to protection of Ohio's Blue Sky Law. 498 F.3d at 391; *see* OHIO REV. CODE ANN. § 1707.43 (West, Westlaw through 2008 File 129 of the 127th Gen. Assembly).

the federal court must interpret the state securities claims as the state court would, B and Z should expect similar treatment of their state securities claims.

Securities fraud can be perpetrated in a number of ways.[3] Based on the plain language of Ohio Revised Code section 1707.43, the right of rescission is limited to defrauded purchasers of securities.[4] The statute is, however, silent as to relief for parties in a stock-for-stock exchange in which there is no clearly defined "purchaser" or "seller."[5] Construing the statute as written, it is possible for a court to confront the situation of either denying statutory relief to a party that is not a "purchaser," or to use a perilous, result-based approach to categorize the parties so that they fit the language of the statute.[6] This Note posits that this approach of the courts is not needed. The necessity of statutory interpretation, illustrated by inconsistent judicial reasoning, signals a need for change.[7]

Part II of this Note discusses the development of state Blue Sky Law, and how the debate surrounding uniformity—both between states, and also between state and federal regulatory agencies—has affected the current configuration of securities fraud regulation.[8] It concludes with

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[3] *See* "Securities Fraud Lawsuit" http://www.onlinelawyersource.com/stock_fraud/securities-Lawuit.html (last visited on Aug. 19, 2008). Investors of securities who have been harmed have the option of filing a securities fraud lawsuit. *Id.* The typical securities fraud lawsuit is filed against "[s]ecurities brokers, dealers, financial advisors, securities corporations, shareholders, and private investors . . . ." found to be responsible for fraud. *Id.* There are four common types of fraud committed by stockbrokers and investment advisors: churning (when a broker engages in "excessive transactions for the purpose of generating commissions . . . for his own benefit rather than the benefit of the client[]"); unsuitability (when a broker breaches his duty by making investments that are inconsistent with the client's "risk tolerance, needs and investment objectives[]"; over-concentration (when a broker "puts too much of . . . [the client's] portfolio in an individual investment (such as the stock of a particular company) or type of investment (such as pharmaceutical stocks)[]"); and misrepresentation/non-disclosure (when a broker "provides false or misleading information to a client regarding an investment."). "Types of Securities Fraud" http://www.securities-fraud-attorneys.com/securities-fraud-types.htm (last visited Aug. 19, 2008). This Note focuses on misrepresentation and non-disclosure—specifically in the instance of a stock-for-stock exchange.

[4] § 1707.43(A). With respect to the right of rescission, "every sale or contract for sale made in violation of Chapter 1707. of the Revised Code, is voidable at the election of the *purchaser*." *Id.* (emphasis added).

[5] § 1707.43.

[6] *See infra* Part III.B (discussing how the Sixth Circuit Court of Appeals interpreted broadly the plain meaning of section 1707.43 when providing the statutory right of rescission to a target corporation acquired by means of a stock-for-stock exchange).

[7] *See infra* Part IV (explaining how the author's proposed statutory amendments to section 1707.43 will provide a workable alternative to inconsistent judicial interpretation caused by overly narrow construction of the statutory language).

[8] *See infra* Parts II.A–B (exploring the development of state securities regulation, and specifically Congress's pro-uniformity legislation enacted to combat the lack of uniformity

how a recent Sixth Circuit decision supports the argument for a consistent, uniform application of state securities fraud regulation statutes.[9] Part III then addresses the effects of Congress's decision to grant fraud regulation to the states, and how the narrow scope of Ohio's Blue Sky Law provides an excellent example of how the dual regulatory system allows for a statutory ambiguity as to who should receive the protection of the Blue Sky Law.[10] Part IV proposes an amendment to section 1707.43 of Ohio's Blue Sky Law to be used in determining which parties should be provided the right of rescission when defrauded by another party.[11]

II. BACKGROUND

> *It will be observed, therefore, that the law is a regulation of business, constrains conduct only to that end, the purpose being to protect the public against the imposition of unsubstantial schemes and the securities based upon them. Whatever prohibition there is, is a means to the same purpose, made necessary, it may be supposed, by the persistence of evil and its insidious forms and the experience of the inadequacy of penalties or other repressive measures. The name that is given to the law indicates the evil at which it is aimed . . . "speculative schemes which have no more basis than so many feet of 'blue sky*[] *. . . .'"*[12]

To understand who should be entitled to the statutory right of rescission under Ohio's Blue Sky Law, it is necessary to explore the broad and jagged landscape in which Ohio's state securities regulations operate. Part II.A of this Note focuses on the development of state Blue Sky Law against the backdrop of increased federal securities regulation.[13] Next, Part II.B examines the effects of the National Securities Markets Improvement Act of 1996 ("NSMIA") on states'

among state securities regulation statutes that caused substantial hardship and confusion when attempting to comply with multiple, often inconsistent, statutes).

9 *See infra* Part II.C.3 (describing the interpretation of section 1707.43 by the Sixth Circuit Court of Appeals, and how this broad statutory interpretation was needed to account for a transaction that fell outside the purview of the statutory language).

10 *See infra* Part III (analyzing how the Sixth Circuit Court of Appeals in *Murphy* construed the explicit language of section 1707.43 broadly, showing the need for clear, consistent interpretation and application of Ohio's antifraud provisions).

11 *See infra* Part IV (suggesting an expansion of the applicability of the right of rescission from only purchasers to all parties acquiring securities by means of an exchange of securities).

12 Hall v. Geiger-Jones Co., 242 U.S. 539, 550 (1917).

13 *See infra* Part II.A (discussing the development state Blue Sky Law leading up to the Uniform Securities Act of 1956).

retention of jurisdiction in fraud actions.[14] Last, Part II.C discusses Ohio Blue Sky Law's antifraud provisions, specifically how the recent Sixth Circuit decision in *Murphy v. Stargate Defense Systems Corp.*[15] supports consistent legislation and interpretation of state Blue Sky Law remedies.[16] As a result of *Murphy*, the critical issue remains whether both parties in a stock-for-stock exchange are afforded the remedies currently available under Ohio Blue Sky Law.[17]

A. *Uniform Securities Act of 1956: An Initial Approach to Uniformity*

The argument for uniformity among state securities has been fertile ground for substantial scholarship and debate.[18] Although states have

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14 *See infra* Part II.B (discussing why Congress enacted the National Securities Market Improvement Act of 1996 as a reaction to a lack of uniformity in the dual regulatory system of securities regulation).

15 498 F.3d 386 (6th Cir. 2007).

16 *See infra* Part II.C (discussing Ohio's antifraud provisions, remedies available to buyers, and how *Murphy* raises the issue of interpreting which parties to a stock-for-stock exchange are afforded these remedies).

17 *See infra* Part III.B.

18 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION VOL. 1 41–49 (3d ed. 1989) (noting how, before the development of federal regulatory authorities, actors involved in interstate securities business sought consistent, uniform regulation from state to state); *see* Kenneth I. Denos, *Blue and Gray Skies: The National Securities Markets Improvement Act of 1996 Makes the Case for Uniformity in State Securities Law*, 1997 UTAH L. REV. 101, 105 (1997) (discussing how the NSMIA's preemption of state securities law is a step towards uniformity, but because of the "duality of the American judicial system[,]" inconsistency still remains among the states regarding authority to combat fraud); Hoffman, *supra* note 1, at 108 ("The most difficult aspect of Blue Sky work is the lack of uniformity of the statutes, both as to substantive and procedural matters."); T. W. Dahlquist, *Regulation and Civil Liability Under the California Corporate Securities Act: II*, 34 CAL. L. REV. 344, 393 (1946) (promoting uniformity among states because of the "stupendous, tedious and wasteful task involved[]" in analyzing all state Blue Sky Law when attempting to ensure that a security issue is in compliance with all applicable state statutes); *see also* Francis J. Facciolo & Richard L. Stone, *Avoiding the Inevitable: The Continuing Viability of State Law Claims in the Face of Primary Jurisdiction and Preemption Challenges Under The Securities Exchange Act of 1934*, 1995 COLUM. BUS. L. REV. 525, 619 n.294 (1995) (discussing the appropriateness of considering federal securities law concepts when construing Blue Sky statutory provisions that are similar to the federal provisions); Martin C. McWilliams, Jr., *Thoughts on Borrowing Federal Securities Jurisprudence under the Uniform Securities Act*, 38 S.C. L. REV. 243 (1987) (discussing the benefits of maintaining uniformity between state and federal law, although cautioning that this pursuit should not serve as a catch-all trump to the unique interests of each state). *But see* LOSS & SELIGMAN, *supra*, at 58 (quoting New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting)). "It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory[] and try novel social and economic experiments without risk to the rest of the country." *Id.* The authors, commenting on Justice Brandeis's admonition of the Court's willingness to embrace notions of uniformity, comment that "[a]s a matter of principle, it is difficult to justify the federal government's telling the states that they cannot try to protect

promulgated their own securities regulations, those states that have done so have legislated against the backdrop of federal securities regulation.[19] But even before the enactment of the first federal securities regulation in the 1930s, a few states had already begun to adopt their own securities regulations.[20]

Kansas is credited with passing the first state securities law in 1911.[21] Motivated by the populist philosophy prevalent throughout the Midwest, the Kansas Securities Act required registration of both securities and securities salesmen.[22] Between 1914 and 1916, despite this

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their citizens beyond the federal disclosure philosophy." *Id.* As the authors point out, however, many who make this argument do not extend its application beyond disclosure regulations. *Id.*

19 *See* Denos, *supra* note 18, at 105 (1997) (describing the following major sources of federal securities legislation: The Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (1933) (regulating public offerings of securities, prohibiting offers and sales of unregistered securities, and prohibiting fraudulent practices in any offer or sale of securities); and The Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78lll (1934) (established the Securities Exchange Commission ("SEC") and extended federal regulation to trading in securities already issued, in addition to many other provisions not critical to analysis in this Note). *See also* Manning Gilbert Warren III, *Legitimacy in the Securities Industry: The Role of Merit Regulation*, 53 BROOK. L. REV. 129, 136–38 (1987). Warren argues that, despite the difference in the scope of regulation, "overlap between the federal and state laws is likely to continue." *Id.* at 138. Even with this overlap, Warren continues, it "serves to fill in the cracks where regulatory protection would not otherwise be provided." *Id.* *See also* Manning Gilbert Warren III, *Reflections on Dual Regulation of Securities: A Case Against Preemption*, 25 B.C. L. REV. 495 (1984) (defending the dual system of regulation, and generally arguing against federal preemption of state regulation).

20 *See* LOSS & SELIGMAN, *supra* note 18, at 29–41. The earliest, rudimentary statutes sprung up in Massachusetts, California, Georgia, Missouri, Connecticut, Nevada, and Rhode Island. *Id.* at 29–35. For example, the 1904 Georgia statute required

> [C]ompanies selling "investment securities of any kind on the partial payment, installment or any other plan of payment, and providing for the redemption and retiring of the same, or any part thereof," to deposit in a trust company at least $25,000, to establish a redemption fund of at least 75 percent of that amount collected in premiums, and to file annual financial statements with the Comptroller General.

Id. at 30 (quoting 1904 Ga. Laws No. 592 at 74).

21 LOSS & SELIGMAN, *supra* note 18, at 32.

22 *See id.* at 34. The Kansas Act provided:

> [I]f said bank commissioner finds that such articles of incorporation or association, charter, constitution and by-laws, plan of business or proposed contract, contain any provision that is unfair, unjust, inequitable or oppressive to any class of contributors, or if he decides from his examination of its affairs that said investment company is not solvent and does not intend to do a fair and honest business, and in his judgment does not promise a fair return on the stocks, bonds, or other securities by it offered for sale, then he shall notify such investment company in writing of his findings, and it shall be unlawful for such company to do any further business in this state. . . .

initial populist surge in favor of state regulation, federal district courts were quite reluctant to uphold state securities statutes due to claims that state regulation was unduly burdensome on interstate commerce.[23] In 1917, however, the Supreme Court reversed course and upheld the Ohio, South Dakota, and Michigan state statutes in the notorious "*Blue Sky Cases*."[24] Now, more than 90 years later, each state and territory has promulgated state securities regulation.[25] Although there is a variety of state statutes, many, if not most, are based on the Uniform Securities Act of 1956.[26]

1. The Uniform Securities Act of 1956—Background, Development, and Influence

Prior to the Uniform Securities Act of 1956,[27] Blue Sky Law varied drastically from state to state.[28] In fact, there were no identical acts prior to 1956, and "the amount of variation and frequently unnecessary complexity in both substance and verbiage [was] staggering."[29] But in

Id. at 34–35 n.22 (quoting 1911 Kansas Law ch. 133, § 5). Under the Kansas Act, fraudulent activities were grounds for appointment of a receiver, and also were criminalized. *Id.* at 35 n.23. Within the first 18 months of enacting the statute, a large portion of the companies that had been investigated had received permits. *Id.*

23 See generally LOUIS LOSS & EDWARD M. COWETT, BLUE SKY LAW 10 (1958), for a discussion of the following cases in which the Iowa, Ohio, South Dakota, West Virginia, and successive regulatory acts in Michigan were found to be in conflict with the federal Constitution: Wm. R. Compton Co. v. Allen, 216 Fed. 537 (S.D. Iowa 1914); Geiger-Jones v. Turner, 230 Fed. 233 (S.D. Ohio 1916); Sioux Falls Stock Yards Co. v. Caldwell, (D. S.D. 1915); Bracey v. Darst, 218 Fed. 482 (N.D. W. Va. 1914); Alabama & New Orleans Transp. Co. v. Doyle, 210 Fed. 173 (E.D. Mich. 1914); N. W. Halsey & Co. v. Merrick, 228 Fed. 805 (E.D. Mich. 1915).

24 Hall v. Geiger-Jones Co., 242 U.S. 539 (1917); Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559 (1917); Merrick v. N.W. Halsey & Co., 242 U.S. 568 (1917) (in each of these three cases, the Supreme Court upheld the state Blue Sky statutes as neither violative of the Fourteenth Amendment nor unduly burdensome of interstate commerce).

25 *50 State Statutory Surveys: Blue Sky Laws Securities Transactions* (2007 Westlaw 50StateSurveysdatabase; then type "Surveys Offer Sale") (reviewing State Blue Sky laws, specifically the applicability of the regulations).

26 *See* LOSS & SELIGMAN, *supra* note 18, at 66 n.89. There are 39 Uniform Securities Act jurisdictions, and most have adopted section 101, the antifraud provision. *Id.*

27 UNIF. SECURITIES ACT 7A U.L.A. 568 (1958), *reprinted in* LOSS & SELIGMAN, *supra* note 18, at 50–79.

28 *See* LOSS & COWETT, *supra* note 23, at 231 (noting how "a number of legislatures and administrators have moved ahead independently in different ways[]").

29 *Id.* at 18–19; *see* Hoffman, *supra* note 1, at 108.

> The most difficult aspect of Blue Sky work is the lack of uniformity of the statutes, both as to substantive and procedural matters. This problem is further complicated by wide variations in administration, not only from state to state, but sometimes from case to case in a single

1956, the North American Securities Administrators Association ("NASAA") addressed this issue.[30] NASAA promulgated the final draft of the Uniform Securities Act after nearly 10 years of structuring "a new uniform or model State Sale of Securities Act . . . to the end that the existing diversity of legal requirements preliminary to the issuance of securities be minimized to the greatest possible extent."[31] In 1978, the National Conference of Commissioners on Uniform State Law sought a revision of the 1956 Uniform Securities Act.[32] But due to significant disagreements arising out of the 1978 revision, the Conference began to undertake a completely new draft in 1983.[33] This new draft, the 1985 Uniform Securities Act,[34] was not met with the same approval as its predecessor in 1956.[35] As a result, the 1956 Act has retained influence

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> state. However in recent years, several steps have been taken to improve this situation.

Id. Hoffman notes that much has been done to improve the variation and complexity that existed prior to the Uniform Securities Act of 1956. *Id.*

30 LOSS & SELIGMAN, *supra* note 18, at 46 (citing 72 ABA REP. 98, 297 (1947)). After the 1956 promulgation, the Act was approved by the American Bar Association and the North American Securities Administrators, and endorsed by the SEC. *Id.* at 47–48. The Chairman of the SEC had the following to say in support of the new Act:

> I have been authorized to advise you that the Commissioners unanimously concur in the principle of uniformity of laws among the states with respect to the control of securities markets. With this principle in mind, the Commission has unanimously endorsed the proposed legislation. It is hoped that its enactment by the states will bring about a better integration of the work of state securities administrators with the work of the Securities and Exchange Commission.

Id. at 48 n.54.

31 *Id.* at 46 (citing 72 ABA REP. 98, 297 (1947)). *See* McWilliams, *supra* note 18, at 253 n.53 and accompanying text. McWilliams cites the standard policy provision of the National Conference of Commissioners on Uniform State Law as follows:

> This Act shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this act with the related federal regulation.

Id. Additionally, McWilliams points out that courts interpreting the Uniform Securities Act have given weight to this purpose statement. *Id.*; *see*, *e.g.*, Kansas State Bank v. Citizens Bank, 737 F.2d 1490, 1496 (8th Cir. 1984) (looking to the standard policy provision of the National Conference of Commissioners on Uniform State Law when construing a provision of the Kansas Act, which does not contain such a clear statement of purpose).

32 LOSS & SELIGMAN, *supra* note 18, at 48.

33 *Id.*

34 *Id.*, at 48.

35 *Id.* at 49. Although the National Conference of Commissioners on Uniform State Law approved the 1985 Uniform Act, it did not receive the same approval from the ABA. *Id.*; *see also* Mark Sargent, *Blue Sky Law: Some Thoughts on the Revised Uniform Securities Act*, 14 SEC. REG. L.J 62 (1986). Sargent notes that the Revised Uniform Securities Act was "not intended to produce a radical transformation of blue sky law." *Id.* at 64. Nevertheless, according to

over the states' legislation, illustrated by the fact that a majority of jurisdictions that adopted the Act's provisions did not do the same with the 1985 Act.[36] Key aspects of the 1985 Act left unenacted by the states were the antifraud provisions.[37]

2. Key Antifraud Provisions of the 1956 Act

It must be noted first that the Uniform Securities Act of 1956 is divided into four parts, as follows: Part I deals with fraudulent and other prohibited practices; Part II concerns registration of broker-dealers, agents, and investment advisers; Part III encompasses registration of securities; and Part IV includes general provisions, including definitions.[38] Each part is constructed so that it may stand alone.[39] Indeed, the Act provided flexibility for states that chose to adopt only certain provisions.[40]

Part I, "Fradulent and Other Prohibited Practices," contains two sections: section 101 outlaws fraudulent practices in connection with the sale or purchase of a security; and section 102 concerns fraudulent and other undesirable investment advisory activities.[41] The language of section 101 is as follows:

> It is unlawful for *any person*, in connection with the offer, sale or purchase of any security, directly or indirectly
>
> > (1) to employ any device, scheme, or artifice to defraud, (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are

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Sargent, the Revised Uniform Securities Act can serve as a collection of new ideas that may potentially "lay the foundation for some future resynthesis." *Id.* at 74.

36 LOSS & SELIGMAN, *supra* note 18, at 48.

37 *See infra* Part II.A.2.

38 See LOSS & SELIGMAN, *supra* note 18, at 51–60, for a more thorough analysis of these four parts of the Uniform Securities Act of 1956. This note focuses on an analysis of Part I of the Uniform Securities Act.

39 *Id.* at 50. The Act was so construed based upon the theory that "it was impractical to expect complete uniformity among states with basically different regulatory philosophies, but that there was some likelihood of achieving a substantial degree of uniformity among those states that followed a particular philosophy." *Id.* As a result, a state that wanted to adopt, for example, the fraud provisions, was able to do so without adopting any other sections, in part or in whole. *Id.* See *id.* at 171–225 for a more in-depth discussion of regulatory philosophies.

40 *See id.* at 50–51.

41 UNIF. SECURITIES ACT §§ 101–02, 7A U.L.A. 568 (1958), *reprinted in* LOSS & SELIGMAN, *supra* note 18, at 62–63 n.83.

> made, not misleading, or (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.[42]

Working in conjunction with the antifraud provisions of section 101 are the provisions setting forth sanctions for unlawful conduct.[43] Sections 409 and 410 establish criminal and civil liability, respectively, for violations of section 101.[44] Most critical to this Note's ultimate

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[42] UNIF. SECURITIES ACT § 101, 7A U.L.A. 568 (1958) (emphasis added), *reprinted in* LOSS & SELIGMAN, *supra* note 18, at 62 (emphasis added). The language of section 101 is modeled after Federal Rule 10b-5 adopted under the Securities Exchange Act of 1934, and on Section 17(a) of the Securities Act of 1933. *See* LOSS & SELIGMAN, *supra* note 18, at 62. The language of Rule 10b-5, is as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (2004). Section 17(a) of the Securities Act is as follows:

> (a) Use of interstate commerce for purpose of fraud or deceit
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> It shall be unlawful for any person in the offer or sale of any securities or any security-based swap agreement (as defined in section 206B of the Gramm-Leach Bliley Act) by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q (2000). It is worth noting that the language of section 501 of the 2002 Uniform Securities Act is identical to the language of section 101 of the 1956 Act. See JOEL SELIGMAN, THE NEW UNIFORM SECURITIES ACT (2003) for discussion and analysis of the most current proposed state securities legislation. For purposes of this Note, however, the focus is limited to the influence of the 1956 Act because it is the most widely adopted version of the Act; *see infra* note 51.

[43] *See* LOSS & SELIGMAN, *supra* note 18, at 63 nn.83–87 (discussing sanctions for unlawful conduct in the 1956 Act, as well as similar provisions in the 1985 Revised Act).

[44] UNIF. SECURITIES ACT §§ 409–10, 7A U.L.A. 568 (1958), *reprinted in* LOSS & SELIGMAN, *supra* note 18, at 64–65. Section 409 provides criminal penalties for willful violations of any

analysis, however, is section 410.[45] The protection of section 410 is limited to "buyers" of securities.[46] As a protected entity, a buyer is permitted under section 410(a) to

> [S]ue either at law or in equity to recover the consideration paid for the security, together with interest at six per cent per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security, or for damages if he no longer owns the security.[47]

Indeed, section 410 provides only buyers of securities with statutory relief in an action for fraud.[48] The Uniform Securities Act of 1956 is silent regarding defrauded sellers.[49]

Based on this analysis and historical background of select provisions of the Uniform Securities Act of 1956, it is clear that states, in promulgating Blue Sky securities legislation, have been encouraged to

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provision of the Act. *Id.* Similarly, section 407(a) authorizes the securities administrator to make public or private investigations of violations of the act, section 407(b) provides for enforcement of court-ordered subpoenas, and section 408 authorizes the securities administrator to seek an injunction from an appropriate court to enjoin violations of the Act. *Id.*

45 *See infra* Part II.C.2 (discussing the rescission provision of OHIO R.C. § 1707.43 that is explicitly limited to purchasers).

46 *See* LOSS & SELIGMAN, *supra* note 18, at 65 (quoting UNIF. SECURITIES ACT § 101, 7A U.L.A. 568 (1958), Draftsman's Commentary) (discussing the limitation to buyers as appropriate in light of "the common-law and equitable remedies of deceit and rescission which are available to the state courts without benefit of statute[]").

47 UNIF. SECURITIES ACT §§ 410(a), 7A U.L.A. 568 (1958), *reprinted in* LOSS & SELIGMAN, *supra* note 18, at 65. In addition, section 410(b) defines who is liable:

> Every person who directly or indirectly controls a seller liable under subsection (a), every partner, officer, or director of such a seller, every person occupying a similar status or performing similar functions, every employee of such a seller[,] . . . and every broker-dealer or agent who materially aids in the sale are also liable jointly and severally with and to the same extent as the seller, unless the non-seller who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

UNIF. SECURITIES ACT §§ 410(b), 7A U.L.A. 568 (1958), *reprinted in* LOSS & SELIGMAN, *supra* note 18, at 65.

48 UNIF. SECURITIES ACT § 410(a), 7A U.L.A. 568 (1958), *reprinted in* LOSS & SELIGMAN, *supra* note 18, at 65; *see* LOSS & SELIGMAN, *supra* note 18, at 65 (quoting UNIF. SECURITIES ACT § 101, 7A U.L.A. 568 (1958), Draftsman's Commentary).

49 *See generally* UNIF. SECURITIES ACT 7A U.L.A. 568 (1958), *reprinted in* LOSS & SELIGMAN, *supra* note 18, at 50–79.

embrace uniformity.[50] Among the 39 Uniform Securities Act jurisdictions, 34 have adopted section 101.[51] Additionally, four non-Uniform Securities Act jurisdictions have done likewise.[52] Although it has not been unanimously adopted by the states, the Uniform Securities Act of 1956 has experienced some success in promoting uniformity from

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50 *See supra* Part II.A.

51 ALA. CODE § 8-6-17 (West, Westlaw through 2008 Reg. and First Spec. Sess.); ALASKA STAT. § 45.55.010 (West, Westlaw through 2008 Sec. Reg. Sess.); ARK. CODE ANN. § 23-42-507 (West, Westlaw through 2008 First Ex. Sess.); CONN. GEN. STAT. § 36b-4 (West, Westlaw through 2008 Feb. Reg. Sess.); DEL. CODE ANN. tit. 6, § 7303 (West, Westlaw through 76 Laws 2008, ch. 416); D.C. CODE § 31-5605.02 (West, Westlaw through July 7, 2008); IDAHO CODE ANN. § 30-14-501 (West, Westlaw through 2008 Sec. Reg. Sess.); IND. CODE § 23-19-5-1 (West, Westlaw through 2008 Sec. Reg. Sess.); IOWA CODE § 502.501 (West, Westlaw through 2008 Reg. Sess.); KAN. STAT. ANN. § 17-12a501 (West, Westlaw through 2007 Reg. Sess.); KY. REV. STAT. ANN. § 292.320 (West, Westlaw through 2007); MD. CODE ANN., CORPS. & ASS'NS § 11-301 (West, Westlaw through 2008 Reg. Sess.); MASS. GEN. LAW ch. 110A, § 101 (West, Westlaw through 2008 Sec. Annual Sess.); MICH. COMP. LAW § 451.501 (West, Westlaw through P.A. 2008, No. 267 of the 2008 Reg. Sess.); MISS. CODE. ANN. § 75-71-501 (West, Westlaw through Ch. 557 of the 2008 Reg. Sess.); MONT. CODE ANN. § 30-10-301 (West, Westlaw through the End of 2007 Reg. Sess. and May 2007 Spec. Sess.); NEB REV. STAT. § 8-1102 (West, Westlaw through 2007 First Reg. Sess.); NEV. REV. STAT. § 90.570 (West, Westlaw through 2007 Reg. Sess. and Spec. Sess.); N.H. REV. STAT. ANN. § 421-B:5 (West, Westlaw through Ch. 236 of the 2008 Reg. Sess.); N.M. STAT. § 58-13B-30 (West, Westlaw through 2008 Sec. Reg. Sess.); N.C. GEN. STAT. § 78A-8 (West, Westlaw through S.L. 2008-23 of the 2008 Reg. Sess.); OKLA. STAT. tit. 71, § 1-501 (West, Westlaw through 2008 Sec. Reg. Sess.); OR. REV. STAT. § 59.055, 135, 335, 345, 365 (West, Westlaw through 2007 Reg. Sess.); 70 PA. CONS. STAT. ANN. § 1-401 (West, Westlaw through Act 2008-18); S.C. CODE ANN. § 35-1-501 (West, Westlaw through 2007 Reg. Sess.); TENN. CODE ANN. § 48-2-121 (West, Westlaw through 2008 Sec. Reg. Sess.); UTAH CODE ANN. § 61-1-1 (West, Westlaw through 2008 Gen Sess.); VA. CODE. ANN. § 13.1-502 (West, Westlaw through 2008 Spec. Sess. I and II; WASH REV. CODE § 21.20.010 (West, Westlaw through 2008); W. VA. CODE § 32-1-101 (West, Westlaw through 2008 Sec. Ext. Sess.); WYO. STAT. ANN. § 17-4-101 (West, Westlaw through 2008 Budget Sess.); GUAM CODE ANN. tit. 22, § 46101 (West, Westlaw through P.L. 29-0003 (2007)); P.R. LAW ANN. tit. 10, § 851 (West, Westlaw through 2005).

52 See LOSS & SELIGMAN, *supra* note 18, at 66–67, for a discussion of those jurisdictions considered to be Uniform Securities Act jurisdictions. Florida, Illinois, Louisiana, Texas, and Vermont are non-Uniform Securities Act jurisdictions, but they have enacted securities fraud provisions similar to § 101 of the 1956 Act. *See* LOSS & SELIGMAN, *supra* note 18, at 67 n.91. Ohio, which is not a Uniform Securities Act jurisdiction, has enacted OHIO REV. CODE ANN. § 1707.01(J) (West, Westlaw through 2008 File 129 of the 127th Gen. Assembly), expanding on the language of § 101, defining "fraud" as:

> anything recognized on or after July 22, 1929, as such in courts of law or equity; any device, scheme, or artifice to defraud or to obtain money or property by means of any false pretense, representation, or promise; any fictitious or pretended purchase or sale of securities; and any act, practice, transaction, or course of business relating to the sale of securities that is fraudulent or that has operated or would operate as a fraud upon the seller or purchaser.

Id.; *see infra* note 80 and accompanying text.

state to state, at least with regard to antifraud provisions of the various states' Blue Sky Law.[53]

B. The National Securities Market Improvement Act of 1996: A Call for Uniformity?

Notwithstanding the positive impact of the Uniform Securities Act of 1956 on encouraging uniformity among states, the dual regulatory system of securities regulation that encompassed both state and federal regulation impeded investors, issuers, and regulators alike with significant obstacles.[54] Despite the challenges inherent in complying with many different statutes in the case of a national securities offering, for example, states have nevertheless continued to maintain a strong interest in preserving their Blue Sky Law.[55] Thus, it was within this

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[53] *See* LOSS & SELIGMAN, *supra* note 18, at 66–67.

[54] *See* Denos, *supra* note 18, at 102. Denos discusses how many state provisions are "at odds with comparable provisions at the federal level, ..." and also how those wishing to comply with both sets of provisions are faced with multiple "layer[s] of red tape[.]" *Id.* (footnote omitted). Additionally, Denos mentions the problem that arises when issuers seek to comply with provisions of multiple states in a single securities offering. *Id.* Ultimately, Denos contends that Congress's intervention vis-à-vis the NSMIA was a preemptive measure in favor of a single regulatory structure. *See also* Therese H. Maynard, *The Uniform Limited Offering Exemption: How "Uniform" is "Uniform"?—An Evaluation and Critique of the ULOE*, 36 EMORY L.J. 357, 359 (1987) ("The logistics and expense of [complying with both sets of laws] can become so substantial that many small issuers ultimately abandon or significantly scale back their efforts to obtain additional capital."); Rutheford B. Campbell, Jr., Jr., *An Open Attack on the Nonsense of Regulation*, 10 J. CORP. L. 553 (1985) [hereinafter Campbell Jr., *An Open Attack*] (noting generally the challenges of complying with various state Blue Sky Laws).

[55] *See* Mark A. Sargent, *A Future for Blue Sky Law*, 62 U. CIN. L. REV. 471, 498–99 (1993) [hereinafter Sargent, *A Future for Blue Sky Law*]. Sargent points out the interests of two primary players in the state securities regulation arena: state regulators and state governments. *Id.* He notes that state regulators and administrators "tend to regard themselves as unusually committed to speaking for investors who cannot speak for themselves." *Id.* at 498. Pitted against this ideological motivation of state regulators and administrators is what Sargent terms rather cynically the "cash cow[]" motivation. *Id.* at 499. Next, Sargent examines the "cash-starved state governments [who] are not likely to surrender such a profitable source of revenues easily[]" as the second key example of the states' interest in maintaining securities regulation. *Id.* Thus, Sargent posits that the states have a "deep[]" interest in Blue Sky Law that is rooted in revenue, but the specifics of the interest, according to Sargent, is a matter of indifference to state governments. *Id.*; *see also* Mark A. Sargent, *The National Securities Markets Improvements Act—One Year Later. Introduction*, 53 BUS. LAW. 507 (1998) [hereinafter Sargent, *NSMIA*] (noting the concern, on behalf of state regulators upon learning of early drafts of the NSMIA legislation, that traditional state regulation would be eradicated in favor of uniform SEC regulation).

complex framework of securities regulations that the regulatory structure received a major overhaul in 1996.[56]

The National Securities Markets Improvement Act of 1996 ("NSMIA") delegated exclusively to the SEC regulation of certain activities related to the offering, promotion, and sale of nationally traded securities.[57] Most important for this Note's analysis, however, is the section of the NSMIA that did not delegate exclusive regulatory control to the SEC; section 102(a) preserved the states' power to prosecute fraud:

> Consistent with this section, the securities commission (or any agency or officer performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions.[58]

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56 *See*, *e.g.*, JAMES HAMILTON, SECURITIES REFORM: NATIONAL SECURITIES MARKETS IMPROVEMENT ACT OF 1996 LAW & EXPLANATION 9–13 (1999) (lamenting the complexities of the dual regulatory structure as requiring excessive costs in arranging a nationwide securities offering).

57 *See* The National Securities Markets Improvement Act ("NSMIA"), §§ 102–103, 15 U.S.C. § 77r (2000). By delegating certain responsibilities to the SEC, Congress exempted areas for state control. *Id.* For example, in the area of broker-dealer regulation, the NSMIA provides an exemption from state regulation for "de minimus transactions;" additionally, the NSMIA declares securities issued by mutual funds under the exclusive control of SEC regulation; finally, the SEC retains exclusive control of supervising investment advisors who manage over $25 million; *see also* Denos, *supra* note 18, at 131 (describing the drastic changes the NSMIA made in allocating the regulatory power between the SEC and the states).

58 NSMIA § 102(a), 15 U.S.C. § 77r(c)(1) (2000). Despite the NSMIA's profound impact on the state-federal regulatory dynamic, however, it surely "fell short of a fundamental reordering of the state-federal system of securities regulation and it certainly did not put finis to almost a century of blue sky law." Sargent, *NSMIA*, *supra* note 55, at 507. Thus, although "[t]he scope and weight of blue sky law has changed in important respects . . . the state regulatory powers remain important." *Id.* at 507–08; *see* Rutheford B Campbell, Jr., *Blue Sky Laws and the Recent Congressional Preemption Failure*, 22 J. CORP. L. 175, 203 (1997) [hereinafter Campbell Jr., *Recent Congressional Preemption*] (positing that the changes effected by the NSMIA are generally insignificant.). *See also* Campbell, Jr., *An Open Attack*, supra note 54. Campbell, Jr. argues that even "state antifraud provisions should be preempted in favor of federal antifraud provisions[.] . . . ." *Id.* at 575 (footnote omitted). His argument is based on the premise that section 101 of the Uniform Securities Act of 1956 is substantially the same as Rule 10b-5 promulgated under the 1934 Securities Act. *Id.* at 576. Campbell, Jr. provides two reasons supporting preemption:

> First, the state antifraud rules are fundamentally the same as the federal antifraud rules[] . . . . As a result, compliance with federal standards normally insures [sic] that an issuer is in compliance with state standards[] . . . . Second, compliance with state antifraud

By enacting the NSMIA, Congress sought to clarify the responsibilities of the SEC and the state regulatory agencies with the twin aims of enhancing investor protection and reducing the costs of investing.[59]

Retaining the power to regulate fraud, states have considerable leeway in the construction of their antifraud provisions.[60] For example, state civil liability statutes predicate antifraud recovery on various levels of culpability, ranging from simple negligence[61] to recklessness or intent.[62] However, this power in the hands of the state could prove counter-productive to some of the preemptive effects of the NSMIA.[63] Consequently, the state power, as a result of the NSMIA's incomplete preemption, has the potential to deliver a "severe blow to the uniformity that is the policy basis for preemption."[64]

These concerns aside, the NSMIA had a monumental impact on the regulatory dynamic, even if the states *did* retain the power to enact their own antifraud legislation.[65] It was clear that the intent of Congress—in essentially preempting the states' Blue Sky Law (except for antifraud legislation)—was to promote uniformity among the states.[66] But in allowing the states to retain antifraud jurisdiction, Congress appeared to

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> provisions does not require any filing or administrative approval as a prerequisite to the completion of a proposed transaction.

Id. Campbell, Jr.'s argument is based on states' duplication of the federal standards. *Id.* He does, however, discuss the (unlikely) possibility that the states could define their provisions differently from the federal provisions, but he views this only as further support of his argument in favor of preemption of state antifraud provisions. *Id.* Campbell, Jr. concludes that total preemption is the obvious alternative when many states merely mimic the federal regulations, and when variations do nothing but generate costs in excess of any societal benefit. *Id.*; *see supra* note 42 and accompanying text (comparing the language of section 101 of the Uniform Securities Act of 1956 with the language of Rule 10b-5). *But see* Sargent, *A Future for Blue Sky Law*, *supra* note 55, at 498–99 (providing states' motivations for maintaining Blue Sky regulations).

59 *See* S. REP. NO. 104–293 (1996); H.R. REP. NO. 104–864, at 39 (1996) (explaining that the Act was intended to modernize "our scheme of securities regulation to promote investment, decrease the cost of capital, and encourage competition[] . . . [in response to] . . . the system of dual Federal and state securities regulation [that] resulted in a degree of duplicative and unnecessary regulation[] . . . [and that] . . . in many instances, is redundant, costly, and ineffective."). *But see* Campbell, Jr., *Recent Congressional Preemption*, *supra* note 58, at 203 (cautioning against optimism that the NSMIA will achieve its goals).

60 *See supra* Part II.A.1.

61 *See*, *e.g.*, *supra* note 51 and accompanying text.

62 *See* Campbell, Jr., *Recent Congressional Preemption*, *supra* note 58, at 201.

63 *Id.*

64 Campbell, Jr., *Recent Congressional Preemption*, *supra* note 58, at 201; *see* Campbell, Jr., *An Open Attack*, *supra* note 54, at 575–77 (arguing in favor of complete federal preemption of state antifraud regulation).

65 *See supra* notes 57–58.

66 *See supra* note 59 and accompanying text.

defeat its own supposed goal of uniformity.[67] As a result, the effects of this incomplete preemption are a lack of uniformity and residual confusion within the dual regulatory structure of antifraud regulation provisions.[68] Even after the NSMIA, antifraud regulation remains inconsistent both between the states, as well as between the state and the federal regulatory agencies, keeping alive the challenges and resulting debates about the dearth of uniformity among state Blue Sky Law.

C. Development and Interpretation of Remedies for Securities Fraud Under Ohio Blue Sky Law

Following Kansas's lead in 1911, Ohio enacted Blue Sky securities legislation in 1913.[69] The 1913 law established a three-part approach to regulating securities: first, the law established a licensing requirement for securities dealers; second, the law required registration of the securities; and third, the 1913 law established prohibitions and penalties for violation of the law.[70] And as mentioned above, the United States Supreme Court upheld the constitutionality of Ohio's 1913 law in the 1917 "Blue Sky Cases."[71]

Notwithstanding the approval of the United States Supreme Court, the Ohio law initially received its fair share of criticism.[72] Responding to such criticism, the 1929 Ohio Securities Act revised the 1913 law.[73] After this revision, those critical of the 1913 law quickly changed their views.[74] Praising the 1929 Securities Act was one previous dissenter, a satisfied, contemporary businessman, who suggested that the new law was "a law which will not only throw the crooks for a loss but will, at the same time, cut away the entangling meshes of red tape and allow legitimate

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67 *See* Campbell, Jr., *Recent Congressional Preemption*, *supra* note 58.

68 *See* Sargent, *NSMIA*, *supra* note 55.

69 *See* Thomas E. Geyer, *Viewing the* Columbus Skyline: *Incorporating Federal Law into the Anti-Fraud Standard of the Ohio Securities Act*, 28 U. TOL. L. REV. 301, 303 (1996). Geyer cites the 1926 decision *The Warren People's Market Co. v. Corbett & Sons* for the notion that the legislators in 1913 "enacted the Ohio 'Blue Sky Law' in 1913 to 'regulate the sale of bonds, stocks, and other securities . . . and to prevent fraud in such sales." *Id.* (quoting The Warren People's Market Co. v. Corbett & Sons, 151 N.E. 51, 55 (Ohio 1926)).

70 *See* Geyer, *supra* note 69, at 303–04.

71 *See supra* note 24 and accompanying text.

72 *See* Geyer, *supra* note 69, at 303. Criticism was rooted in the typical laissez faire arguments launched against government regulation of commerce. *Id.* at 304. Geyer cites one unhappy securities practitioner who complained of the statute's potential to harass business. *Id.*

73 *See id.* at 303. The 1929 Ohio Securities Act had the effect of essentially repealing the entire 1913 code. *Id.* In fact, as Geyer notes, the 1929 Act added almost an entire new chapter to the Code. *Id.*

74 *See id.*

business to swoop gracefully down the field for a touchdown."[75] The new law stayed true to the original twin aims of investor protection and encouragement of capital development by re-working the regulatory structure that had served to handcuff both the "crooks" and the legitimate securities dealers alike.[76] In fact, the 1929 Act was so successful that it has remained structurally unchanged by the current Ohio Securities Act.[77]

1. Ohio's Interpretation of Fraud

After the NSMIA's preemption of much state regulatory power, what remains of Ohio's Blue Sky securities regulations is the power to prosecute fraud.[78] Even though much state power is preempted by federal regulations, preventing exploitation of investors through the sale of fraudulent securities remains the primary focus of state regulators—just as it was at the time of enacting both the 1913 and 1929 Ohio Securities Acts.[79]

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[75] *Id.* at 303 (quoting J. C. Little, *The New Ohio Securities Act*, CLEV. BAR ASS'N J. 5, 5 (Oct. 1929)).

[76] *See supra* note 69; *see also* Geyer, *supra* note 69, at 305 (discussing capital development).

[77] Geyer, *supra* note 69, at 305.

[78] *See supra* Part II.B.

[79] *See* Geyer, *supra* note 69, at 301 n.1 (quoting Ohio State Bar Association Corporation Law Committee Comments Accompanying the 1929 Amendments to the Ohio Securities Act, *reprinted in* HOWARD FRIEDMAN, OHIO SECURITIES LAW & PRACTICE 23 (Supp. 1994)).

> The proposed act gives to the Division of Securities broadly inclusive powers as to fraud . . . . We believe that this law, as we have drafted it, will not unduly restrict the activities of honest men dealing in honest securities, and that it will provide the means by which deceptive acts can be discovered, prevented and punished.

Id. (footnote omitted); *see also* Hall v. Geiger-Jones Co., 242 U.S. 539, 550–51 (1917) (upholding the constitutionality of the former Ohio Blue Sky Law in regulating the sale of securities). *See also* United States v. Tehan, 365 F.2d 191, 194 (6th Cir. 1966). Upholding a prior challenge to the constitutionality of the Ohio Securities Act, the Sixth Circuit discussed the reasons for having antifraud provisions in the first place:

> The power of the State to provide for the general welfare authorizes it to establish such regulations as will secure or tend to secure the people against ignorance often due from an incomplete disclosure of facts by one in the unique position to know the facts. The Ohio Securities Act [of 1929], commonly referred to as Ohio Blue Sky Law, was adopted to prevent fraudulent exploitations through the sale of securities.

Id. *See also* Bronaugh v. R. & E. Dredging Co., Inc., 242 N.E.2d 572, 576 (Ohio 1968). Similarly, the Ohio Supreme Court reiterated the necessities of the antifraud provisions:

> [T]he purpose . . . 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

Because Ohio is not a Uniform Securities Act jurisdiction, it tends to define "fraud" more broadly than the aforementioned Uniform Securities Act jurisdictions.[80] Coinciding with the NSMIA, in a 1996 case, *In re Columbus Skyline Securities, Inc.*,[81] the Ohio Supreme Court had the opportunity to interpret the state constitutionality of Ohio's antifraud provision.[82] The *Columbus Skyline* court considered the co-existence of

> designed to protect the public from its own stupidity, gullibility and avariciousness.

Id.

[80] OHIO R.C. § 1701.01(J) (West, Westlaw through 2008 File 129 of the 127th Gen. Assembly). The language defining "fraud" is more expansive than the proposed language of the Uniform Securities Act of 1956:

> "Fraud," "fraudulent," "fraudulent acts," "fraudulent practices," or "fraudulent transactions" means anything recognized on or after July 22, 1929, as such in courts of law or equity; any device, scheme, or artifice to defraud or to obtain money or property by means of any false pretense, representation, or promise; any fictitious or pretended purchase or sale of securities; and any act, practice, transaction, or course of business relating to the sale of securities that is fraudulent or that has operated or would operate as a fraud upon the seller or purchaser.

Id. To constitute fraud, one must be engaged in selling securities. State v. Walsh, 420 N.E.2d 1013, 1017 (Ohio Ct. App. 1979). The Court in *Walsh* distinguished an act or practice in connection with the sale of the security from an act or practice "*subsequent* to the sale." *Id.* (emphasis added). Additionally, in 1982, the Ohio Court of Appeals determined that fraud, for purposes of securities regulation, is not the same as criminal fraud, as defined in section 2912.01(K). State v. Trivedi, 457 N.E.2d 868 (Ohio Ct. App. 1982). As a result, the Court held that restitution was not appropriate. *Id.* But in the 1996 case *State v. Clark*, the same court held that *Trivedi* had been implicitly overruled by a previous decision, and concluded that restitution, in fact, was appropriate. No. C-960103, 1996 WL 741972 (Ohio App. 1 Dist. Dec. 31, 1996).

[81] Holderman, Comm'r v. Columbus Skyline Sec. (*In re* Columbus Skyline Sec., Inc.), 660 N.E.2d 427 (Ohio 1996); *see* Geyer, *supra* note 69. Geyer discusses the significance of the *Columbus Skyline* decision in that few courts have incorporated federal standards into state law. Geyer, *supra* note 69, at 314. Additionally, Geyer discusses how this decision confirms the states' retention of power to prosecute fraud, noting, "[i]n reaffirming the dual nature of securities regulation, the NSMIA . . . fully sanctions the expansive reach of state securities anti-fraud authority." *Id.* at 317. Geyer concludes his support of the *Columbus Skyline* decision by noting that this incorporation "permits maximum enforcement, uniform application and the maintenance of an appropriate balance between investor protection and capital formation." *Id.*

[82] *Columbus Skyline*, 660 N.E.2d at 428–29. The precise issue here was whether section 1707.01(J) gives to intrastate securities dealers adequate notice that federal case law may be used (to calculate the current market price of over-the-counter stock) to determine if the dealer's conduct is fraudulent. *Id.* at 428. The Ohio Supreme Court upheld the constitutionality of the statute, but *Columbus Skyline* is most relevant for its analysis of the reasoning behind the drafting of the statute. *Id.* at 429. Citing the definition of "fraud" in section 1707.01(J), the Court emphasizes the key language of the first clause, "*anything recognized* on or after July 22, 1929, as such *in courts of law or equity*[.]" *Id.* at 428. The Court was faced with a challenge for vagueness on the grounds that this language was too broad

Ohio's Blue Sky law with federal securities regulation—specifically the expansive nature of Ohio's statutory language.[83] Keeping in line with the dual-regulatory structure, the Court was unwilling to grant exclusive jurisdiction in antifraud matters to either state or federal regulatory agencies.[84] Rather, the Court determined that it was necessary for state law to work in conjunction with federal regulations in determining what constitutes fraudulent behavior.[85] Indeed, *Columbus Skyline* is illustrative of the state-federal securities regulatory dichotomy in that it demonstrates the willingness of the Ohio courts to construe "fraud" broadly, and thus equitably, in maintaining and promoting the goals of the original Ohio Securities Act.[86] And despite the difference in the general language of the statute, the Ohio fraud statute operates to treat fraud in a fashion quite similar to other state law.[87] Having thus laid the

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and far-reaching. *Id*. But in disagreeing with the lower court, which held that "[a] general rule stating that federal securities law applies to Ohio intrastate securities trading would be insufficient as it would be impossible for anyone to know what standard applied[,]" the Ohio Supreme Court emphasized a liberal construction of the antifraud provisions in order to further the protectionist goals of the statute. *Id.* at 429. The Court thus found it necessary to construe the statute so broadly because it was drafted "to address unforeseen variations in factual circumstances." *Id.*

83 *Id.* at 429. The Court discussed the necessity of creating such sweeping language in order "to address unforeseen variations in factual circumstances." *Id.* Discussing the evolving nature of fraudulent conduct—specifically the "creativity of unscrupulous securities dealers intent on defrauding Ohio investors[]"—the Court noted that the lawmakers defined the statute so broadly so as not to exclude potentially fraudulent conduct. *Id.* Then, the Court provided two specific reasons as to why the legislators defined "fraud" in such generalities: first, "[b]y incorporating into the statute a larger body of law by which to define fraudulent conduct, the General Assembly has provided for inevitable changes in market structure that might otherwise require redrafting of the statute[;]" second, federal standards are often more developed than state standards, and by allowing this incorporation, the state lawmakers prudently differ to the more specialized SEC in certain matters. *Id.* at 429–30.

84 *Id.* at 429.

> [T]he General Assembly did not limit the source of the definition [of certain measuring standards] solely to courts of Ohio, or even to state courts generally, as it easily could have done. Rather, the legislature broadly drafted R.C. 1707.01(J) to draw from *all* securities case law defining fraudulent conduct in both state and federal courts.

Id.

85 *Id*.

86 *Id*. at 430; *see also* United States v. Tehan, 365 F.2d 191, 194 (6th Cir. 1966); Bronaugh v. R. & E. Dredging Co., Inc., 242 N.E.2d 572 (Ohio 1968).

87 *See* State v. Walsh, 420 N.E.2d 1013 (Ohio Ct. App. 1979) (finding criminal liability for fraud when a person represents facts to be different than he should have known them to be if he had exercised reasonable diligence in attempting to ascertain the facts). Following the lead of *Walsh*, the Ohio Supreme Court clarified its meaning of the due diligence standard for fraud in 1990:

> First, it must be ascertained whether defendant exercised reasonable diligence to ascertain the true state of facts; and, second, it must be

foundation for Ohio's general securities fraud regulation, this Note now shifts its focus to the issue of remedies in an unlawful sale—specifically the statutory language defining precisely who is afforded the remedies of section 1707.43.

2. Buyers' Remedies

Since the NSMIA was promulgated in 1996, Ohio has retained the power to prosecute violators of securities fraud.[88] To this end, Ohio provides defrauded investors with statutory relief.[89] Specifically, redress is available under sections 1707.41,[90] 1707.42,[91] and 1707.43[92] of the Ohio

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> determined whether he should, not merely could, have learned of the true facts in the exercise of reasonable diligence. This is not a situation where one fact is presumed to exist because of the existence of another; but, instead in the context of this case, the jury is required to make a factual determination of whether the defendant represented the facts to be different than he should have known them to be, in the exercise of reasonable diligence. This in no way infringes upon the presumption of innocence, since the state is required to prove, beyond a reasonable doubt, that the defendant in the exercise of reasonable diligence should have known the facts to be different than he represented them to be. Actually, there is little difference between this standard and the standard that is ordinarily used, since it is permissible to infer that a defendant has knowledge of facts which he should have known under the circumstances involved.

State v. Warner, 564 N.E.2d 18, 42 (Ohio 1990).

88 *See supra* Part II.B.

89 *See* Thomas E. Geyer, Michael P. Miglets, & Keith A. Rowley, *Civil Liability and Remedies in Ohio Securities Transactions*, 70 U. CIN. L. REV. 939 (2002). The authors note that Ohio common law supplements the Ohio Securities Act. *Id.* at 940. The authors go on to describe how the state law has grown in importance after the NSMIA, which contributed to

> reduc[ing] the number of avenues by which plaintiffs relying on federal law may pursue alleged wrongdoers for securities fraud, impos[ing] significant additional requirements on plaintiffs suing under federal securities law, . . . and curb[ing] the availability of state courts as an alternative forum in which plaintiffs may pursue securities fraud claims.

Id. at 941 (quoting Keith A Rowley, *Muddy Waters, Blue Skies: Civil Liability Under the Mississippi Securities Act*, MISS. L. J. 683, 684 (2000)). Consequently, the authors argue, Ohio law may nevertheless present "attractive alternatives" in the form of state common law fraud claims. *Id.*; *see* Robert L. Matia, *Express and Implied Civil Liability Provisions in State Blue Sky Laws*, 17 CASE W. RES. L. REV. 1173 (1966) (discussing the multitude of available remedies to purchasers in securities transactions). *See generally* Dale C. LaPorte, Note, *Voidability Provisions Under State Blue Sky Laws*, 17 CASE W. RES. L. REV. 1148 (1966) (discussing the voidability remedy under both federal and state regulations, and arguing that the protection afforded buyers is adequate).

90 OHIO REVISED.CODE. ANN. § 1707.41 (West, Westlaw through 2008 File 129 of the 127th Gen. Assembly) provides, in pertinent part:

Revised Code. Stemming from the Code's definition of fraud, section 1707.43 provides the primary source of remedies for the purchaser in an unlawful sale.[93]

> (A) In addition to the other liabilities imposed by law, any person that, 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 that purchased the security relying on the circular, prospectus, or advertisement, for the loss or damage sustained by the relying person by reason of the falsity of any material statement contained therein or for the omission of material facts, unless the offeror or person that receives the profits establishes that the offeror or person had no knowledge of the publication prior to the transaction complained of, or had just and reasonable grounds to believe the statement to be true or the omitted facts to be not material. . . .
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> . . . .
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> (C) For purposes of this section, lack of reasonable diligence in ascertaining the fact of a publication or the falsity of any statement contained in it or of the omission of a material fact shall be deemed knowledge of the publication and of the falsity of any untrue statement in it or of the omission of material facts.

Id.

[91] OHIO REV. CODE ANN. § 1707.42 (West, Westlaw through 2008 File 129 of the 127th Gen. Assembly) provides, in pertinent part:

> (A) Whoever, with the intent to secure financial gain to self, advises and procures any person to purchase any security, and receives any commission or reward for the advice or services without disclosing to the purchaser the fact of the person's agency or interest in such sales, shall be liable to the purchaser for the amount of the purchaser's damage thereby, upon tender of the security to, and suit brought against, the adviser, by the purchaser.

Id.

[92] OHIO REV. CODE ANN. § 1707.43 (West, Westlaw through 2008 File 129 of the 127th Gen. Assembly) provides, in pertinent part:

> (A) Subject to divisions (B) [statute of limitations] and (C) [correction of error by seller] . . . , every sale or contract for sale made in violation of Chapter 1707. of the Revised Code, is voidable at the election of the purchaser. The person making such sale or contract for sale, and every person that has participated in or aided the seller in any way in making such sale or contract for sale, are jointly and severally liable to the purchaser, in an action at law in any court of competent jurisdiction, upon tender to the seller in person or in open court of the securities sold or of the contract made, for the full amount paid by the purchaser and for all taxable court costs, unless the court determines that the violation did not materially affect the protection contemplated by the violated provision.

Id.

[93] *See* James B. Farmer & Toba Jeanne Feldman, *Fraud in Securities Transactions: A Comparison of Civil Remedies Under the Ohio Securities Act, the Uniform Securities Act, and the Federal Securities Acts*, 49 U. CIN. L. REV. 814, 820–21 (1980). The authors note the relatively narrow scope of section 1707.41. *Id.* at 820. Because the section applies only to

As the statutory remedy, section 1707.43's protective umbrella is limited to *purchasers* of securities; indeed, it fails to provide statutory relief for defrauded sellers.[94] Armed with this statutory protection, a purchaser has the right to elect to void a sales contract that violates any provision of the Ohio Securities Act.[95] Conversely, the statute fails to provide a statutory remedy for defrauded *sellers*.[96] Moreover, as a frame of reference, the statutory language of Ohio's corporate merger statute is much broader in providing remedies to parties that have been the victims of fraud.[97] It is from this starting point that this Note proceeds to

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"misrepresentations or omissions made in printed material utilized in the sale of a security[,]" its usefulness is "limited." *Id.* Additionally, "[o]nly a defrauded purchaser may seek relief under the statute, upon proof of materiality, negligence and reliance." *Id.* Likewise, section 1707.42 is also limited, as it "contains a scienter requirement and applies only to financial advisors." *Id.*; *see also* Matia, *supra* note 89.

94 *Compare* UNIF. SECURITIES ACT § 410(a), 7A U.L.A. 568 (1958), *reprinted in* LOSS & SELIGMAN, *supra* note 18, at 65, *with* OHIO R.C. § 1707.43.

95 § 1707.43; *see* Farmer & Feldman, *supra* note 93 (discussing how only purchasers are granted the statutory right of rescission).

96 *See* Farmer & Feldman, *supra* note 93, at 822. The authors raise a compelling question—a question that, in fact, this Note aims to discuss in Part IV, with the facts of the stock-for-exchange transaction in *Murphy* as the springboard—"Because misstatements and omissions can just as easily induce a sale as a purchase," why is not the statute expanded to provide a civil remedy for defrauded *sellers*? *Id.* at 822.

97 OHIO REV. CODE § 1701.78 (West, Westlaw through 2008 File 129 of the 127th Gen. Assembly) is Ohio's corporate merger statute:

> (D) To effect the merger or consolidation, the agreement shall be approved by the directors of each domestic constituent corporation, adopted by the shareholders of each domestic constituent corporation, other than the surviving corporation in the case of a merger, at a meeting of the shareholders of each such corporation held for the purpose, and approved or otherwise authorized by or on behalf of each foreign constituent corporation in accordance with the Law of the state under which it exists. In the case of a merger, the agreement shall also be adopted by the shareholders of the surviving corporation at a meeting held for the purpose, if one or more of the following conditions exist: . . .
>
> . . . .
>
> (3) The merger involves the issuance or transfer by the surviving corporation to the shareholders of the other constituent corporation or corporations of such number of shares of the surviving corporation as will entitle the holders of the shares immediately after the consummation of the merger to exercise one-sixth or more of the voting power of that corporation in the election of directors[] . . . .

Id. In the case of fraud perpetrated during the course of such a transaction, OHIO REV. CODE § 1701.93 (West, Westlaw through 2008 File 129 of the 127th Gen. Assembly), in pertinent part, provides general prohibitions and penalties:

> (A) No officer, director, employee, or agent of a corporation shall, either alone or with another or others, with intent to deceive:

explore section 1707.43 in terms of the Sixth Circuit's recent decision in *Murphy v. Stargate Defense Systems Corp*.[98]

3. Murphy's Law

Murphy considers the subtle issue of precisely who is entitled to statutory protection under Ohio's Blue Sky Law, specifically the rescission provision of section 1707.43(A).[99] Appellants (Plaintiffs at the trial court level) were owners of Spectrum Infrared, Inc. ("Spectrum").[100] In 2005, Appellants sold all shares of Spectrum to Stargate Defense Systems Corp. ("Stargate"), a business operated by the Appellees (Defendants at the trial court level).[101] The sale was structured as a stock exchange whereby the Appellants traded all their stock in Spectrum for stock in Stargate, essentially acquiring an interest in Stargate while relinquishing control of Spectrum.[102] Unfortunately for Appellants, however, their acquired stock interest in Stargate turned out to be worth no value.[103]

> (1) Make, issue, deliver, publish, or send by mail or by any other means of communication any prospectus, report, circular, certificate, statement, balance sheet, exhibit, or document, respecting the shares, assets, liabilities, capital, business, dividends or distributions, earnings, or accounts of a corporation, that is false in any material respect, knowing the statement to be false; . . .
>
> . . . .
>
> (B) *Whoever violates this section shall be personally liable, jointly and severally, with all other persons participating with the offender in any act of that type, to any person for any damage actually suffered and proximately resulting from the act*. . . .
>
> (D) Remedies under this section are not exclusive of other remedies at common law or under other statutes.

Id. (emphasis added). From the general language of section 1707.93(B), it appears that the applicability of these corporate fraud statutes is not limited to just one party in the transaction. *But see* § 1701.43 (the language of the statute limits the applicability to purchasers of securities).

[98] Murphy v. Stargate Defense Sys. Corp., 498 F.3d 386 (6th Cir. 2007) (the Sixth Circuit Court of Appeals applied section 1707.43, fraud during the purchase of securities, in a stock-for-stock exchange; sections 1707.78 and 1707.93, Ohio's corporate merger statutes, were not considered in *Murphy*).

[99] *Id*. at 390.

[100] *Id*. at 388.

[101] *Id*. In addition, plaintiffs agreed to purchase stock from defendants in two transactions independent of the 2005 acquisition. *Id.* at 388–89. *See infra* note 93 (a description of the dealings between Plaintiffs Murphy and Smith and Defendant Woodruff).

[102] *Id*. at 388.

[103] *Id*. at 389. The trial court made many specific findings of fact; those that follow serve to illustrate the nature of the fraud perpetrated by Stargate Defense Systems against Plaintiffs John Murphy and James Smith. Murphy v. Stargate Defense Sys. Corp., No. 1:05

CV 2121, 2006 WL 721746, at *1 (N.D. Ohio Mar. 21, 2006), *aff'd in part, denied in part*, 498 F.3d 386 (6th Cir. 2007). Murphy and Smith were each 50 percent shareholders in Spectrum, an Ohio corporation that manufactured infrared heaters used for a variety of commercial applications. *Id.* Contemplating retirement, the Plaintiffs advertised the availability of their manufacturing business. *Id.* Shortly thereafter, Defendant James Woodruff responded to the advertisement and requested additional information. *Id.* Nearly six months later Woodruff represented to Smith that his corporation, Q Corp, was going public soon, and he was still interested in acquiring Spectrum. *Id.* at *2. During a meeting between Murphy and Woodruff, Woodruff represented that Q Corp did 60 percent of its business with the United States Government, and that Q Corp was in the process of acquiring another business for 1.5 million dollars. *Id.* On January 4, 2002, Woodruff and Mitchell visited Spectrum's facility in Cleveland, Ohio and met with Murphy and Smith. *Id*. at *2. At this meeting, Woodruff represented that Q Corp was in the process of acquiring yet another company—a gas infrared manufacturing company business with sales of $400,000 per year. *Id.* Murphy sent to Woodruff an appraisal of the Spectrum equipment, as well as a breakdown of Spectrum's sales. *Id.* Woodruff then called Murphy, and left a phone message representing to Murphy that Q Corp was in the process of going public, and that Woodruff was interested in purchasing Spectrum with stock. *Id.* Woodruff further suggested that Murphy should consider making a small investment in Q Corp stock as part of the deal. *Id.* Murphy, Smith, and Plaintiff's personal accountant met with Woodruff at the offices of Q Corp, during which time Woodruff represented that Q Corp had a net worth of 3.5 million dollars, and that shares were selling at $15 per share. *Id.* On January 25, 2002, Murphy and Smith agreed to purchase jointly 400 shares of Q Corp and tendered a check payable to Q Corp in the amount of $12,000; despite this payment, no stock certificates were ever delivered. *Id.* Murphy requested additional information from Woodruff regarding Q Corp; in response, Woodruff corrected his earlier misstatement and represented to Murphy that Q Corp stock had never sold for less than $30 per share. *Id.* at *3. On February 1, 2002, Murphy and Smith delivered the signed copy of the letter of intent and Woodruff represented that everything was in place to close on another acquisition. *Id.* On February 4, 2002, Murphy purchased an additional 1,000 shares of Q Corp for $20,000; no stock certificates were delivered. *Id.* The trial court found that Woodruff made several misrepresentations to Murphy, including that he had no plans to take Q Corp public. *Id.* In addition, Woodruff had been prosecuted for many previous fraudulent schemes involving investors. *Id.* On March 1, 2002, the Certificate of Incorporation of Q Corp was cancelled for failure to file annual reports and the non-payment of taxes to the State of Delaware. *Id.* at *4. On February 20, 2002, Woodruff delivered to Murphy and Smith Q Corp's Profit and Loss Statements, Balance Sheets, and a Prospectus for Q Corp. *Id.* This prospectus included an amalgamation of several corporations, financial information based on these entities, and various other information regarding the business activities of Q Corp. *Id.* Woodruff explained to Murphy that he anticipated better performance in 2002, and was now waiting for money to complete the acquisition of Spectrum. *Id.* at *5. Murphy and Woodruff made a number of communications throughout the remainder of 2002, and in March of 2003, Plaintiffs decided to resume their advertisement of Spectrum; they never received any serious interest, however. *Id.* at *6. But in June 2003, Woodruff called Murphy to assure him that he would have the available funds in a matter of weeks, and "they would need to get serious about completing the acquisition of Spectrum[.]" *Id.* Having assured Murphy that Q Corp was in a position to complete the acquisition, Woodruff presented Murphy and Smith stock certificates representing their ownership in Stargate Defense Systems (a Delaware Corporation formerly known as Interwoven Technologies), as well as a copy of a purchase agreement. *Id.* at *6. Plaintiffs executed the purchase agreement, but consulted an attorney on March 18, 2005. *Id.* Plaintiffs suggested that the contract should be between

Upon suspecting Stargate's fraud, Murphy filed suit against Stargate seeking to rescind the transaction pursuant to section 1707.43(A).[104] The District Court granted Murphy the right of rescission of previous stock purchases, but denied them rescission of the 2005 stock exchange.[105] On appeal, the Sixth Circuit Court of Appeals disagreed with the district court's conclusion that Plaintiffs were not stock "purchasers," and reversed the decision in part accordingly.[106]

Plaintiffs as individual shareholders of Spectrum and Stargate rather than between Spectrum and Stargate, but Woodruff rejected this proposed change. *Id.* at *7. The Purchase Agreement provided that Stargate would purchase all of the stock, assets, and business or product lines owned and conducted by Spectrum for $1,008,000.00 in the form of shares of Stargate stock which is valued at $30.00 per share. *Id.* When Murphy and Smith were issued shares in Stargate in March of 2005, no such corporation known as Stargate existed on record in either Delaware or Ohio. *Id.* Defendants were aware, but did not disclose, that Stargate was not qualified for holding a government contract because of Defendants' previous indictments for fraud. *Id.* Despite the inconsistencies in the stock certificates, representations made about products and acquisitions, and the previous indictments and sentencing of Woodruff, Plaintiffs did not begin to suspect until June 2005 that that a fraud had been perpetrated upon them because the Defendants isolated the Plaintiffs and their former employees from the corporate records and the operations of Stargate. *Id.* at *8. During the period in which Stargate acquired the operations of Spectrum, Spectrum received cancellation of its insurance coverage for nonpayment of its premiums and a a demand letter for two months rent in arrears, and Stargate began to run its payroll through Spectrum because Stargate had no money coming in and its bank account balances were negative. *Id.* at *9. Additionally, suppliers of Spectrum indicated that accounts had become past due, and they threatened to cut off critical supplies. *Id.* Finally, on August 3, 2005, Plaintiffs tendered their share certificates into the court, and requested rescission of the stock sales. *Id.*

104 *Murphy*, 498 F.3d at 388. Central to Plaintiffs complaint is their allegation that they were induced to enter the transactions as a result of the fraudulent misrepresentations and omissions made by Defendants. *Id*. Plaintiffs brought federal claims in addition to their state statutory and common law claims. *Id.* Their allegations charged defendants with violations of federal Rule 10b-5, OHIO REV. CODE ANN. § 1707.44, and Ohio common law. *Id.* The only issue on appeal, however, concerns the scope of Ohio's Blue Sky law, OHIO REV.CODE ANN §§ 1701.01–99, specifically whether the Plaintiffs were "purchasers" for purposes of the right of rescission available under section 1707.43. *Id*.

105 *Murphy*, 2007 WL 721746 at *1. In a brief footnote, the district court addressed the issue of whether the Plaintiffs were entitled to protection under the Ohio Blue Sky law. *Id.* at *12. Determining that, in fact, Plaintiffs were *not* purchasers, the district court relied on the well-settled law of *Nickels v. Koehler Mgmt. Corp*., 541 F.2d 611, 616 (6th Cir. 1976), *cert. denied*, 429 U.S. 1074 (1977). *Murphy*, 498 F.3d at 391. *Nickels* expounds clearly the standard: "The blue sky law provides a remedy only for a defrauded purchaser, and not for a defrauded seller." 541 F.2d at 616. Nevertheless, the Sixth Circuit found error in the district courts failure to examine the specifics of the transaction, i.e., a stock-for-stock transaction, in determining who, in fact, is the "purchaser" and who is the "seller." *Murphy*, 498 F.3d at 391.

106 *Murphy*, 498 F.3d at 391 (reversing the district court with respect to its denial of Plaintiffs' right of rescission under section 1707.43).

Although Murphy conceded that *Nickels v. Koehler Management Corp.*[107] precludes Blue Sky protection for defrauded sellers, they argued that *both* parties acted as stock purchasers in the 2005 stock exchange, and therefore are entitled to protection under section 1707.43.[108] After reviewing the purpose of the Ohio Blue Sky Law,[109] the Sixth Circuit court rested its analysis on the unique nature of the stock exchange in which both parties essentially purchased shares in a different corporation.[110] The court relied on *Indemnity Insurance Co. of North America v. Kircher*[111] in distinguishing the stock-for-stock transaction from the typical buy-sell transaction to which the statutory language specifically referred.[112] Thus, it is this critical distinction for which the district court failed to account when it simply ignored the pressing question: who, for purposes of Blue Sky protection, was the actual seller?[113]

After *Murphy*, there is uncertainty when it comes to who is afforded the protection of Ohio's Blue Sky Law as illustrated by the disagreement in interpretation between the District Court and the Sixth Circuit.[114] The Sixth Circuit held narrowly that, in the instance of this stock-for-stock exchange, both parties are afforded the remedy of rescission when the other acts fraudulently.[115] It is within this framework that this Note proceeds to analyze the implications of the *Murphy* ruling for future securities-fraud actions in the unique case of a defrauded "seller" in a

107 541 F.2d 611.

108 *Murphy*, 498 F.3d at 391.

109 *See supra* note 79 and accompanying text.

110 *Murphy*, 498 F.3d at 391. Holding that "plaintiffs should be regarded as purchasers for purposes of Ohio's Blue Sky Law[,]" the court then examined the meaning of "sale" in a securities transaction: "'The sale of a security . . . means among other things an exchange of securities, and as one who acquires by sale is a purchaser, so is a purchaser one who acquires by an exchange of securities.'" *Id.* (quoting Indem Ins. Co. of N. Am. v. Kircher, 191 N.E. 374, 376 (Ohio Ct. App. 1934)). *See* Sec. Exch. Comm'n. v. Nat'l Sec., Inc., 393 U.S. 453, 467–68 (1969) (quoting Dasho v. Susquehanna Corp., 380 F.2d 262, 269 (7th Cir. 1967) (holding that, "in a merger, shareholders . . . effectively purchas[ing] shares in a new corporation while 'losing their status as shareholders' in the previous corporation[]"); Mader v. Armel, 402 F.2d 158, 160 (6th Cir. 1968) (quoting *Dasho*, 380 F.2d at 269) (holding that, in the context of a federal securities fraud claim, "when the merger was approved and the exchange of securities occurred, the owner of stock had in effect purchased a new security and paid for it by turning in his old one[]").

111 191 N.E. at 376.

112 *Murphy*, 498 F.3d at 391.

113 *See generally* Murphy v. Stargate Defense Sys. Corp., No. 1:05 CV 2121, 2006 WL 721746.

114 *See supra* note 106 (discussing the Sixth Circuit's reversal of the lower court's decision to deny the seller of stock the statutory right of rescission when defrauded by a buyer).

115 *Murphy*, 498 F.3d 386 at 391.

stock-for-stock exchange.[116] To this end, Part III examines the relevancy of the uniformity debate, how the Sixth Circuit court's interpretation of Ohio's Blue Sky Law in *Murphy* has effectively expanded the protection afforded to parties seeking securities-fraud remedies, and ultimately, whether there is a need to amend section 1707.43 to include a statutory right of rescission in a stock-for-stock exchange.[117]

III. ANALYSIS

Because misstatements and omissions can just as easily induce a sale as a purchase, the state statutes should be expanded to provide a civil remedy for defrauded sellers.[118]

With a history dominated by a dual regulatory structure, it is clear that no mandatory uniform standards exist among states in their securities fraud regulation.[119] As a result, states have defined fraud uniquely, and additionally, made available specific remedies to victims of fraud.[120] Despite a movement towards uniformity, however, the effort has fallen short of achieving its goal—specifically among the various state antifraud statutes.[121]

As a case-in-point, Ohio has limited the right of rescission in securities fraud actions to buyers of stock.[122] In determining how to interpret Ohio's Blue Sky law in terms of stock exchanges, three major points of analysis must be considered. First, Part III.A of this Note addresses how after the NSMIA the debate surrounding uniformity appears to be well-settled: the states retain power to prosecute fraud, and, despite proposed uniform acts, there appears to be little motivation for states to eradicate inconsistencies among their antifraud provisions.[123] Second, Part III.B discusses the *Murphy* Court's

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116 *See infra* Part III.
117 *See infra* Part III.
118 Farmer & Feldman, *supra* note 93, at 822.
119 *See supra* Part II.B (discussing the NSMIA as a response to a lack of uniformity, and the resulting lack of uniformity vis-à-vis state securities fraud regulation).
120 *See supra* note 25.
121 *See supra* Part II.B (discussing the states' ultimate retention of power to prosecute fraud, and consequently, the power to construe their fraud provisions as they see fit); *see also* Denos, *supra* note 18, at 105 (discussing how the NSMIA was a step toward uniformity between the state and federal securities regulation agencies, but because of the deeply-rooted dual regulatory structure, total federal preemption of state law has not been achieved).
122 *See supra* Part II.C (explaining Ohio's Blue Sky Law remedies, specifically how sellers of stock have no statutory right of rescission when defrauded by a buyer in a stock-for-stock exchange).
123 *See infra* Part III.A.

construction of Ohio's Blue Sky Law in the case of a fraudulent stock-for-stock transaction, focusing specifically on the ambiguity in the text of the statute concerning who is afforded the right of rescission.[124] Finally, in light of the *Murphy* Court's willingness to extend Blue Sky protection to both parties in a stock-for-stock transaction, Part III.C addresses why Ohio's Blue Sky statute should be re-formulated to explicitly include both parties in a stock-for-stock exchange.[125] In sum, Part III examines how the analysis of fraud in a stock-for-stock exchange introduces a set of circumstances that need to be accounted for in Ohio's state securities fraud regulation.[126]

A. Uniformity: How Has the NSMIA Affected the Uniformity Debate?

Reacting to multiple unsuccessful attempts to overhaul the complex dual regulatory system of securities regulation, Congress enacted the NSMIA in 1996.[127] Because of the frustrating complexity, those who supported the NSMIA lauded its attempts to address the patchwork system that existed under one federal regulatory umbrella.[128] To those in favor of state uniformity, however, the NSMIA's ultimate effect proved to be much more form than substance.[129] Although the NSMIA developed under the auspices of encouraging uniformity, certainly its effect has not been to establish uniformity among all aspects of securities regulation.[130] As a result, commentators on both sides of the uniformity debate are left unsatisfied.[131]

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124 *See infra* Part III.B.
125 *See infra* Part III.C.
126 *See infra* Part III.
127 *See supra* note 58.
128 *See supra* note 58 and accompanying text.
129 *See* Sargent, *NSMIA*, *supra* note 55, at 507 (describing how the NSMIA fell short of a fundamental reordering because the states retained so much regulatory power); *see also* Campbell, Jr., *Recent Congressional Preemption*, *supra* note 58 (explaining that changes are generally insignificant as the states ultimately retained the most important power—prosecution of fraud).
130 *See supra* notes 57–58 and accompanying text (describing precisely what powers were granted to the states and what powers were left to the SEC).
131 *Compare* McWilliams, *supra* note 18 (lauding the benefits of establishing uniformity between state and federal law, although cautioning that this pursuit should not serve as a catch-all trump to the unique interests of each state), *with* Campbell, Jr., *Open Attack*, *supra* note 58 (promoting total preemption because state antifraud laws are essentially the same as federal laws), Dahlquist, *supra* note 18, at 393 (encouraging uniformity among states because of the time-consuming task involved in analyzing all state blue sky laws when attempting to ensure that a security issue is in compliance with all applicable state statutes), Maynard, *supra* note 54, at 393 (same), *and* Denos, *supra* note 18, at 102 (discussing how many state provisions are at odds with comparable federal provisions).

1. Uniformity: The Arguments on Both Sides of the Debate

The most basic proposition asserted against a uniform system of federal securities regulation is rooted in Federalism.[132] Historically, state Blue Sky Law was the first type of securities regulations, and by 1933, every state had such a law.[133] Moreover, each state has its own unique motivation regulating securities in a particular manner.[134] Flowing naturally from these positions is the fear that the federal government would unnecessarily usurp too much power from the states if it had sole jurisdiction over securities regulation.[135] Additionally, and more pragmatically, there are necessary limitations on the effectiveness and prudence of allowing the SEC full regulatory power over the "tremendously variegated industries in this vast country."[136] Relying on this practicality argument, those opposed to a uniform system of federal regulation understand that "reasonabl[e] coordinat[ion] with the federal legislation[]" is a satisfactory alternative to the "hodgepodge" of state statutes that flourished prior to any efforts aimed at uniformity.[137]

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132 *See* LOSS & SELIGMAN, *supra* note 18, at 57–58.

133 *See* McWilliams, *supra* note 18, at 248. McWilliams discusses two reasons for having two sets of regulations—one historical, one theoretical. *Id.* First, states had regulations in place before 1933, the time at which the first federal securities regulation statute was enacted. *Id.* Second, the federal securities laws "embody a theory of enforcement different than that of most state laws[] . . . ." *Id.* For these reasons, McWilliams argues, it is necessary to look at both regulatory structures in terms of the other. *Id.*

134 Sargent, *Future for Blue Sky Law*, *supra* note 55, at 498–99. Sargent, admittedly cynically, describes state agencies as "cash cows for state general revenues." *Id.* at 499. He notes that it is typical for a state to have a very high ratio of budgets to revenues. *Id.* As a result, according to Sargent, there is an economic disincentive for the states to relinquish regulatory control to the federal government. *Id.*; *see also* LOSS & SELIGMAN, *supra* note 18, at 149 (citing a 1984 study that reports in more than 30 jurisdictions Blue Sky Law securities enforcement has become a primary source of revenue).

135 *See supra* note 55 and accompanying text (explaining that states retained substantial interest in maintaining jurisdiction over securities regulation, whether it be from a financial or states' rights perspective); *see also supra* note 132 (discussing the federalism concerns of states).

136 LOSS & SELIGMAN, *supra* note 18, at 59. Loss and Seligman point to the abstract and theoretical underpinnings of the argument in favor of total uniformity as reasons why the dual regulatory structure should be maintained. *Id.* In support of their position, they cite a study of the SEC for the opinion of those who have experienced the intricacies and complexities of the regulatory structure first hand: "There has not been and should not be Federal preemption in the field of securities regulation." *Id.* (citing *Report of Special Study of Securities Markets*, H.R. DOC. NO. 95, 88th Cong., 1st Sess. 734 (1963)). Loss and Seligman, speaking from experience, suggest that "[p]erhaps it requires a substantial tenure in government to appreciate the limitations of government." LOSS & SELIGMAN, *supra* note 18, at 59.

137 *Id.* The authors appear to be content with this current system of "reasonabl[e] coordinat[ion]" as a satisfactory middle ground that encompasses aims of both federalism and post-1956 coordination of state securities regulation. *Id.*

On the other hand, strong support exists for absolute federal preemption of state securities regulation.[138] Eugene Rostow condemns Justice Brandeis's federalism argument as supportive of excessive regulation.[139] Moreover, the complexities of the various state regulations have all but rendered state Blue Sky Law meaningless in effect.[140] And

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[138] Eugene V. Rostow, Book Review, 62 YALE L.J. 675, 677 (1953). Rostow takes great issue with the federalism argument posited by Loss and Seligman. *Id.* Trumpeting the simplification of "financial practice without weakening the protection of investors[,]" Rostow concludes that the dual-regulatory structure was needless. *Id.* In addition, the former Chairman of the SEC, after his resignation, commented that:

> The 'blue sky' law had come to have a special meaning—a meaning full of complexities, surprises, unsuspected liabilities for transactions normal and usual—in short, a crazy-quilt of state regulations no longer significant or meaningful in purpose, and usually stultifying in effect, or just plain useless.

J. Sinclair Armstrong, Comment, *The Blue Sky Laws*, 44 VA. L. REV. 713, 714–15 (1958). It is clear from this scathing condemnation of the state regulation that Armstrong favored federal preemption. *Id.*; *see* Campbell, Jr., *Open Attack*, *supra* note 54, at 575 (noting that state antifraud regulation should be preempted by federal regulation because of the similarities between section 101 of the Uniform Securities Act of 1956 and rule 10b-5 under the 1934 Act). *But see* LOSS & SELIGMAN, *supra* note 18, at 59 (arguing against Rostow's simplification argument by suggesting that the securities regulation field is too complex for federal preemption). *But see* LOSS & SELIGMAN, *supra* note 18, at 57–58 (quoting New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting)). "It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory[] and try novel social and economic experiments without risk to the rest of the country." *Id.* Loss & Seligman, commenting on Justice Brandeis's admonition of the Court's willingness to embrace notions of uniformity, comment that "[a]s a matter of principle, it is difficult to justify the federal government's telling the states that they cannot try to protect their citizens beyond the federal disclosure philosophy." *Id.* As the authors point out, however, many who do make this argument do not extend its application beyond disclosure regulations. *Id.*

[139] *See* Rostow, *supra* note 138, at 677 (commenting that securities regulation is an area in which "multiple regulation by the states and the national government is a monument to the shibboleth, not the reality, of federalism[]").

[140] *See* Armstrong, *supra* note 138. Armstrong extends the uniformity argument to its logical extreme—total preemption of state regulation. Considering the interest of the public investor along side the regulatory purpose served by state regulation of securities, Armstrong concludes that state regulation is meaningless; he views these regulations as unnecessary interference with the interstate securities markets. *Id.* at 713–14. As a result, he posits not an overhaul of state law, but rather federal preemption. *Id.* at 714. Armstrong, aware of those in favor of states' rights who would oppose his rather extreme argument, finds nothing in his argument that should be opposed by those in favor of states' rights. *Id*. According to Armstrong, the process of investment and capital formation is necessarily national in nature; the investment market is nationwide, and to this end, only federal regulation should be mandated. *Id*. at 717. Ultimately, Armstrong supports his position against state co-ordinate antifraud regulation with the following argument:

> Thus the states, exercising their sovereign police power in an economic area of interstate significance, have distorted their original purpose to protect their citizens against fraud. Instead they have set up a

as Rutheford B. Campbell, Jr. posits, the similarities in statutory language between the antifraud provisions of the 1934 Act and section 101 of the Uniform Securities Act provide convincing evidence for total preemption.[141] From the perspective of one dealing in securities, working with multiple, varied state statutes entails unnecessary duplicative work.[142]

Nevertheless, regardless of one's position in the uniformity debate, Blue Sky Law appears to be a fixture in securities regulation.[143] Accepting this position, it appears as if the best response to the uniformity debate is to recognize the dual-regulatory structure as a reality and to proceed with an optimistic recognition that state and federal regulation work together, both serving valid regulatory purposes.[144] Indeed, it is clear that strong arguments exist both in favor of and against uniformity—so strong, in fact, that Congress addressed the matter by enacting the NSMIA.[145] Whether Congress achieved this goal, however, is a critical point of analysis.[146]

> protective machinery, often based on local interests, which is completely antithetical to the public interest in free and open corporate securities markets.

Id. at 718. Therefore the nation-wide scope of the market renders the "appearance of providing a state's citizens with protection against investment folly[]" illusory when a citizen of one state could easily travel to another state, engage in a securities transaction, and be subject to a different set of fraud statutes. *Id.*

141 *See* Campbell, Jr., *Open Attack*, *supra* note 54, at 576; *see also supra* note 58 and accompanying text.

142 *See* Dahlquist, *supra* note 18, at 393. As a lawyer with actual experience in the field of securities regulation, Dahlquist expresses his displeasure with being forced to comply with multiple, inconsistent statutes:

> Only a lawyer who has had the actual experience of qualifying a security issue in almost all of the . . . states which have some form of blue-sky law, concurrently with or immediately following registration under the Securities Act of 1934, has any real comprehension of the stupendous, tedious and wasteful task involved. It entails a vast amount of expensive duplicative work, most of which signifies nothing.

Id.; *see also* Denos, *supra* note 18 (admonishing the dual-regulatory structure as a hindrance when attempting to combat fraud); *supra* note 59 (discussing the aims of investor protection and efficiency as supportive of uniformity).

143 *See* Warren, *Merit Regulation*, *supra* note 19. Warren analyzes the history of the state regulations, and concludes that "[l]egislative and judicial recognition ha[ve] established and preserved a dual regulatory system." *Id.* at 134. In addition to this firm historical foundation, Warren praises the dual system as assisting to "provide the legitimacy required for investor participation in the capital formation process." *Id.*

144 *See* Facciolo & Stone, *supra* note 18 (suggesting that considering federal securities law concepts when construing state statutory provisions).

145 *See* S. REP. NO. 104–293, *supra* note 59, at 39 (the Act was intended to modernize regulatory scheme, characterized by duplicative and unnecessary regulation); *see also* Dahlquist, *supra* note 18, at 393 (speaking from the perspective of a lawyer with actual

2. Did the NSMIA Achieve Its Goal of Uniformity?

Reacting to the lack of regulatory uniformity that has spawned more than half a century of fervent debate, Congress set out to eradicate the inefficiencies caused by the duplicative regulatory structure.[147] Prior to the NSMIA, the arguments in support of Blue Sky Law supported the complex dual-regulatory scheme.[148] Attempting to combat this disarray and inconsistent regulatory landscape, Congress approved the legislation.[149] Granting the SEC exclusive regulatory powers appeared to be a step toward the goal of uniformity between the states and the federal government.[150] However, by allowing the states to retain the power to prosecute fraud, it appears that the NSMIA failed in its goal of achieving total uniformity.[151]

One argument, although made prior to the enactment of the NSMIA, is particularly relevant to this analysis because it champions consistent, federal antifraud regulation, precisely that which the NSMIA sought to avoid.[152] Campbell, Jr. poses the typical argument in favor of absolute preemption.[153] His reasons include a reduction of unnecessary and superfluous regulation, as well as a reduction of the economic burdens created by state variations.[154] But while seemingly workable in the abstract, Campbell, Jr.'s argument fails to account for the practical

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experience in the field of securities regulation, the author expresses displeasure with being forced to comply with multiple, inconsistent statutes).

146 *See infra* Part III.A.2 (positing that by leaving antifraud regulation with the states, the NSMIA failed in achieving uniformity between state and federal securities regulation).

147 *See* S. REP. NO. 104–293 (1996), *supra* note 59, at 39 (explaining that Congress set out to promote investment and capital development in response to the ineffective, duplicative regulatory system).

148 *See*, *e.g.*, Sargent, *A Future for Blue Sky Law*, *supra* note 55, at 498–99 (noting how both state governments and state regulators were committed to providing state protection to investors).

149 *See supra* notes 57, 59 and accompanying text; *see also* Denos, *supra* note 18, at 102 (noting that the NSMIA is a manifestation of strong feelings in favor of a single regulatory system).

150 *See supra* note 57 (although regulation of fraud was left to the states, the NSMIA delegated exclusively to the SEC regulation of certain activities related to the offering, promotion, and sale of nationally traded securities).

151 *See* Sargent, *A Future for Blue Sky Law*, *supra* note 55; *supra* note 59 and accompanying text.

152 *See supra* note 138 and accompanying text.

153 Campbell, Jr., *An Open Attack*, *supra* note 54, at 575 (Campbell, Jr. argues in favor of absolute preemption because most state antifraud laws are substantially the same as the federal 10b-5 standard).

154 *See id.* at 577 (discussing the economic burdens of researching and evaluating materials in multiple jurisdictions); *see also* Dahlquist, *supra* note 18, at 393 (expressing his displeasure as a practicing attorney having to comply with multiple, inconsistent statutes); *supra* note 140 and accompanying text.

limitations of such preemption.[155] The SEC is simply not capable of prosecuting all cases of fraud, and Congress consciously reserved these powers for the states.[156]

It is clear that the NSMIA's delegation of antifraud regulation to the states fell short of uniformity in the eyes of those who argue for absolute uniformity.[157] Nevertheless, the promulgation of the NSMIA made it clear that a need still exists for some semblance of consistency in the language of the statutes.[158] Consistency among the state fraud statutes does not require uniform federal regulation, however.[159] The arguments in favor of uniformity, particularly Dahlquist's position rooted in economic efficiency, still provide an incentive for consistency in fraud regulation from state to state.[160] What is clear from this debate is that uniformity among the state regulatory structures is a worthwhile pursuit, even if not mandated by federal legislation.[161]

3. A More Effective Means of Promoting Uniformity—The Uniform Securities Act of 1956

It is apparent that granting the SEC partial regulatory power has not proven to be an effective means toward promoting uniformity among state regulatory agencies.[162] Before the NSMIA's move toward a uniform, federal regulatory structure, the Uniform Securities Act of 1956 first sought to minimize the diversity that flourished among the various state Blue Sky Laws.[163] The 1956 Act was intended to promote uniformity in a manner substantially different from the NSMIA.[164]

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[155] *See supra* notes 136–38 (Loss and Seligman argue against preemption by suggesting that the securities regulation field is too complex for federal preemption).

[156] *See supra* notes 136–38 (Loss and Seligman argue against preemption by suggesting that the securities regulation field is too complex for federal preemption).

[157] *See* Sargent, *NSMIA*, *supra* note 55, at 507 (noting how despite the NSMIA's profound impact on the state-federal regulatory dichotomy, it surely fell short of a fundamental reordering); *see also supra* note 58 and accompanying text.

[158] *See* S. REP. NO. 104–293, *supra* note 59, at 39 (the NSMIA was intended to modernize the regulatory scheme, characterized by unnecessary regulation).

[159] *See infra* Part III.A.3 (discussion of the Uniform Securities Act of 1956 as an effective means of promoting uniformity).

[160] *See supra* notes 138–42 and accompanying text; Dahlquist, *supra* note 18, at 393 (emphasizing the practical difficulties of the necessary duplicative work caused by being forced to comply with multiple, inconsistent statutes.

[161] *See supra* note 18 and accompanying text.

[162] *See supra* Part III.A.2 (discussing the NSMIA's shortcomings in promoting uniformity among state legislation).

[163] *See supra* note 18 and accompanying text.

[164] See *supra* note 58 and accompanying text for a discussion of how, by leaving antifraud regulation with the states, the NSMIA seemed to achieve the result of dissuading the states from seeking uniformity. *Compare* LOSS & SELIGMAN, *supra* note 18, at 50 (exploring the

Analyzing this difference between a model act and federal legislation makes clear that a carefully structured model act does more to encourage uniformity among the states than legislation that essentially grants the states free reign in constructing their legislation.[165]

As a model act, the Uniform Securities Act of 1956 operates as a paradigm of securities regulation intended to better integrate the regulatory action of states and the SEC.[166] After the NSMIA, it is clear that the fore of this state and federal integration is in the form of antifraud regulation.[167] Thus, it makes perfect sense that the Act proposed a uniform definition and treatment of fraud.[168] Desiring to embrace this uniform approach, many states have adopted, or have substantially adopted, the Act's antifraud provisions.[169] Based on the Uniform Securities Act of 1956, many states have taken affirmative steps toward adopting uniform antifraud provisions in an effort to minimize the "burden of their separate legislation on interstate commerce."[170]

But in order to achieve its desired ends most effectively, a uniform act must be either entirely thorough—explicitly enumerating as many possible contingencies as necessary—or substantially general, so as not to exclude any possible contingencies.[171] A regulatory scheme can promote uniformity either concerning those aspects of the regulatory system that it mentions explicitly, or, conversely, by being so general as

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inherent impracticalities of expecting complete uniformity among states with different regulatory philosophies), *with* Part II.B (discussing how the NSMIA was federal legislation, and as such, states were not left with the option to choose model legislation).

165 *See* LOSS & SELIGMAN, *supra* note 18, at 50.

166 *See supra* note 42 and accompanying text (comparing the language of the model act for states found in the Uniform Securities Act of 1956 with the language of federal regulation 10b-5).

167 *See supra* note 58 and accompanying text.

168 *See supra* notes 44–49 (discussing the model statutory definition of fraudulent practices in connection with the sale or purchase of a security, sanctions for fraudulent practices, and precisely who is afforded the protection of these statutes).

169 *See supra* notes 38–40 (noting that 34 out of the 39 Uniform Securities Act Jurisdictions have adopted section 101—the general definition of fraudulent practices in connection with the sale or purchase of a security).

170 LOSS & SELIGMAN, *supra* note 18, at 60; *see also supra* note 18 (discussing of the arguments in favor of uniformity both between states and also between state and federal regulation).

171 *See generally* Part II.C.3. *See, e.g.*, Murphy v. Stargate Defense Sys. Corp., 498 F.3d 386 (6th Cir. 2007) (analyzing the unique instance of a stock-for-stock exchange in which it is difficult to determine who is the seller, and thus who is protected by the statute; this specific instance is not covered by Ohio's Blue Sky provision); *see also* Farmer & Feldman, *supra* note 93, at 822 (raising the obvious—yet critical—question as to what practical reasons exist for excluding defrauded sellers or securities?).

not to exclude implicit contingencies.[172] Thus, if truly seeking consistency, the model act must be able to account for all areas in which inconsistency is possible.[173]

Fitting squarely into this assessment is the Uniform Securities Act's omission of sellers of securities from the protection of state Blue Sky antifraud regulation.[174] Section 410(a) explicitly limits the statutory protection of the Act to buyers.[175] The Act would have been best served to preempt the possibility of leaving to state courts the responsibility of construing common-law seller remedies by simply including them with the remedies available to sellers.[176]

Although providing seller protection was not a concern to the drafters of the 1956 Act, it is nonetheless worth analyzing for two reasons.[177] First, this absence from the regulatory scheme seems to contravene the goals of uniformity.[178] Second, and most important to the analysis that follows, omitting sellers leaves unnecessary interpretive discretion to the courts, resulting in potentially inconsistent statutory construction that could be easily avoided.[179] To this end, the remainder of Part III explores these issues in the framework of the Sixth Circuit

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172 *See supra* note 58 and accompanying text. The NSMIA delegated to the SEC all aspects of securities regulation except for regulating fraud, which it specifically excluded. *See supra* note 58 and accompanying text. By a similar analysis, model statutes can promote uniformity only as to those provisions it mentions explicitly; model statutes cannot be expected to achieve uniformity as to that which is excluded. *See supra* note 58 and accompanying text.

173 *See infra* Part III.B (discussing, as a case in point, the failure to account for cases in which it might be difficult to define precisely who is the "purchaser" and who is the "seller" for purposes of statutory protection).

174 *See* LOSS & SELIGMAN, *supra* note 18, at 65 (quoting UNIF. SECURITIES ACT § 101, 7A U.L.A. 568 (1958), Draftsman's Commentary) (discussing the limitation to buyers as appropriate in light of common-law remedies of rescission). The drafters of the Act felt compelled to limit the protection to buyers because of the common-law and equitable remedies available to the state courts. *Id.*; *see also supra* note 42 (noting that the language of model section 410(a) excludes sellers from the category of "protected entity[]").

175 UNIF. SECURITIES ACT § 410(a), 7A U.L.A. 568 (1958), *reprinted in* LOSS & SELIGMAN, *supra* note 18, at 65.

176 *See infra* Parts III.B–C (discussing why sellers should be granted the same statutory remedies as buyers).

177 *See* LOSS & SELIGMAN, *supra* note 18, at 65 (quoting UNIF. SECURITIES ACT § 101, 7A U.L.A. 568 (1958), Draftsman's Commentary).

178 *See* McWilliams, *supra* note 18, at 253 n.53 (noting that the purpose behind the Uniform Securities Act of 1956 was to promote uniformity in the interpretation and administration of state regulation); *see also supra* note 172 and accompanying text (discussing how the omission of buyers necessarily hinders uniformity by inviting inconsistent judicial interpretation).

179 *See supra* Sections II.C.2–3 (discussing the issue of potentially inconsistent judicial interpretation in the context of the *Murphy* decision).

Court's interpretation of who is afforded statutory relief under Ohio Blue Sky Law in the case of a stock-for-stock exchange.[180]

B. The Murphy *Court's Broad Interpretation of Available Statutory Remedies Due to an "Unforeseen Variation in Factual Circumstances"*

To probe how Ohio's Blue Sky Law regulates a stock-for-stock exchange, this Note explores Ohio case law interpretation of the reasoning behind Ohio's Blue Sky statutes.[181] Although the language is not fashioned after the model statute, Ohio's fraud remedy statute operates similarly.[182] Both statutes provide a statutory cause of action exclusively to buyers of securities, and both statutes neglect to provide such relief to sellers in such transactions.[183] Thus, based on the plain meaning of these statutes, sellers and buyers are granted substantially different avenues of relief.[184] In order to unravel the meaning of this subtle distinction it is necessary to examine further the rationale behind Ohio's Blue Sky statutes.[185]

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180 *See infra* Parts III.B–C.

181 *See* United States v. Tehan, 365 F.2d 191, 194 (6th Cir. 1966) ("The power of the State to provide for the general welfare authorizes it to establish such regulations as will secure or tend to secure the people against ignorance often due from an incomplete disclosure of facts by one in the unique position to know the facts."); Bronaugh v. R. & E. Dredging Co., Inc., 242 N.E.2d 572, 576 (Ohio 1968) ("[T]he purpose . . . 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 from its own stupidity, gullibility and avariciousness.").

182 *Compare* UNIF. SECURITIES ACT § 410(a), 7A U.L.A. 568 (1958), *reprinted in* LOSS & SELIGMAN, *supra* note 18, at 65.

> Section 410(a) permits a buyer to sue either at law or in equity to recover the consideration paid for the security, together with interest at six per cent per year from the date of payment, costs, and reasonable attorney's fees, less the amount of any income received on the security, upon the tender of the security, or for damages if he no longer owns the security.

Id., *with* OHIO REV. CODE ANN. § 1707.43 (West, Westlaw through 2008 File 129 of the 127th Gen. Assembly) which provides, in pertinent part: "(A) Subject to divisions (B) [statute of limitations,] and (C) [correction of error by seller], every sale or contract for sale made in violation of Chapter 1707 of the Revised Code, is voidable at the election of the *purchaser*." *Id.* (emphasis added).

183 *See supra* note 182 and accompanying text.

184 *See supra* note 182 and accompanying text; *see also* Farmer & Feldman, *supra* note 93; *supra* note 94.

185 *See* LOSS & SELIGMAN, *supra* note 18, at 65 (quoting UNIF. SECURITIES ACT § 101, 7A U.L.A. 568 (1958), Draftsman's Commentary); *see also infra* Part III.C (discussing sections 1707.43's limitation to purchasers of securities in light of the statute's purpose of protecting individuals from incomplete disclosure of facts by one in a unique position to know all the facts).

Just as with statutory interpretation, much can be gleaned from the chosen language of the courts. In *United States v. Tehan*, the Sixth Circuit Court of Appeals discussed the reasons for the antifraud provisions, referring to aims of "secur[ing] the people against ignorance often due from an incomplete disclosure of facts by one in the unique position to know the facts."[186] In *Tehan*, the court does not distinguish between buyers and sellers regarding who needs protection of the laws; rather, the court specifically refers to protecting "the people . . . from an incomplete disclosure of the facts[.]"[187] Additionally, the *Tehan* Court does not limit its analysis to either buyers or sellers, thereby not foreclosing the possibility that a seller, too, could be in a "unique position" of not knowing all the facts.[188] Moreover, in *Holderman v. Columbus Skyline*, the Ohio Supreme Court found it necessary to construe the fraud statute broadly because it determined that the statute was drafted "to address unforeseen variations in factual circumstances."[189] It is apparent that the broad interpretation and application of Ohio's Blue Sky antifraud statutes, combined with the judicial recognition of the potential for unforeseen variations, support the contention that sellers, too, should be afforded statutory causes of action—or at the very least these judicial interpretations support the argument that the exclusion of

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186 United States v. Tehan, 365 F.2d 191, 194 (6th Cir. 1966).

187 *Id.*

188 *Id.* But when the buyer is "purchasing" from the seller by means of a stock, the positions are in essence reversed, placing the seller in the "unique position" of not knowing all the facts pertaining to the tendered security. *See* Murphy v. Stargate Defense Sys. Corp., 498 F.3d 386, 391 (6th Cir. 2007):

> Under the circumstances of the exchange of stock between the parties to this action, we hold that plaintiffs should be regarded as purchasers for purposes of Ohio's Blue Sky Law. 'The sale of a security . . . means among other things an exchange of securities, and as one who acquires by sale is a purchaser, so is a purchaser one who acquires by an exchange of securities.'

Id. (quoting Indem Ins. Co. of N. Am. v. Kircher, 191 N.E. 374, 376 (Ohio Ct. App. 1934); *see also* Bronaugh v. R. & E. Dredging Co., Inc., 242 N.E.2d 572 (Ohio 1968). *Bronaugh* cites the following as the purpose of the antifraud provisions: "[T]o prevent those persons willing to market worthless or unnecessarily risky securities from soliciting the purchasing public . . . and . . . to protect the public from its own stupidity, gullibility and avariciousness." *Id.* This is clearly language referencing a seller taking advantage of the purchasing public. However, this language does not prevent a broad interpretation of the statute; indeed, both the seller and the buyer could potentially market worthless or unnecessarily risky securities for sale, *or as a means of purchase*. *But see supra* note 3 and accompanying text (noting that the majority of securities fraud cases involve the seller as the party in the unique position of knowing all the facts).

189 Holderman, Comm'r v. Columbus Skyline Sec. (*In re* Columbus Skyline Sec., Inc.), 660 N.E.2d 427, 428 (Ohio 1996); *see* Geyer, *supra* note 69 (providing support of the *Columbus Skyline* Court's decision to affirm the state's expansive reach regarding fraud prosecution).

sellers should *not* preclude them from being afforded the same statutory remedies as buyers.[190]

It was not until the 2007 *Murphy* decision that such an unforeseen variation in the typical securities transaction tested the breadth of Ohio's Blue Sky antifraud statute.[191] Based on the precedent set forth herein, both the Ohio state courts and the federal courts appeared willing to construe the antifraud regulation in the Ohio Blue Sky Law as broadly as they saw fit in the particular situation, bearing in mind the possibility of an unforeseen variation.[192] But in a move seemingly contrary to the judicial reasoning of prior cases interpreting Ohio Blue Sky Law, the Northern District of Ohio did not construe section 1707.43 broadly; rather, the court strictly adhered to the plain language of the statute.[193]

Applying the unambiguous language of section 1707.43, the district court concluded that the Plaintiffs—determined by the court to be the *sellers* in the stock transaction—were not entitled to rescission under section 1707.43.[194] Following the precedent of prior decisions such as *Nickels*, the district court applied the language of section 1707.43 to the facts—Plaintiffs did not "purchase" stock, and therefore, they were not

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190 *See infra* Part IV (for this Note's proposed model statute and commentary).

191 *Murphy*, 498 F.3d 386.

192 *See*, *e.g.*, *Columbus Skyline*, 660 N.E.2d at 429 (holding that broad statutory language is essential in order to account for unforeseen situations); *see also supra* Sections II.C.1–3.

193 Murphy v. Stargate Defense Corp., No. 1:05 CV 2121, 2006 WL 721746, at *1 (N.D. Ohio Mar. 21, 2006), *aff'd in part, denied in part*, 498 F.3d 386 (6th Cir. 2007). In reaching this conclusion, the court relied on Nickels v. Koehler Mgmt. Corp., 541 F.2d 611, 616 (6th Cir. 1976) for the well-settled interpretation of section 1707.43 that the law "provides a remedy only for a defrauded purchaser, and not for a defrauded seller." *Murphy*, 2006 WL 721746 at *12 n.1.

194 *Id.* at *12. Surprisingly, and maybe most telling of the subtlety of the issue, is the fact that the court simply concluded the following without much analysis: "The March 18, 2005 transaction must be excluded from Plaintiffs' claims under the Ohio Blue Sky Law because Plaintiffs were sellers in the last transaction and the Ohio Blue Sky Law does not provide a remedy for defrauded sellers. *Id*. The only legal reasoning undertaken by the court was in a footnote. *See id*. at *12 n.1. In this footnote, the court addresses the buyer/seller distinction in a stock-for-stock exchange and follows the plain meaning of the statute:

> While neither party has addressed this issue, the Court's research indicates that Ohio's blue sky law provides a remedy only for a defrauded purchaser, not for a defrauded seller. In this case, Plaintiffs were purchasers in the first two stock purchases on January 25, 2002 and February 4, 2002. Plaintiffs were the *sellers* in the stock-for-stock transaction on March 18, 2005. Accordingly, their only recourse as defrauded sellers in the March 18, 2005 transaction is their federal cause of action under 10b-5 and their state law claim for common law fraud.

Id. (emphasis added). In so reasoning, the court references *Nickels*, most likely for the proposition of the unambiguous standard that the "law provides a remedy only for a defrauded purchaser, and not for a defrauded seller." *Nickels*, 541 F.2d at 616.

entitled to the rescission provision of section 1707.43.[195] But this surface analysis of the stock-for-stock exchange, although it is consistent with the statutory language, is nevertheless inconsistent with the purpose of the statute, as well as the interpretation of this purpose by Ohio courts.[196] As these courts have reasoned, the definition of a "purchaser" should be construed broadly to include one who acquires by an exchange of securities.[197] Indeed, it is this tension that proved to be the source of the Sixth Circuit court's disagreement with the district court.[198]

Fortunately for the Plaintiffs in *Murphy*, the Sixth Circuit Court of Appeals undertook a more critical analysis of section 1707.43's exclusion of sellers.[199] The court's reasoning went beyond a cursory analysis of section 1707.43 and supported Plaintiff's argument that because the deal was a trade, both parties acted as purchasers.[200] Looking to the purpose of Ohio Blue Sky Law, and specifically the unique nature of the transaction, the court reasoned that Plaintiffs should be treated as purchasers.[201] The reasoning of the Sixth Circuit Court is twofold: first, the purpose of the Blue Sky Law is to prevent the advertising of worthless securities; second, with this purpose in mind, the Court proceeded to apply a prior interpretation of an Ohio appellate court to this unique factual situation in order to give section 1707.43 an equitable interpretation.[202]

Ultimately, the Sixth Circuit court reached the proper result in *Murphy*, in spite of section 1707.43's omission of an explicit right of rescission to a defrauded seller in a stock-for-stock exchange.[203] Reaching this conclusion, the Sixth Circuit court reasoned that both parties were purchasers and provided a section 1707.43 right of rescission to Plaintiffs; this Note, however, ultimately contends that this interpretation is unnecessary because the rationale for providing the right of rescission to sellers in certain circumstances is the same as the

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195 *See supra* note 194 and accompanying text.

196 *See supra* note 79 and accompanying text.

197 *See* Murphy v. Stargate Defense Sys. Corp., 498 F.3d 386, 391 (6th Cir. 2007); Indem. Ins. Co. of N. Am. v. Kircher, 191 N.E. 374, 376 (Ohio Ct. App. 1934) ("The sale of a security[] . . . means among other things an exchange of securities, and as one who acquires by sale is a purchaser, so is a purchaser one who acquires by an exchange of securities.").

198 *Murphy*, 498 F.3d at 391.

199 *Id.*

200 *Id.* at 390.

201 *Id.*; *see also supra* note 110 and accompanying text.

202 *Murphy*, 498 F.3d at 390; *see also* United States v. Tehan, 365 F.2d 191, 194 (6th Cir. 1966) (holding that the purpose of the statute is to protect the party who is not in the unique position to know the facts.).

203 OHIO REV. CODE. ANN. § 1707.43 (West, Westlaw through 2008 File 129 of the 127th Gen. Assembly); Murphy, 498 F.3d 386.

original rationale for providing the right to purchasers.[204] To this end, Part III.C of this Note further explores how a stock-for-stock exchange demands a more comprehensive construction of Ohio's Blue Sky Law.[205]

C. *The Argument for Inclusion: Why the* Murphy *Reasoning Is Not Necessary*

An analysis of the parties in a stock-for-stock exchange leads to the conclusion that the distinction between buyer and seller is unnecessary.[206] Based on the legislative history and case law interpreting section 1707.43, it is clear that the intent was to protect less knowledgeable individuals from predatory acts of more savvy and sophisticated persons.[207] Most often, this situation is present in the form of an unsophisticated buyer purchasing from a savvy, knowledgeable, and potentially predatory seller.[208] As a result, section 1707.43 is structured specifically with these types of transactions in mind.[209] Notwithstanding its general applicability to these standard transactions, the language of section 1707.43 has proven ineffective in carrying out its purpose to the fullest extent possible.[210]

In a stock-for-stock exchange, one party acquires stock from another party in exchange for stock.[211] Just like a transaction involving a buyer and a seller, the stock exchange can be viewed from the perspective of which party is in a better position to know all the facts.[212] With a buyer and a seller, most often the seller is in the best position to know all the facts; therefore, it follows that the buyer is most likely to be a victim of fraud.[213] Returning to the case of a stock exchange, however, there is

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204 *Murphy*, 498 F.3d 386; *see also supra* note 79 and accompanying text.

205 *See infra* Part III.C.

206 *See infra* Part III.C; *see also infra* Part IV The author of this Note's commentary to the proposed model statute).

207 *See supra* note 79 and accompanying text.

208 *See supra* note 79 and accompanying text; *see also supra* note 3 and accompanying text.

209 OHIO REV. CODE. ANN. § 1707.43 (West, Westlaw through 2008 File 129 of the 127th Gen. Assembly).

210 United States v. Tehan, 365 F.2d 191, 194 (6th Cir. 1966) (holding that the regulations were intended to provide for the "general welfare . . . secur[ing] the people against ignorance often due from an incomplete disclosure of facts by one in the unique position to know the facts."); *see also* Holderman, Comm'r v. Columbus Skyline Sec. (*In re* Columbus Skyline Sec., Inc.), 660 N.E.2d 427 (Ohio 1996) (creating broad, sweeping statutory language was necessary in order to address potential unforeseen variations).

211 *See supra* note 103 and accompanying text; *see also supra* Part I (describing a stock-for-stock exchange modeled after the facts in *Murphy*).

212 *See Tehan*, 365 F.2d at 194 (differentiating the parties to a transaction based on one party's "unique position to know the facts.").

213 *See supra* note 3 and accompanying text (noting that sellers of securities are the most common perpetrators of fraud).

nothing inherent in the dynamics of the transaction that makes one party more likely to be a victim of fraud. Because the transaction is structured as an exchange, whereby either party could be more knowledgeable or vulnerable, it is in furtherance of public policy to grant both parties the right of rescission when one party becomes aware that the other party is acting fraudulently. Indeed, section 1707.43 would be most fulfilling of its purposes either by explicitly including the right of rescission for both buyers and sellers, or accounting for the instance of a stock-for-stock exchange, and therefore eliminating the need to delineate remedies based on a characterization of "buyer" or "seller."[214]

Moreover, there seems to be little logic in limiting the applicability of the right of rescission in a stock-for-stock transaction.[215] It is clear from both the legislative intent and case law that the statute was meant to enjoy a broad construction.[216] Moreover, public policy dictates protecting those investors who might be less knowledgeable than those in whom they are investing, regardless of whether they are considered to be a buyer or a seller.[217] Despite the fact that buyers are most often the defrauded party, this generality should not limit the breadth of a statute meant to serve equitable measures.[218] In the end, this distinction has little basis in logic.[219]

Ultimately, section 1707.43 needs to be amended to include all parties that could be victimized by fraud. For the courts, this statutory clarification will remove the need for abhorring equity at the altar of strict statutory interpretation, and will further eliminate the need for

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214 *See supra* note 79 and accompanying text.

215 *See* Farmer & Feldman, *supra* note 93, at 822 (wondering why, because misstatements and omissions can just as easily induce a sale as a purchase, does the statute not provide a civil remedy for defrauded *sellers*?).

216 *See* Geyer, *supra* note 69, at 301 n.1 (quoting Ohio State Bar Association Corporation Law Committee Comments Accompanying the 1929 Amendments to the Ohio Securities Act, *reprinted in* HOWARD FRIEDMAN, OHIO SECURITIES LAW & PRACTICE 23 (Supp. 1994)) (noting that the broad, inclusive powers given to the Division of Securities will enable discovery, prevention, and punishment of fraud). *See* United States v. Tehan, 365 F.2d 191, 194 (6th Cir. 1966) (holding that the regulations were intended to combat incomplete disclosure by protecting those parties not in the best position to know all the facts); *see also* Holderman, Comm'r v. Columbus Skyline Sec. (*In re* Columbus Skyline Sec., Inc.), 660 N.E.2d 427 (Ohio 1996) (creating broad statutory language to account for unconsidered situations).

217 *See* Bronaugh v. R. & E. Dredging Co., Inc., 242 N.E.2d 572 (Ohio 1968) (holding that the purpose of securities regulation is to protect the public from acquiring securities that might be worthless or unnecessarily risky).

218 *See supra* note 3 and accompanying text; *see also Columbus Skyline*, 660 N.E.2d 427 (holding that the securities statute should be construed broadly, so as not to exclude potentially fraudulent conduct).

219 *See* Farmer & Feldman, *supra* note 93 (noting that there is no reason for preventing sellers of securities from having a statutory remedy for fraud).

legal analysis aimed at achieving a desired result.[220] Therefore, section 1707.43 of Ohio's Blue Sky Law should be amended to clarify the law, and ultimately give effect to the original intended purposes of the legislation.

IV. PROPOSED AMENDMENT TO OHIO REV. CODE ANN. § 1707.43

[A]s one who acquires by sale is a purchaser, so is a purchaser one who acquires by an exchange of securities.[221]

Ohio's Blue Sky Law was enacted to provide statutory relief to a party defrauded in a securities transaction.[222] In interpreting the language of Ohio Blue Sky statutes, the Ohio Supreme Court has suggested construing the statute broadly in order to "address unforeseen variations in factual circumstances[,]" and ultimately not to exclude potentially fraudulent conduct.[223] In tension with this judicial guidance is the clear language of section 1707.43, which provides the right of rescission only to "purchasers" of securities.[224] Illustrative of this tension is the case of rescission of a stock-for-stock exchange, in which the parties do not fit squarely into the buyer-seller framework of section 1707.43.[225] To account for this unforeseen variation not provided for in the statute, this Note proposes an amendment to section 1707.43 in an effort to include both parties to a stock-for-stock exchange.[226]

Section 1707.43 should not limit the right of rescission to buyers of securities.[227] To realize the full extent of its purpose, section 1707.43 should include both parties to account for fraud perpetrated in a stock-for-stock exchange.[228] The amended statute appears as follows, with the author's commentary inserted throughout:

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220 *See*, *e.g.*, Murphy v. Stargate Def. Sys. Corp., 498 F.3d 386, 391 (6th Cir. 2007).

221 Indem. Ins. Co. of N. Am. v. Kircher, 191 N.E. 374, 376 (Ohio Ct. App. 1934).

222 *See supra* note 79 and accompanying text.

223 *See Columbus Skyline*, 600 N.E.2d at 429.

224 OHIO REV. CODE. ANN. § 1707.43 (West, Westlaw through 2008 File 129 of the 127th Gen. Assembly); *see* Nickels v. Koehler Mgmt. Corp., 541 F.2d 611, 616 (6th Cir. 1976) (interpreting the statutory right of rescission under section 1707.43 as follows: "The blue sky law provides a remedy only for a defrauded purchaser, and *not for a defrauded seller*[]") (emphasis added).

225 *See*, *e.g.*, *Murphy*, 498 F.3d at 391.

226 *See infra* notes 227–48.

227 § 1707.43 ("[E]very sale or contract for sale made in violation of Chapter 1707. of the Revised Code, is voidable at the election of the *purchaser*.") (emphasis added).

228 *See supra* notes 216–17 and accompanying text.

Proposed Amendment to OHIO REV. CODE § 1707.43[229]

> (A) Every sale, ~~or~~ contract for sale, or exchange of securities made in violation of Chapter 1707. of the Revised Code, is voidable at the election of the purchaser or one who acquires by an exchange of securities. The person making such sale, ~~or~~ contract for sale, or exchange of securities, and every person who has participated in or aided the seller in any way in making such sale, ~~or~~ contract for sale, or exchange of securities, are jointly and severally liable to such purchaser or one who acquires by an exchange of securities, in an action at law in any court of competent jurisdiction, upon tender to the seller in person or in open court of the securities sold or exchanged, or of the contract made, for the full amount paid by such purchaser or one who acquires by an exchange of securities and for all taxable court costs, unless the court determines that the violation did not materially affect the protection contemplated by the voided provision.

Commentary

First, by expanding the scope of the statute from "sale" to "sale or exchange of securities," the proposed amendment clarifies its applicability to a stock-for-stock exchange.[230] This clarification will ultimately free the courts from the burden of having to determine whether the right of rescission applies to a stock-for-stock exchange.[231] Second, and most importantly, adding after "purchaser" the phrase "or one who acquires by an exchange of securities" will allow for the inclusion of both parties to a stock-for-stock exchange.[232] No longer will the courts be forced to categorize parties in order to determine the applicability of the statute.[233] As a result of this change, no longer will

[229] The proposals are the contributions of the author. Proposed additions are underlined, and proposed deletions are struck out. The language in regular font is taken from § 1707.43.

[230] *See* § 1707.43. *See also* Indem. Ins. Co. of N. Am. v. Kircher, 191 N.E. 374, 376 (Ohio Ct. App. 1934). Here, the Court was forced to categorize a stock-for-stock exchange as a sale. *Id.* The court reasoned, "The sale of a security . . . means among other things an exchange of securities, and as one who acquires by sale is a purchaser, so is a purchaser one who acquires by and exchange of securities." *Id.*

[231] *See supra* note 220.

[232] *See* § 1707.43.

[233] *See*, *e.g.*, Murphy v. Stargate Def. Sys. Corp., 498 F.3d 386 (6th Cir. 2007).

the right of rescission in a stock-for-stock exchange be limited to the party determined by the court to be the "purchaser."[234]

> (B) No action for the recovery of the purchase price or rescission of the exchange as provided for in this section, and no other action for any recovery based upon or arising out of a sale, ~~or~~ contract for sale, or exchange of securities made in violation of Chapter 1707. of the Revised Code, shall be brought more than two years after the plaintiff knew, or had reason to know, of the facts by reason of which the actions of the person or director were unlawful, or more than four years from the date of such sale, ~~or~~ contract for sale, or exchange of securities, whichever is the shorter period.
>
> (C) No purchaser or one who acquires by an exchange of securities is entitled to the benefit of this section who has failed to accept, within thirty days from the date of such offer, an offer in writing made after two weeks from the date of such sale, ~~or~~ contract of sale, or exchange of securities, by the seller or by any person who has participated in or aided the seller in any way in making such sale, ~~or~~ contract of sale, or exchange of securities, to take back the security in question and to refund the full amount paid by such purchaser or void the exchange of securities.

Commentary

In the second and third sections of proposed section 1707.43, the changes made to proposed section 1707.43(A) have been incorporated.[235] Additionally, the right to "refund the full amount paid by such purchaser" has been supplemented with the option to "void the exchange of securities."[236] In parts (B) and (C), the proposed amendment seeks to expand the right of rescission that was limited to a purchaser of securities to both parties in a stock-for-stock exchange.[237]

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234 *See id.* Constrained by the limitation of section 1707.43 to purchasers of securities, the Court in *Murphy* was forced to reason that, in a stock-for-stock exchange, one party effectively purchases shares from the other corporation. *Id.* at 391.

235 *See supra* notes 230–34.

236 *See* § 1707.43.

237 *See supra* notes 206–20.

Opponents of the proposed amendment are likely to make the following arguments. First, states have the police power to regulate securities fraud as they see fit, so why should Ohio broaden its statute?[238] Second, because the Uniform Securities Act of 1956 does not extend statutory protection to sellers, why should Ohio Blue Sky Law?[239] Third, if the statute does not provide an explicit right of rescission, why not pursue common law remedies that are already in place?[240] Each of these arguments is addressed in turn.

The first argument can be attacked simply by looking to the intent of Ohio Blue Sky Law, and determining that limiting the right of rescission contravenes the goal of broad, sweeping applicability vis-à-vis regulating fraud.[241] Second, relying on section 410 of the 1956 Act simply begs the question.[242] Third, forcing one party to resort to common law remedies necessitates an inherent distinction between the two parties, and this Note contends that there is no logical reason for providing the right of rescission to one party but not the other in a stock-for-stock exchange.[243] Moreover, it is the party in the position not likely to be aware of all the facts that should be afforded the statutory right of rescission, and in the case of a stock-for-stock exchange, either party can potentially assume this position.[244]

Ultimately, this proposed amendment to section 1707.43 would eliminate the need for such judicial reasoning found in the quote at the heading of this section.[245] No longer will courts be forced to construe parties to a stock-for-stock exchange as either a "purchaser" or a

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238 *See* New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting). Speaking to the state and federal regulation uniformity debate, Justice Brandeis noted that "It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory[,] and try novel social and economic experiments without risk to the rest of the country." *Id.*

239 *See supra* notes 46–47.

240 *See* Geyer, Miglets, & Rowley, *supra* note 89, at 941 (noting that Ohio common law supplements the Securities Act with attractive alternatives in the form of state common law fraud claims); Matia, *supra* note 89 (discussing the various remedies available to parties in securities transactions).

241 *See supra* notes 79, 83.

242 UNIF. SECURITIES ACT § 410(a), 7A U.L.A. 568 (1958), *reprinted in* LOSS & SELIGMAN, *supra* note 18, at 65; *see also supra* note 80 (noting that Ohio is not a Uniform Securities Act jurisdiction; and consequently, it has used more expansive language pertaining to fraud).

243 *See supra* notes 215–19.

244 *See* United States v. Tehan, 365 F.2d 191, 194 (6th Cir. 1996) (holding that states should provide regulations that "tend to secure the people against ignorance often due from an incomplete disclosure of facts by *one in the unique position to know the facts*[]") (emphasis added).

245 *See supra* note 221.

"seller."[246] As a result, no longer will such parties seeking rescission under section 1707.43 find the fate of their claim in the hands of judicial interpretation.[247] The proposed amendments to section 1707.43 will expand the applicability of the statute, both fulfilling the original intent of Ohio Blue Sky Law and eliminating the possibility of inconsistent judicial interpretation.[248]

V. CONCLUSION

Returning to the rescission claims set forth in Part I, B's suit against A in state court for rescission of a stock-for-stock exchange under current section 1707.43 will likely be successful, but surely not guaranteed.[249] Likewise, after the *Murphy* court clarified the issue, Z's suit against Y in federal court will also likely be successful.[250] Unfortunately for both B and Z, to rescind statutorily a stock-for-stock exchange under current section 1707.43, the court must first find that they are each a "purchaser" of securities.[251] Inconsistent judicial interpretation should not be determinative; both B and Z are entitled to the assurance that the right of rescission will be available to them under the statute. For this reason, it is clear that section 1707.43 needs to be amended to expand the scope of its applicability.

It would be naïve to expect statutes to account for the potentiality of all unforeseen variations in factual circumstances. If this were the case, then our judiciary would cease to function as an interpreter of the law. However, it is through judicial interpretation that the law grows and develops. If the courts find vagueness or ambiguity in the language, then the legislature needs to amend its language. In the case of remedies available to a defrauded party in a stock-for-stock exchange, Ohio courts

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246 *See*, *e.g.*, Murphy v. Stargate Def. Sys. Corp., 498 F.3d 386, 391 (6th Cir. 2007).

247 *See supra* Part III.C (describing how courts have interpreted the language of Ohio's Blue Sky Law, specifically the rescission provision of section 1707.43).

248 *See supra* Part IV.

249 *See* Nickels v. Koehler Mgmt., 541 F.2d 611, 616 (6th Cir. 1976) ("The blue sky law provides a remedy only for a defrauded purchaser, and not for a defrauded seller."). But if the state court were to abide by the instructions of the *Columbus Skyline* Court to construe the statute broadly in order "to address unforeseen variations in factual circumstances[,]" it would likely find that B is entitled to the right of rescission. Holderman, Comm'r v. Columbus Skyline Sec. (*In re* Columbus Skyline Sec., Inc.), 660 N.E.2d 427, 429 (Ohio 1996).

250 498 F.3d at 391 ("[P]laintiffs should be regarded as purchasers for purposes of Ohio's Blue Sky Law . . . . The sale of a security . . . means among other things an exchange of securities, and as one who acquires by sale is a purchaser, so is a purchaser one who acquires by an exchange of securities.") (quoting Indem Ins. Co. of N. Am. v. Kircher, 191 N.E.374, 376 (Ohio Ct. App. 1934)).

251 *See* OHIO REV. CODE ANN. § 1707.43 (West, Westlaw through 2008 File 129 of the 127th Gen. Assembly).

have spoken. After the *Murphy* Court's analysis of section 1707.43, it is clear that the statute needs to be amended.

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