Has My Bank Violated the Ohio Securities Act? The Bullet Point: Volume 2, Issue 17

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The Bullet Point is a biweekly update of recent, unique, and impactful cases in Ohio state and federal courts in the area of commercial litigation.

Ohio Securities Act Liability

Boyd v. Kingdom Trust Co., 2018-Ohio-3156

In this appeal of a certified question to the Ohio Supreme Court, the court found that R.C. 1707.43, a provision of the Ohio Securities Act, does not impose joint and several liability on persons who aided in the purchase of illegal securities but who did not participate or aid in the sale of the illegal securities.

The plaintiffs in the case were victims in a Ponzi scheme. The defendant allegedly convinced plaintiffs to open self-directed individual retirement accounts (IRAs) to invest in equity interests in companies he owned. The defendant then convinced plaintiffs to give him powers of attorney, giving him the ability to direct the companies' purchases of securities using the plaintiffs' IRA assets. He then used the money raised from the plaintiffs to pay off earlier investors or to fund his own personal expenses. Eventually, plaintiffs filed a class action against defendant and his companies for violating the Ohio Securities Act. The complaint does not allege that the companies themselves had any role in the Ponzi scheme or that they knew of the fraud committed by defendant. The companies moved to dismiss the lawsuit, and the district court granted the motion. Finding the absence of any allegation that the trust companies acted outside the scope of routine banking activities, the district court held that their mere involvement in the transactions is insufficient to impose liability on them under the Ohio Securities Act.

On appeal, the Sixth Circuit Court of Appeals certified a question to the Ohio Supreme Court on whether "R.C. 1707.43 impose[s] joint and several liability on a person who, acting as the custodian of a self-directed IRA, purchased—on behalf and at the direction of the owner of the self-directed IRA—illegal securities?"

The Ohio Supreme Court answered the question in the negative, finding that the statute at issue only imposes joint and several liability on three people: (1) the person making a sale or contract for sale of illegal securities, (2) "every person that has participated in * * * such sale or contract for sale," and (3) "every person that has * *

* aided the seller in any way in making such sale or contract for sale." The Court applied normal rules of statutory construction and found that if the General Assembly had wanted to expand the potential individuals who could have been liable for a violation of R.C. 1707.43, it could have done so.

The Bullet Point: The Ohio Securities Act, R.C. 1707.01 et seq., governs the sale and purchase of securities in Ohio. The act requires securities to be registered (R.C. 1707.08 through 1707.13), imposes licensing requirements on dealers and salespersons (R.C. 1707.14 through 1707.19), and proscribes fraudulent conduct (R.C. 1707.44). R.C. 1707.43 states: "[t]he 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 * * * for the full amount paid by the purchaser and for all taxable court costs * * *."

Ohio courts have held that a financial institution's mere participation in a transaction, absent any aid or participation in the sale of illegal securities, does not give rise to liability under R.C. 1707.43(A). As one court noted, "the willingness of a bank to become the depository of funds does not amount to a personal participation or aid in the making of a sale." Despite this, the Ohio Supreme Court cautioned: "[n]othing in our holding today would insulate from liability a self-directed IRA custodian who colludes with the seller in an unlawful sale of securities or actively participates or aids in the sale of illegal securities."

Writ of Procedendo

State ex rel. Sponaugle v. Hein, Slip. Op. No. 2018-Ohio-3155.

In this case, the Ohio Supreme Court affirmed the judgment of the court of appeals denying Appellant's complaint for writs of prohibition and procedendo against Darke County Court of Common Pleas Judge Jonathan P. Hein, holding that Appellant was not entitled to either writ. The petitioners were defendants in a foreclosure action before Judge Hein. He eventually granted the bank a judgment entry and decree in foreclosure, and the petitioners appealed. While the appeal was pending, they failed to post a bond to avoid the foreclosure sale, and the sale eventually happened, with the bank purchasing the property at sale. At the same time, the appellate court dismissed the appeal for lack of a final appealable order. Despite this, Judge Hein entered an order confirming the sale and the property was transferred to the bank. Petitioners then filed the various writs with the appellate court who denied both. On appeal the Ohio Supreme Court affirmed, finding that procedendo was inappropriate because Petitioners sought to undo a court order rather than to compel the judge to issue a ruling. Similarly, the court found that a writ of prohibition was improper because it was moot based on the appeals court vacating the confirmation of sale order.

The Bullet Point: "A writ of procedendo is appropriate when a court has either refused to render a judgment or has unnecessarily delayed proceeding to judgment." It is not appropriate to undo a court ruling. Likewise, to be entitled to a writ of prohibition, a party must establish that the court exercised judicial power or is about to do so, that the court lacks authority to exercise that power, and that denying the writ would result in injury for which no adequate remedy exists in the ordinary course of the law. If a court patently and unambiguously lacks jurisdiction, then a petitioner does not need to establish the third element to be entitled to a writ of prohibition. However, when jurisdiction is not patently and obviously absent, " 'an appeal is generally considered an adequate remedy in the ordinary course of law sufficient to preclude a writ.' "

Cognovit Note

1st Natl. Fin. Servs. v. Ashley, 10th Dist. Franklin No. 17AP-638, 2018-Ohio-3134.

In this case, the Tenth Appellate District reversed the trial court's decision denying a common law motion to vacate. Defendant had obtained a loan from the plaintiff and executed a loan repayment agreement. The plaintiff eventually filed suit, claiming the defendant failed to make payments as agreed under the loan. To resolve that issue, the parties entered into a payment arrangement, but again, the defendant breached the terms of the agreement. To remedy that breach, the plaintiff contended that the defendant agreed to sign a cognovit note. Defendant allegedly defaulted under that and the plaintiff initiated a new lawsuit under the cognovit note. In accordance with its terms, an answer was filed on behalf of the defendant confessing to judgment and the court entered judgment on the note and subsequently garnishment proceedings began.

Defendant filed a motion to vacate the judgment, arguing that the municipal court lacked subject-matter jurisdiction over the action. The trial court disagreed and defendant appealed. On appeal, the Tenth Appellate District reversed, finding that the underlying arrangement was a consumer transaction and, by law, the court lacked subject matter jurisdiction to enter judgment on a cognovit note when it involved such a transaction.

The Bullet Point: "The cognovit is the ancient legal device by which the debtor consents in advance to the holder's obtaining a judgment without notice or hearing, and possibly even with the appearance, on the debtor's behalf, of an attorney designated by the holder." Strict compliance with statutory requirements is required to obtain judgment on a cognovit note. "A cognovit judgment is valid if the warrant of attorney to confess judgment and all note terms are strictly construed against the person obtaining the judgment, and court proceedings, based upon such warrant, must conform to every essential detail with the statutory law governing the subject."

Notwithstanding the long legal recognition of cognovit notes in Ohio, the General Assembly has curtailed the use of cognovit notes in consumer transactions. R.C. 2323.13(E) provides that "[a] warrant of attorney to confess judgment contained in any instrument executed on or after January 1, 1974, arising out of a consumer loan or consumer transaction, is invalid and the court shall have no jurisdiction to render a judgment based upon such a warrant." A consumer loan is defined as "a loan to a natural person and the debt incurred is primarily for a personal, family, educational, or household purpose." R.C. 2323.13(E)(1). If a cognovit note arises out of a consumer loan or a consumer transaction, then a judgment entered based on that cognovit note is void and must be vacated for lack of subject-matter jurisdiction.

Jurisdictional Priority Between Probate and Common Pleas Courts

Sosnoswsky v. Koscianski, 8th Dist. Cuyahoga No. 106147, 2018-Ohio-3045.

In this case, the Eighth Appellate District found that the "jurisdictional priority rule" did not apply to the concurrent pending lawsuits in both probate court and the common pleas court involving the same or similar claims. Specifically, the Eighth Appellate District noted that probate courts are courts of limited jurisdiction and only have concurrent jurisdiction with the common pleas in very specific, enumerate situations, none of which applied here.

The Bullet Point: "The jurisdictional priority rule prevents the prosecution of two actions involving the same controversy in two courts of concurrent jurisdiction at the same time." "The jurisdictional priority rule provides that 'as between [state] courts of concurrent jurisdiction, the tribunal whose power is first invoked by the institution of proper proceedings acquires jurisdiction, to the exclusion of all other tribunals, to adjudicate upon the whole issue and to settle the rights of the parties.'"

Ohio's Uniform Fraudulent Transfer Act

UBS Fin. Servs., Inc. v. Lacava, 8th Dist. Cuyahoga No. 106461, 2018-Ohio-3055.

Defendant's husband used to work for the plaintiff. During the course of his employment, he received two loans from the plaintiff, secured through promissory notes. The husband was terminated in 2008 and as of the date of his termination, had not yet satisfied the full amount owed on the loans. The husband eventually commenced a Financial Industry Regulatory Authority (FINRA) claim against the plaintiff, raising various tort claims, and the plaintiff filed a counterclaim for the balances owed on the loans. Eventually, the FINRA panel denied the husband's claims and awarded judgment to the plaintiff.

While the FINRA proceedings were ongoing, defendant's husband formed his own investment management company and eventually gave defendant most of the ownership interest in the company. Plaintiff then began to try and collect on its judgment and uncovered the company and financial arrangement the defendant's husband had entered into to shield his assets. The plaintiff sought to unwind the transaction under a theory of fraudulent transfer, and eventually, the trial court granted the plaintiff judgment.

Defendant appealed but the Eighth Appellate District affirmed, finding that the plaintiff sufficiently established fraud under Ohio's Uniform Fraudulent Transfer Act, and the defendant failed to rebut the presumption of fraud by failing to establish that the transfer was made in good faith and/or that she paid "reasonably equivalent value" for the transfer of ownership in the company.

The Bullet Point: Ohio's Uniform Fraudulent Transfer Act (UFTA), set forth in R.C. Chapter 1336, creates a right of action for a creditor to set aside an allegedly fraudulent transfer of assets. A creditor seeking to vacate a fraudulent transfer must prove the essential elements of fraudulent conveyance by clear and convincing evidence. “If a transfer is fraudulent, then a creditor has the right to sue the original transferee and any subsequent transferee for the value of the transferred property.”

To set forth a claim under R.C. 1336.04, a creditor must show (1) a conveyance or incurring of a debt, (2) made with actual intent to defraud, hinder, or delay, and (3) present or future creditors.

Since “intent to defraud” can be so hard to prove, the law outlines “badges of fraud” (i.e. factors) that courts consider in determining whether a transfer of assets was fraudulent:

1. Whether the transfer or obligation was to an insider;
1. Whether the debtor retained possession or control of the property transferred after the transfer;
1. Whether the transfer or obligation was disclosed or concealed;
1. Whether before the transfer was made or the obligation was incurred, the debtor had been sued or threatened with suit;
1. Whether the transfer was of substantially all of the assets of the debtor;
1. Whether the debtor absconded;
1. Whether the debtor removed or concealed assets;
1. Whether the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;
1. Whether the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
1. Whether the transfer occurred shortly before or shortly after a substantial debt was incurred;
2. Whether the debtor transferred the essential assets of the business to a lienholder who transferred the assets to an insider of the debtor.

A creditor does not have to prove every “badge” in order to establish a fraudulent transfer.