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THOUGHTS ON BORROWING FEDERAL SECURITIES JURISPRUDENCE UNDER THE UNIFORM SECURITIES ACT

MARTIN C. McWILLIAMS, JR.*

I. INTRODUCTION

The South Carolina Uniform Securities Act (SCUSA),¹ enacted in 1961, has substantial implications for those conducting their affairs within its jurisdictional reach; it is complex and in some respects obscure. In addition, virtually no aids to its construction are available. This situation is as troublesome to the courts as it is to those seeking to comply with the terms of the Act. The South Carolina courts have sought help from the federal cases. As the South Carolina Court of Appeals has expressed it, "In construing the South Carolina Uniform Securities Act, our courts look for guidance to cases interpreting the federal [securities regulation] statute."² The purpose of this Article is to

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1. S.C. CODE ANN. §§ 35-1-10 to -1590 (1976).

2. *McGaha v. Mosley*, 283 S.C. 268, 273, 322 S.E.2d 461, 464 (1984) (citing *Bradley v. Hullander*, 272 S.C. 6, 249 S.E.2d 486 (1978)). Strictly speaking, *Bradley* stands for a more limited proposition. In *Bradley* the South Carolina Supreme Court decided that in construing a Uniform Act provision which had been "taken almost verbatim from [a provision of] the Securities Act of 1933," cases interpreting that federal law provision, "while not binding authority in this Court, are looked to for guidance in interpreting the

consider this proposition and its implications for the application of the SCUSA.

Many provisions of the SCUSA are textually similar to provisions of federal securities regulation statutes.³ In some cases these similar provisions were borrowed from earlier blue sky laws for the federal statute. In other cases the blue sky laws borrowed provisions from the federal statute. This shared heritage, culminating in similarly worded provisions, inclines us to construe such provisions similarly.⁴

The Uniform Securities Act (Uniform Act),⁵ which was the model for the SCUSA and more than thirty other state securities statutes,⁶ contains much material borrowed from the federal securities laws.⁷ Professor Loss, the principal draftsman of the Uniform Act, has written that he hoped for “interchangeability”

corresponding [Uniform Act] provision with which we are dealing.” *Id.* at 21, 249 S.E.2d at 494.

3. Principal reference is to the Securities Act of 1933, 15 U.S.C. §§ 77a-77ff (1982 & Supp. II 1984 & Supp. III 1985) [hereinafter Securities Act], and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1982 & Supp. I 1983 & Supp. II 1984 & Supp. III 1985) [hereinafter Exchange Act], including, in each case, the applicable rules and regulations.

4. For example, in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), the United States Supreme Court gave “investment contract,” a term found in the federal definition of “security,” *see* Securities Act § 2(1), 15 U.S.C. § 77b(1) (1982); Exchange Act § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1982), the broad meaning that the term had acquired in state blue sky usage. The *Howey* court observed that when Congress included “investment contract” in the definition of “security,” it “was using a term the meaning of which had been crystallized by . . . prior [state] judicial interpretation.” *Id.* at 298 (citing *State v. Gopher Tire & Rubber Co.*, 146 Minn. 52, 56, 177 N.W. 937, 938 (1920)).

5. UNIF. SEC. ACT, 7B U.L.A. 515-680 (1958) (superceded 1985). For a concise description of the Uniform Securities Act, *see* L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION, 9-12 (1983) [hereinafter FUNDAMENTALS].

6. *See* 1 Blue Sky L. Rep. (CCH) ¶ 5501 (1986).

7. An example of this borrowing is the investment advisor provisions of the Uniform Securities Act. *See* L. LOSS & E. COWETT, BLUE SKY LAW 241 (1958); *see also* S.C. CODE ANN. §§ 35-1-1220 to -1230. Securities Exchange Commission rule 10b-5, 17 C.F.R. § 240.10b-5 (1986), was the model for the securities fraud provision of the Act, *see* S.C. CODE ANN. § 35-1-1210 (1976), but the implied private right of action under rule 10b-5 was not intended to be carried over, *see* L. LOSS, COMMENTARY ON THE UNIFORM SECURITIES ACT, at 6-8 (1976) [hereinafter COMMENTARY]. The broad definition of fraud, *see* S.C. CODE ANN. § 35-1-20(4) (1976), “codifies holdings that ‘fraud’ as used in federal and state securities statutes, as well as the federal mail fraud statute, is not limited to common-law deceit.” COMMENTARY, *supra*, at 3. Other important definitions were modeled on their federal counterparts, for example, “issuer,” “person,” “sale,” “offer,” and “security.” *See* S.C. CODE ANN. § 35-1-20 (1976); COMMENTARY, *supra*, at 99-108. For further examples of Act provisions modeled on federal ones and for an understanding of the relative closeness of the modeling, *see* generally COMMENTARY, *supra*.

between state and federal precedent in certain areas.⁸ In the case of the SCUSA, "interchangeability," as a practical matter, means one-way borrowing by state courts. There is vastly more judicial and academic gloss upon the federal statutes than upon the South Carolina statute. Consequently, there is more opportunity and temptation to borrow from the federal statute.

Borrowing can be beneficial because it keeps South Carolina securities law up-to-date and engrafts learning and erudition upon the State's relatively sparse securities jurisprudence. Such borrowing also serves substantial "inclusive"⁹ interests in uniformity among state schemes of securities regulation and in coordination (that is, minimization of conflict) with the federal scheme. Nevertheless, pursuit of the goals of convenience and uniformity should not, without analysis, subsume other, "exclusive" state values and interests. If employed mechanically as a rule of construction, wholesale borrowing can become a substitute for analysis. Wholesale borrowing is dangerous when borrowed material proceeds from an analytical basis different from that which underlies the local law.¹⁰ It is a familiar idea in the law that a word can have different meanings according to the purpose underlying its use.¹¹ Accordingly, although the borrowing of the construction of similarly worded statutes may be useful, a consideration of the appropriateness of the basis for that construction in terms of local values and interests must accompany statutory borrowing by state courts.¹² A consideration of

8. *E.g.*, COMMENTARY, *supra* note 7, at 147.

9. This term is liberally borrowed from Professor McDougal's comprehensive interest analysis relating to conflict of laws. It refers to the propriety of decisionmaking by one state based upon values that are not peculiar to that state but in respect of which all of the states are interdependent. *See, e.g.*, R. LEFLAR, L. McDUGAL & R. FELIX, *AMERICAN CONFLICTS LAW*, at 322-24 (1982).

10. *See, e.g.*, *People v. Terranova*, 38 Colo. App. 476, 480, 563 P.2d 363, 366 (1977) (federal authorities are "highly persuasive" to the extent that "the purposes and provisions of our statute parallel those of the federal enactments").

11. "Congress itself has cautioned that the same words may take on a different coloration in different sections of the securities laws." *SEC v. National Sec., Inc.*, 393 U.S. 453, 465-66 (1969); *see, e.g.*, *United Hous. Found. v. Forman*, 421 U.S. 837, 849, *reh'g denied*, 423 U.S. 884 (1975) (quoting *Church of the Holy Trinity v. United States*, 143 U.S. 457, 459 (1892)); *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 350-51 (1943); *Briggs v. Sterner*, 529 F. Supp. 1155, 1174 (S.D. Iowa 1981) ("any ambiguous language contained in the blue sky laws must be construed to effect the primary purpose of such laws"); *Thiel v. Taurus Drilling Ltd.*, 710 P.2d 33, 37 (Mont. 1985).

12. "This court will construe the provisions of the state statute 'not in total disre-

appropriateness of borrowing federal jurisprudence for the SCUSA requires inquiry into the purposes of the SCUSA, which follows.

II. PURPOSES AND POLICIES UNDERLYING THE SCUSA

The starting point in determining legislative intent is the plain language of the statute.¹³ The words of the SCUSA leave little doubt that its fundamental purpose is the protection of those who invest or are invited to invest in securities.¹⁴ How are the provisions of the Act to be implemented to accomplish this purpose? How broad in scope is the statute meant to be? Is it primarily penal in nature, or is it regulatory, or is it meant to provide compensatory and restitutionary remedies? One could ask many similar questions. The identification of some unifying theme of implementation of the Act would promote harmonious and predictable answers to such questions.

The Legislature provided no express guidance to the inter-

gard of federal interpretations of identical language, but with reference to the wisdom of adopting those interpretations for our state.” *State v. Hawaii Mkt. Center*, 52 Haw. 642, 647 n.2, 485 P.2d 105, 108 n.2 (1971) (quoting *State v. Teixeira*, 50 Haw. 138, 142 n.2, 433 P.2d 593, 597 n.2 (1967)); *see also* *Diamond v. LaMotte*, 709 F.2d 1419, 1423 (11th Cir.), *reh’g denied*, 716 F.2d 914 (11th Cir. 1983) (federal court declined to construe Georgia state securities law provision following parallel federal law provision for lack of indication that such borrowing was appropriate).

13. *Kansas State Bank v. Citizens Bank*, 737 F.2d 1490, 1496 (8th Cir. 1984) (plain language is “best” but must be read in light of statutory purposes and objectives); *see also* *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 685 (1985), in which Justice Powell stated, “It is axiomatic that ‘[T]he starting point in every case involving construction of a statute is the language itself.’” (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring)).

14. *See, e.g.*, S.C. CODE ANN. § 35-1-50 (1976) (requiring approval by the Securities Commissioner of securities sales and advertising literature); *id.* § 35-1-160 (making unlawful any false or misleading statements in documents filed with the Commissioner); *id.* § 35-1-330 (power of Commissioner to revoke certain exemptions from registration); *id.* §§ 35-1-410 to -620 (registration and regulation of brokers, dealers and investment advisers); *id.* § 35-1-810 (requirement of registration of nonexempt offerings and securities); *id.* § 35-1-1010 (grounds for issuance of stop order by Commissioner, including insufficient or inadequate disclosure, tendency of the stopped offering to “work a fraud upon purchasers,” or unreasonable promoter’s commissions or profits); *id.* § 35-1-1210 (making unlawful fraud or material misstatements or omissions in the “offer, sale or purchase of any security”); *id.* § 35-1-1220 (making unlawful deceptive advertising of securities); *id.* § 35-1-1490 (private action for buyers of securities); *id.* § 35-1-1580 (powers of Commissioner and Attorney General to institute criminal proceedings founded upon SCUSA violations).

pretation of the SCUSA. Courts construing South Carolina law have never been called upon to take a considered view of the purposes of the Act.¹⁵ Therefore, one must look elsewhere for material from which to establish a framework for analysis. This Article discusses three sources of such material: (1) the historical basis of state securities regulation, including the doctrine of merit regulation which underlies the SCUSA; (2) the goals addressed by the draftsmen of the Uniform Act, the model for the SCUSA; and (3) judicial construction of other states' versions of the Uniform Act. These sources are useful both in seeking a general theme of implementation of the Act and in interpreting particular provisions of the Act.

A. Some General Background

The general purpose of the SCUSA—the protection of those who invest or are invited to invest in securities—is the same as that underlying the federal securities laws.¹⁶ In that case, why

15. See *Kosnoski v. Bruce*, 669 F.2d 944, 946 (4th Cir. 1982) (court said definition of "security" is "broad, encompassing almost every conceivable investment scheme," without further discussion of purpose of Act); *Carver v. Blanford*, 288 S.C. 309, 342 S.E.2d 406 (1986) (no discussion of purpose of Act); *O'Quinn v. Beach Assocs.*, 272 S.C. 95, 105-06, 249 S.E.2d 734, 739 (1978) (no discussion of purpose of Act); *McGaha v. Mosley*, 283 S.C. 268, 273, 322 S.E.2d 461, 464 (Ct. App. 1984) ("Since the securities laws are remedial in nature, they should be liberally construed to protect investors."). But see *Freeman v. Campbell*, No. 83-CP-10-2867, at 7 (S.C. Ct. Com. Pleas, Final Order of July 6, 1985). In *Freeman* the trial court stated, "The apparent purpose of this extensive regulation is to let everyone make informed decisions when dealing in securities, to make the accumulation of capital relatively easy by assuring investors of basic protections, and to prevent persons entrusted with other people's money from taking advantage of that trust" *Id.*

16. The Supreme Court stated as follows:

The primary purpose of the [Securities] Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors.

United Hous. Found. v. Forman, 421 U.S. 837, 849 (1975); see also, e.g., *Smith v. State*, 266 Ark. 861, 864, 587 S.W.2d 50, 52 (Ct. App. 1979), *cert. denied*, 445 U.S. 705 (1980) (purpose of Uniform Securities Act is the same as that of the federal securities laws, i.e., "to protect investors by promoting full disclosure of information thought necessary to informed investment decisions"); cf. FUNDAMENTALS, *supra* note 6, at 6-7; *Report on State Merit Regulation of Securities Offerings*, 41 BUS. LAW. 785, 791-95 (1986) [hereinafter *Merit Regulation Report*].

have two sets of laws?¹⁷ This question was addressed in the floor debates accompanying the passage of the federal securities regulation statutes.¹⁸ The record of those debates indicates there are at least two reasons for having two sets of laws regulating securities, one historical and one theoretical. State blue sky laws were the first securities regulation measures adopted in this country. By 1933 every state had such a law.¹⁹ Application of these state laws was constrained by the limits of state legislative and judicial jurisdiction. The federal securities laws were designed to regulate transactions in interstate commerce that was in many cases already regulated within state jurisdiction.²⁰ This is the historical reason for having two sets of laws based on a similar general purpose.

The theoretical reason for having two sets of laws lies in the fact that the federal laws embody a theory of enforcement different than that of most state laws, including those based upon the Uniform Act.²¹ Because of this difference, judicial gloss cannot be borrowed without comparing the two laws. The next subsection discusses this difference.

B. Merit Regulation Versus Disclosure

The nature of the federal scheme of securities regulation, borrowed from the English pattern,²² is informational.²³ Its es-

17. The set of offerings to which the "two sets of laws" would apply in a registration context is not coextensive. For example, offerings by issuers listed on a national securities exchange are exempt from registration under the Uniform Act. See S.C. CODE ANN. §§ 35-1-310(7) (1976). See generally *Merit Regulation Report*, *supra* note 16, at 796-97. The securities so offered, however, are not exempt from the antifraud and broker-dealer provisions of the Act. See S.C. CODE ANN. §§ 35-1-310 to -320 (1976). The Securities Commissioner may by order revoke such exemptions. See *id.* § 35-1-330.

18. See 1 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934 2931, 2947-49, 2983 (J. Ellenberger & E. Mahar comp. 1973) [hereinafter LEGISLATIVE HISTORY].

19. Every state had a securities regulation statute before 1933, when the first federal securities regulation statute was enacted. See BLUE SKY LAW, *supra* note 7, at 17.

20. See Warren, *Reflections on Dual Regulation of Securities: A Case Against Pre-emption*, 25 B.C.L. REV. 495 (1984), and authority cited therein.

21. Professors Cowett and Loss state that "the rationale is clearly different at the federal and state levels." BLUE SKY LAW, *supra* note 7, at 37.

22. See L. LOSS, 1 SECURITIES REGULATION 3 (2d ed. 1961) [hereinafter SECURITIES REGULATION].

23. The "fundamental purpose" of the federal securities laws is "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high

stantial requirement is complete and correct disclosure, which is intended to permit the investor to protect himself by the exercise of his informed judgment.²⁴ As Justice White noted, "[O]nce full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the [federal securities laws]."²⁵ To promote complete and correct disclosure, antifraud devices are placed in the hands of federal agencies, restricted classes of injured investors employing express private rights of action, and, in limited circumstances, injured investors employing implied private rights of action. Private rights of action under the federal statutes have been construed to be primarily in the nature of supplemental public enforcement, rather than a method of compensation for the injured investor.²⁶ The existence of causes of action in favor of private parties, and standing of private parties, is accordingly limited.²⁷ In short, the federal law is regulatory in nature, not compensatory; and its regulatory aim is full and fair disclosure enabling the investing public to exercise informed judgment.

Traditional state securities laws, too, are regulatory, not compensatory, in nature. State securities laws, however, traditionally have been much more paternalistic than the federal ones. The goal of the federal securities laws is the prohibition of the offering of unsound securities. To this end, state securities administrators inquire into the bona fides and fairness of terms of offerings proffered for registration.²⁸ These regulators seek to

standard of business ethics in the securities industry." SEC v. Capital Gains Research Bureau, 375 U.S. 180, 186 (1963).

24. "Show up the roguery and it is harmless." *FUNDAMENTALS*, *supra* note 5, at 35 (quoting *The Times*, July 4, 1844).

25. *Santa Fe Indus. v. Green*, 430 U.S. 462, 478 (1977).

26. *See, e.g., Santa Fe Indus. v. Green*, 430 U.S. 462 (1977).

27. Limitations in the scope of federal securities regulation concomitantly broaden the role of state regulation and remedies, through statutory and case law. *Cf. FUNDAMENTALS*, *supra* note 5, at 899.

28. "The primary difference between the state and federal registration is the power of the state securities administrator to review the merits of the investment." T. HAZEN, *THE LAW OF SECURITIES REGULATION* 222 (1985). Under the South Carolina version of the Uniform Securities Act, the Securities Commissioner has broad discretion to issue a stop order in respect of any offering regardless of the provision under which it was registered. *See S.C. CODE ANN. § 35-1-1010* (1976). Such discretion of blue sky administrators has withstood attack on federal preemption grounds. *See, e.g., North Star Int'l v. Arizona Corp. Comm'n*, 720 F.2d 578 (9th Cir. 1983). *See generally SECURITIES REGULATION*, *supra* note 22, at 34, 57-61 (2d ed. 1961).

protect the unsophisticated investor (at least in the most extreme cases) from the possibility of the adverse results of his own bad judgment²⁹ by substitution of the judgment of the securities administrator.³⁰ The administrator can exercise his judgment either to prohibit the offering altogether or to rewrite the terms of the offering to be more favorable to the prospective investor.³¹ This pattern of regulation is usually called “merit review” or “merit regulation.”³²

According to the American Bar Association Section of Corporation, Banking, and Business Law, “The first goal of merit regulation is to ensure fair treatment of the public investor by the promoters of the corporation.”³³ Merit regulation is oriented toward offerings; particularly, the fairness of the terms of offerings and the risk posed to the investor in light of benefits to the promoter. This protection is meant collaterally to promote investor confidence in the securities markets.³⁴

29. For example, the purported purpose of the Michigan Uniform Securities Act is “to prevent stockholders and promoters from perpetrating frauds and impositions on unsuspecting investors . . . and to protect credulous and incompetent persons from their own inclination to speculate in hazardous enterprises.” Fred J. Schwaemmle Constr. Co. v. Department of Commerce, 420 Mich. 66, 67, 360 N.W.2d 141, 146 (1984) (quoting *People v. Breckinridge*, 81 Mich. App. 6, 14-15, 263 N.W.2d 922, 926 (1978)). “Blue sky laws have as their primary purpose the suppression of fraudulent practices and the protection of the public from their own gullibility.” *Gaudin v. Haberman*, 644 P.2d 159, 164 (Wyo. 1982) (construing the Uniform Securities Act as adopted in Wyoming, see Wyo. STAT. §§ 17-4-101 to -129 (1977)).

30. See BLUE SKY LAW, *supra* note 19, at 37. The Uniform Act contains disclosure requirements, but these were intended by the draftsmen to “supply enough information to enable the [State] Administrator to apply the stop-order standards.” COMMENTARY, *supra* note 7, at 44; see BLUE SKY LAW, *supra* note 7, at 37. On the other hand, “the SEC cannot routinely and directly force the kind of substantive restructuring that [merit regulation] states can.” *Merit Regulation Report*, *supra* note 16, at 823.

31. *Merit Regulation Report*, *supra* note 16, at 823.

32. For a concise history of merit regulation, see *id.* at 791-94. For a discussion of the nature and relative advantages and burdens of merit regulation, see *id.* at 795-852.

33. *Merit Regulation Report*, *supra* note 16, at 824. For a discussion of the “Uniform [Securities] Act’s solution of the merit question,” see generally *id.* at 808 n.136. The discussion concludes that the Act “contemplates a merit authority both specifically stated and limited in extent. The message to the administrator is restraint. The statute contemplates the use of objective merit criteria, rather than reliance on the administrator’s sense of what is fair and fitting. A statute that tracks the Uniform [Securities] Act and contains no fair, just and equitable language cannot be used to support a regulatory system in which finite, objective merit standards do not predominate.” *Id.* at 809 n.136.

34. Professor Loss views the Uniform Securities Act as “not fundamentally a disclosure statute like the Securities Act of 1933,” but considers the disclosure requirements of the Act to serve a valuable back-up function to merit regulation. See COMMENTARY,

Registration and disclosure provisions of merit regulation statutes, such as those in the SCUSA, may be similar in appearance to federal requirements. Their purpose, however, is different: they are directed toward the exercise of the judgment of the securities administrator.³⁵ Investor self-protection is only a secondary goal.³⁶

In the congressional debates accompanying the passage of the Securities Act of 1933 (Securities Act),³⁷ proponents of merit regulation gave two reasons why it was the superior theory of securities regulation. First, investors were considered incapable of protecting themselves from the wiles of the securities salesman.³⁸ Second, remedies were a problem: issuers of unsound securities frequently were not amenable to judgment by the time an unsophisticated investor became aware of his injury.³⁹ Presumably, these were among the reasons why so many states had adopted merit regulation statutes by 1933 and retain them today.⁴⁰ Additionally, it is often unrealistic to believe that small investors understand or rely upon required disclosures, although at the federal level disclosure is designed for investor protection and to provide a basis for fraud claims.⁴¹ Furthermore, in retroactive fraud actions founded upon disclosure deficiencies are often too expensive to be of practical use to the small investor.⁴² For all of these reasons, merit regulation blue sky laws do not rely on fraud-related remedies to protect or make whole the injured investor.⁴³ Indeed, their genesis was in the failure of fraud

supra note 8, at 84.

35. As an illustration, the Securities Commissioner can issue a stop order in his discretion in respect of any offering regardless of provision under which it was registered. See S.C. CODE ANN. § 35-1-110 (1976). Professor Loss views the Uniform Securities Act as "not fundamentally a disclosure statute like the Securities Act of 1933," but considers the Act's disclosure requirements to serve a valuable back-up function to merit review. See COMMENTARY, *supra* note 7, at 84.

36. The Uniform Securities Act is a blend of three philosophies of regulation: merit review, full disclosure, and antifraud. See BLUE SKY LAW, *supra* note 7, at 238-43. The merit component is the predominant philosophy because substantial discretion is placed in the administrator.

37. 15 U.S.C. §§ 77a-77ff (1982 & Supp. II 1984 & Supp. III 1985).

38. See LEGISLATIVE HISTORY, *supra* note 18, at 1934, 2931, 2947-49, 2983.

39. See *id.*

40. See *Merit Regulation Report*, *supra* note 16, at 827-28.

41. See *id.* at 830.

42. See *id.* at 828; Tyler, *More About Blue Sky*, 39 WASH. & LEE L. REV. 904 (1982).

43. This is illustrated by the extremely limited private causes of action created by

actions as a suitable remedial device in the securities context. The thrust of merit regulation is to prevent unfair offerings in the first instance, either through administrative action or by an *in terrorem* effect.⁴⁴ This has a substantial impact upon private remedies available under the SCUSA.⁴⁵

In short, the federal securities laws and merit-regulation blue sky laws proceed from differing views of the investor and from differing views of the function of government.⁴⁶ Discussion of these differences was an element of the floor debates preceding the passage of the Securities Act⁴⁷ and they were explicitly given scope in the federal securities statutes.⁴⁸ In some circumstances, these differences render unsatisfactory the borrowing from one statutory scheme to interpret the other.

The SCUSA is primarily a merit regulation statute. We must assume that the Legislature purposefully adopted such a statute. Thus, when construing the statute, one must take into account its paternalistic, market-regulatory character.

the Uniform Act. For example, S.C. CODE ANN. § 35-1-1490 (1976) creates a right of action in cases of statutory violations or deceit for buyers against their sellers and prescribes as remedies rescission or, if the securities have been unsold, damages. Injured sellers or other persons injured in connection with securities transactions must rely on common-law fraud and other such state-law actions if they cannot meet federal securities fraud requirements for standing or establishing a cause of action. This was the clear intention of the draftsmen of the Uniform Securities Act. *See, e.g.,* COMMENTARY, *supra* note 7, at 7-8; *infra* notes 65-70 and accompanying text.

44. *See generally* Merit Regulation Report, *supra* note 16, at 824-30. This is not intended as a defense of merit regulation, but as a description. For a view of the disadvantages of merit regulation, see *id.* at 831-43. The report observes that merit regulation works best when market forces will not establish a balance of fairness between promoter and investor, particularly in connection with small first-time or one-of-a-kind offerings. It works least well as protection against the promoter who, through ignorance or bad motive, ignores the statute altogether. In these cases, merit regulation is “no substitute for a strong system of private antifraud remedies.” *Id.* at 843.

45. *See infra* notes 65-70 and accompanying text.

46. The power of the merit regulator “is different in both kind and degree from the SEC’s. It contemplates the state acting on behalf of investors as a negotiator of terms.” Merit Regulation Report, *supra* note 16, at 823; *see* Warren, *supra* note 20, at 528-32. *See generally* FUNDAMENTALS, *supra* note 5, at 29-38.

47. *See* LEGISLATIVE HISTORY, *supra* note 18, at 2930-32, 2947-50.

48. *See* Securities Act § 18, 15 U.S.C. § 77r (1982 & Supp. II 1984 & Supp. III 1985); Exchange Act § 28(a), 15 U.S.C. § 78bb(a) (1982); *see also* BLUE SKY LAW, *supra* note 7, at 237 n.1. The resulting dual system of securities regulation has survived constitutional review. *See, e.g.,* Merrick v. N.W. Halsey & Co., 242 U.S. 568 (1917); Caldwell v. Sioux Fall Stock Yards Co., 242 U.S. 559 (1917); Hall v. Geiger-Jones Co., 242 U.S. 539 (1917). These cases are known collectively as the Blue Sky Cases.

C. *Intentions of the Draftsmen of the Uniform Act*

In construing versions of the Uniform Act, courts often give weight to the intentions of those who drafted and promulgated the Act.⁴⁹ This theory of construction is reasonable, especially in the absence of legislative history, because one may fairly assume that a legislature is aware of draftsmen's published intentions when it adopts an essentially prefabricated piece of legislation, such as the Uniform Act. Thus, absent contrary legislative expressions, one may consider legislators to be endorsing the goals of the draftsmen. Furthermore, when a legislature adopts a statutory scheme in relatively complete form, as was the SCUSA, the draftsmen's views are valuable indicators of the intended operation of the statutory mechanism.⁵⁰

The Uniform Act was drafted under the auspices of, and promulgated by, the National Conference of Commissioners on Uniform State Laws.⁵¹ With respect to the Act, at least three of the Conference's goals are discernible: uniformity among state schemes and coordination with the federal scheme of securities regulation; a principally merit-regulation philosophy;⁵² and a market-regulatory, rather than compensatory, concept.

1. *Uniformity and Coordination*

The Uniform Act contains its own expression of statutory policy: "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."⁵³ Professor Loss has

49. See, e.g., *Cahill v. Ernst & Ernst*, 625 F.2d 151, 154-55 (7th Cir. 1980); *IDS Progressive Fund, Inc. v. First of Michigan*, 533 F.2d 340, 343 (6th Cir. 1976); *Goodman v. Poland*, 395 F. Supp. 660, 680-81 (D. Md. 1975).

50. See *Data Access Sys. v. State Bureau of Sec.*, 63 N.J. 15, 305 A.2d 427 (1973) (action requiring construction of New Jersey version of Uniform Securities Act, which denied motion to suppress "extrinsic materials," including Professor Loss' views concerning interpretation of the Act).

51. See COMMENTARY, *supra* note 7, at 165.

52. See *supra* notes 16-21 and accompanying text.

53. UNIF. SEC. ACT § 415, 7B U.L.A. 678 (1958). This is the standard policy provision of the National Conference of Commissioners on Uniform State Laws. See COMMENTARY, *supra* note 7, at 165. Courts interpreting versions of the Uniform Securities Act have given weight to this statement of purpose. See, e.g., *Kansas State Bank v. Citizens Bank*, 737 F.2d 1490, 1496 (8th Cir. 1984) (construing a version of the Act that, like the South

pointed out the need for national uniformity of the law is nowhere greater than in the area regulating the securities markets.⁵⁴ Uniformity benefits the states by permitting “an interchangeability of precedent and practice” among the states, while minimizing burdens on legitimate interstate business.⁵⁵ The securities markets are increasingly efficient, timing and rapidity of transactions are increasingly important commercial values, and novel and sophisticated investment schemes are rife.⁵⁶ Consequently, the need for uniformity is growing. The promulgation of the Uniform Act was a conscious effort to address to this need.⁵⁷ It has been enacted in some form in at least thirty-nine states.⁵⁸ A state does not achieve uniformity simply by enacting similarly worded statutes. Differing interpretations by courts or by securities administrators can result in divergent construction of similarly worded statutes in different states.⁵⁹ Accordingly, Uniform Act states make an effort to interpret their laws in similar ways, insofar as this is not inconsistent with subjective state interests.⁶⁰ Courts in Uniform Act states are able to look to germane decisions in other such states and to give weight to such decisions for the sake of uniformity as well as for their qualities of persuasiveness.

In expressing their intentions with respect to the relationship between the federal and state securities laws, the draftsmen of the Uniform Act did not use the term “uniformity.” They wrote of “coordination,” by which they meant minimizing conflicts between the two bodies of law.⁶¹ This is quite different

Carolina version, does not include § 415); *People v. Dempster*, 96 Mich. 700, 704, 242 N.W.2d 381, 384 (1976).

54. See, e.g., *BLUE SKY LAW*, *supra* note 7, at 230.

55. *Id.* at 238.

56. See generally *Merit Regulation Report*, *supra* note 16, at 794-95.

57. See generally *BLUE SKY LAW*, *supra* note 7, at 230-31.

58. See 1 *Blue Sky L. Rep.* (CCH) ¶ 5500 (1986).

59. See, e.g., *BLUE SKY LAW*, *supra* note 7, at 44; *Merit Regulation Report*, *supra* note 16, at 789.

60. See, e.g., *State v. Hawaii Mkt. Center.*, 52 Haw. 642, 647 n.2, 485 P.2d 105, 108 n.2 (1971); *Pratt v. Kross*, 276 Or. 483, 555 P.2d 765 (1976).

61. In his treatise on blue sky law, Professor Loss stated as follows:

The only hope for simplification lies in uniformity [of state laws] and federal-state coordination. . . . [S]tate administration will benefit from an act which is reasonably coordinated with the federal legislation, as well as uniform from state to state, in that it will not only help legitimate interstate business but also facilitate an interchangeability of precedent and practice.

from uniformity, and the difference stems from the differing interests served by, and theories of regulation of, the two bodies of law.⁶² In other words, neither uniformity nor coordination provides a basis for construing a state statute to have an identical meaning as a similar federal statute. As a regulatory goal, coordination is intended to enhance the smooth functioning of the national securities market.⁶³ In addition, minimizing conflict with the federal securities regulation scheme rebuffs arguments for federal preemption of state securities laws.⁶⁴

Uniformity and coordination, at their most potent, are no more than policy. To exalt them above legitimate, subjective state interests, without analysis, would be questionable, particularly if the result were the adoption of federal jurisprudence proceeding from a theoretical basis which, in some respects, is inconsistent with that of the SCUSA.

2. *Regulatory Versus Compensatory Orientation*

The Uniform Act offers a three-pronged regulatory framework: registration of offerings, registration of market professionals, and antifraud. A fourth section of the Act contains provisions of general applicability, such as definitions. The intention of the draftsmen was for each adopting state to adopt the general section, promoting uniformity in these generally applicable provisions, and to adopt one or more of the three regulatory sections. At least among those states adopting a particular regulatory section, uniformity would be promoted.⁶⁵

The "fraud" contemplated by the Act's antifraud provisions is not common-law fraud. Federal and state securities regulation statutes have created a statutory wrong related to common-law deceit, but lacking the focusing characteristics of the common-law action, such as the requirements of privity, reliance, and

BLUE SKY LAW, *supra* note 7, at 238.

62. The Uniform Securities Act "had to be coordinated with the federal legislation, but not at the price of relegating the state statutes to a subordinate position [M]ost of the existing state laws go beyond the disclosure philosophy of the federal act." *Id.* at 237.

63. Professor Loss observes, "An intelligent and workable system of federalism requires that the states cooperate in reducing to a minimum the burden of their separate legislation on interstate commerce." *Id.* at 238.

64. See generally Warren, *supra* note 20.

65. See BLUE SKY LAW, *supra* note 7, at 236-38.

causation.⁶⁶ It would have been possible, although perhaps technically difficult, to base general compensatory remedies upon this special "securities fraud." Congress, however, drafted the federal statutes to include only carefully limited private causes of action designed to assist public enforcement, which are too limited in nature to be characterized as compensatory. An agonizing evolution of highly technical and confusing limitations now accompanies judicial recognition under the federal statutes of wider, implied private rights of action. The Uniform Act, like the text of the federal statutes, lacks any general compensatory cause of action for investors injured by securities fraud. The draftsmen of the Uniform Act recognized the confusion of courts construing the federal securities statute and expressly intended that the Act imply no private civil cause of action. Accordingly, the sanctions for violations of the antifraud provisions of the Act are almost exclusively market-regulatory in nature—injunction, administrative proceedings, and criminal prosecution.⁶⁷ The sole exception is the availability of rescission to buyers whose sellers violated the Act in some way.⁶⁸ Even this provision is essentially regulatory in nature, simply constituting the undoing of a wrongful sale. The rescission action will lie for negligence. The buyer/plaintiff in such an action need not show injury. Thus, rescission deprives the violator of his bargain. The wronged buyer's only remedy is restoration of his prepurchase condition, since consequential damages are unavailable. The Act does not provide even this limited right of action for wronged sellers.⁶⁹

66. Compare Securities Act §§ 11, 12, 17, 15 U.S.C. §§ 77k, 77l, 77q (1982) and Exchange Act § 10(b), 15 U.S.C. § 78j(b) (1982) and UNIF. SEC. ACT § 410(a), 7B U.L.A. 643 (1958) with W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS § 105, at 728 (5th ed. 1984) [hereinafter PROSSER & KEETON].

67. See UNIF. SEC. ACT §§ 407, 408, 409, 7B U.L.A. 625, 628, 631.

68. See *id.* § 410(a), 7B U.L.A. 643.

69. This lack of symmetry is explained by Professor Loss in the draftsmen's commentary to the Uniform Securities Act. It is partly historical: the blue sky laws traditionally have been directed toward regulating sellers, protecting against unfair offerings in the first instance. It is partly theoretical: the states have existing actions contemplating fraud and misrepresentation which are available to redress injury. The federal law had none; therefore, the lack of such actions was made up by implication. Professor Loss' view is that comprehensive securities fraud remedies should not displace existing and developing state remedies. In other words, the Uniform Securities Act is intended to regulate the securities market, not displace fraud actions under state law. See COMMENTARY, *supra* note 7, at 7-8. Of course, a state may add buyer protections to its version of the Uniform Securities Act. See, e.g., PA. STAT. ANN. tit. 70, §§ 1-101 to -704 (Purdon

The draftsmen's comments and this pattern of remedies under the Uniform Act illustrate two characteristics of the Act. One characteristic is the orientation of the Act toward offerings of securities, not toward the secondary market, in which sellers are as likely as buyers to be victims of securities fraud. The other characteristic is the market-regulatory orientation, as opposed to any compensatory orientation, of the Act. The Act does not provide an avenue for litigation for those alleging injury from securities fraud.⁷⁰ In other words, the Act does not establish securities fraud as a private wrong. It is a public wrong and the remedy is designed as a means of enforcement of a regulatory statute. This is congruent with the Act's paternalistic character, focusing on public policing of the market and attempting to prevent injudicious offerings in the first instance.

D. Decisions Construing Other Versions of the Uniform Act

In construing the SCUSA, decisions interpreting other states' versions of the Uniform Act are important for two reasons. One is to serve the policy of uniformity among the states. The other is that such decisions relate to statutes doctrinally related to the SCUSA. The theory of enforcement of these statutes is presumptively similar to ours and the decisions are correspondingly persuasive. This view is widely held.⁷¹

Therefore, it is useful to review what courts in other states have said about the purposes of the Uniform Act. As noted previously, there is agreement that courts should liberally interpret the Act to achieve its remedial purpose.⁷² Beyond this, the pre-

Supp. 1986). A state also may delete provisions in the Uniform Securities Act that prohibit implication of private civil actions. *See, e.g.*, KY. REV. STAT. ANN. § 292.530 (Michie/Bobbs-Merrill 1981); *see also* Carothers v. Rice, 633 F.2d 7, 10-12 (6th Cir. 1980).

70. Such plaintiffs should seek their right of action in common-law fraud or conversion, or, in appropriate cases, violation of fiduciary duties. When the wrong is perpetrated in an anonymous market, such as a securities exchange, these state causes of action may not be available because of lack of privity or some other requirement, but federal rights of action may be available. *See supra* note 66 and accompanying text.

71. *See, e.g.*, Schultz v. Rector-Phillips-Morse, Inc., 261 Ark. 769, 778, 552 S.W.2d 4, 9 (1977); Department of Commerce v. DeBeers Diamond Inv., 89 Mich. App. 406, 410, 280 N.W.2d 547, 550 (1979); People v. Dempster, 51 Mich. App. 612, 616, 216 N.W.2d 81, 82-83 (1974); State v. Russell, 119 N.J. Super. 344, 347, 291 A.2d 583, 585 (1972).

72. *But see* People v. Lyons, 93 Mich. App. 35, 44, 285 N.W.2d 788, 792 n.6 (1979) ("[L]iberality of construction should not include stretching the language of the [Michigan Uniform Securities Act, MICH. COMP. LAWS ANN. §§ 451.501-.818 (West 1967 & Supp.

ponderance of decisions indicates that the protections of the Uniform Act are oriented toward protecting offerees and buyers of securities.⁷³ This reading of the Act is consistent with its nature as a merit regulation statute. It is also consistent with the Act's primary focus on first-time and one-of-a-kind offerings and its emphasis upon the "seasoning" of securities.

E. Summary

Similarity of words alone is an inadequate, even dangerous, basis for borrowing gloss from the informationally oriented federal securities laws to inform our own merit regulation statute. The temptation is great because borrowing is easy and because it serves a perceived policy of uniformity. On the other hand, if similar provisions serve similar purposes within the two schemes, borrowing may sometimes be indulged with beneficial results. To illustrate these ideas, the following sections contain discussions of two volatile areas of the law in which borrowing federal law to aid in interpreting the SCUSA would be tempting because of statutory verbal similarity, complexity of issues, and the existence of a substantial amount of analysis at the federal level: the meaning of "security" and implied private rights of action.

1986)] to encompass evils not addressed within the statutory purpose").

73. See, e.g., *Briggs v. Sterner*, 529 F. Supp. 1155, 1174 (S.D. Iowa 1981) (the "primary purpose" of blue sky laws "is to protect the public from deceit perpetrated in the sale of securities") (citing *Midwest Management Corp. v. Shepers*, 291 N.W.2d 896, 901 (Iowa 1980)); *Upton v. Trinidad Petroleum Corp.*, 468 F. Supp. 330, 335 (N.D. Ala. 1979) (purpose is "for the general welfare and to protect the public from diversified methods of deceit and fraud in the sale of securities") (quoting Uniform Securities Act, 1 Blue Sky L. Rep. ¶ 1021); *Hardtke v. Love Tree Corp.*, 386 F. Supp. 1085, 1092 (E.D. Wis. 1975) ("The Wisconsin Supreme Court has repeatedly stated that the broad purpose underlying the Wisconsin Securities Law is the protection of the public from the sale of worthless securities"); *Fred J. Schwaemmle Constr. Co. v. Department of Commerce*, 420 Mich. 66, 77, 360 N.W.2d 141, 146 (1984); *Dunn v. Bemor Petroleum, Inc.*, 680 S.W.2d 304, 306 (Mo. App. 1984) (state securities law drafted "to prevent fraud in the sale of securities"); *Garbo v. Hilleary Franchise Sys.*, 479 S.W.2d 491, 499 (Mo. App. 1972) ("[P]rimary purpose . . . is protecting buyers of securities"); *Higgins v. New Jersey Bureau of Sec.*, 100 N.J. Super. 266, 271-72, 241 A.2d 660, 663 (App. Div. 1968) (protecting the "buying public"). But see *Roberts v. Magnetic Metals Co.*, 463 F. Supp. 934, 940 (D.N.J. 1978) (purpose is to protect buyers and sellers); COMMENTARY, *supra* note 7, at 7.

III. APPROPRIATE BORROWING: "SECURITY"

An example of an area of securities law generally appropriate for borrowing is the definition of "security." This follows from the similarity between the general purposes of the federal and state statutes, juxtaposed with the jurisdictional nature of the definition. Additionally, the draftsmen of the Uniform Act borrowed much of the wording of the federal definition.⁷⁴ Courts in Uniform Act jurisdictions have generally accepted the guidance of the substantial federal precedent in construing their own states' definition of "security."⁷⁵ In a few cases, however, strong subjective state interests led state courts to give broader meaning to statutory terminology than had been given in federal decisions.⁷⁶ There are indications that the federal courts may be following these state court decisions—borrowing in the less usual direction.

A. *Purpose Plus Jurisdictional Scope*

As already noted, the general purpose of the SCUSA and the federal securities laws is the same: protection of investors in securities by regulation of the securities markets. As this brief statement implies, the concept of "security" is jurisdictional in a fundamental sense. Courts at both the federal and state levels have determined that a broad construction each statute is necessary to effect its remedial purpose.⁷⁷ Therefore, each statute must have the broadest appropriate jurisdictional reach. This means that the concept of "security" should encompass all arrangements that implicate the protections intended by the statutes. Accordingly, despite their differing theories of enforcement, the SCUSA and the federal securities statutes share a

74. Compare S.C. CODE ANN. § 35-1-20(12) (1976) with Securities Act § 2(1), 15 U.S.C. § 77b(1) (1982) and Exchange Act § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1982). Although the Securities Act and Exchange Act definitions are slightly different—the Exchange Act definition does not mention "evidence of indebtedness"—they are construed as being identical. See, e.g., *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 556 n.7 (1979).

75. See J. LONG, 1985 BLUE SKY LAW HANDBOOK §§ 2.01-.06 (1984).

76. See *supra* note 95 and accompanying text.

77. With respect to the federal securities laws, authority for this proposition is too numerous to merit citation. With respect to the Uniform Act, see, e.g., *McGaha v. Mosley*, 283 S.C. 268, 273, 322 S.E.2d 461, 464 (1984).

general purpose from which proceeds an interest in a broad and flexible definition of "security."⁷⁸ This sharing of purposes suggests the appropriateness of borrowing.

The term "security" is assigned to a dynamic phenomenon possessing qualities that render it peculiarly susceptible to manipulative and deceptive practices. These qualities include the investor's hope for gain premised, to some extent, on the effort and expertise of another.⁷⁹ Because the investor's own efforts are not the vital ones, the medium for producing benefits is not specific to any particular investor. Therefore, the medium may be attractive to more than one investor and have value independent of its intrinsic capability to generate benefit.⁸⁰ This characteristic transferability implies amenability to marketing⁸¹ and, therefore, the potential for deception in marketing and manipulation of the market. The necessity for reliance on the capabilities of another implies the possibility of deception about the qualities of the risk.

These dangers are the same, whether they are being addressed by the federal laws or by the Uniform Act. Both regulatory schemes address these dangers through disclosure, but differ with regard to the objective of the disclosure. In the federal scheme, as previously discussed, disclosure is addressed to the investor, who exercises his own judgment concerning the merits of the investment. Regulation protects against the wrongful inducement to make an investment decision. In the Uniform Act scheme, the disclosure is addressed to the securities administrator who, at least in the first instance, exercises his judgment concerning the basic soundness of the investment as a matter of

78. The definition should be as broad as it needs to be to accomplish the relevant statutory purpose. See *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953). A dilemma shared by the federal and state regulators is to define "security" to give sufficient scope to the statutes without being unduly intrusive into transactions which do not fairly implicate the perceived dangers which the law seeks to address. "[L]iberality of construction should not include stretching the language of the act to encompass evils not addressed within the statutory purpose." *People v. Lyons*, 93 Mich. App. 35, 44 n.6, 285 N.W.2d 788, 792 n.6 (1979).

79. See *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946).

80. The stock market is the clearest example of this phenomenon. Shares of stock gain and lose value on the basis of perceptions of value to members of a market unrelated, in most cases, to the shares' intrinsic ability to generate benefit for their holder.

81. The Comptroller of the Currency, for example, defines "investment security" as a "marketable obligation in the form of a bond, note, or debenture. . . ." 12 C.F.R. § 1.3(b) (1986) (emphasis added).

public interest. Regulation polices the terms of particular offerings.

In each case, however, it is recognized that restriction of the reach of regulation to particular known species of investment is inappropriate.⁸² In each scheme, if the broad, remedial purposes are to be fulfilled, the *scope* of regulation must be broad enough to include the entire potential range of the subject matter sought to be regulated. State securities regulation schemes need, in effect, a common law of securities fraud that is sufficiently flexible to follow developments in the securities industry and in the imaginations of practitioners of manipulation and deception. There are few reasons why federal and Uniform Act jurisdictions could not share this common law. In fact, in order for regulators to keep pace with a rapidly evolving securities market, such sharing is probably necessary.

B. *The Draftsmen's Intentions*

For their definition of "security," the draftsmen of the SCUSA chose the wording of section 2(1) of the Securities Act,⁸³ with minor changes.⁸⁴ The official comment to the Uniform Act notes that "[s]ection 2(1) was modeled on the definition in some of the state statutes, and the federal definition has in turn influenced many of the new state statutes"⁸⁵ and that the definition

82. The blue sky commissioners understood the need for such flexibility quite early. See *State v. Gopher Tire & Rubber Co.*, 146 Minn. 52, 177 N.W. 937 (1920) and authorities cited therein. It was to their formulation that Congress looked in defining "security" in the federal statutes and to which the Supreme Court looked in construing the federal definition of "security" in *United Hous. Found. v. Forman*, 421 U.S. 837 (1975); *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946); *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943). For the same reason, Professor Loss "borrowed it back" for the Uniform Securities Act.

Similar recognition is reflected in the English experience and the resulting scope of their new Investor Protection Law, proposed to replace their Protection of Fraud (Investments) Act, 6 & 7 Eliz. 2, ch. 45 (1958). The Official Statutory Study Commission realized that the definition of "investment" would define this scope, but noted fears that "it was impossible to foresee what new types of investment would be invented." See COMMENTARY, *supra* note 7, at 106. The Commission concluded that "flexibility must and can be built into any new legislation." L. GOWER, REVIEW OF INVESTOR PROTECTION—REPORT: PART 1 26 (1984).

83. 15 U.S.C. § 77b(1).

84. See COMMENTARY, *supra* note 7, at 106.

85. UNIF. SEC. ACT § 410 official comment, 7B U.L.A. 583 (1958).

has been universally broadly construed.⁸⁶ A broadly applicable definition clearly serves the interests of merit regulation, bringing the largest appropriate universe of transactions within the scope of the securities administrator's judgment. Similarly, a broad definition serves the market-regulatory concept by ensuring that the entire market is in fact regulated.

Borrowing in this area particularly serves the policies of uniformity and coordination. Manifestly, it is advantageous to investors, promoters, and regulators if something that is a security under one applicable regulatory scheme is a security under other such schemes. This was certainly in the minds of the Uniform Act draftsmen when they borrowed the federal definition. As a result, every Uniform Act jurisdiction has adopted a statutory definition of "security" similar to that in the federal statutes.⁸⁷

C. *Serving State Interests*

Similarity of heritage, wording, and general purpose, in conjunction with values of uniformity and coordination, make the definition of "security" possibly the best example of a provision suitable for borrowing. Even so, complete uniformity has not been achieved.⁸⁸ The policy of uniformity has given way, in some instances, to state interests. As an example, consider the term "investment contract." The definition of "security" explicitly includes as securities several familiar classes of instrument, such as shares of stock. Decisions make clear that anything termed "shares of stock" and manifesting "some of the significant characteristics typically associated with stock" is a security.⁸⁹ Other categories of security named in the definition might receive similar treatment.⁹⁰ More complex difficulties arise in con-

86. *Id.*

87. See J. LONG, *supra* note 75.

88. See COMMENTARY, *supra* note 7, at 106.

89. *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 686 (1985) (quoting *United Hous. Found. v. Forman*, 421 U.S. 837, 851 (1975)). In this manner, *Landreth* effectively extinguished the "sale of business" doctrine.

90. See *Landreth*, 471 U.S. at 685-88. The opinion observes that "most instruments bearing such a traditional title are likely to be covered by the definition," *Id.* at 686 (citing *Forman*, 421 U.S. at 650). The *Landreth* court, however, left open the question whether other categories listed in the definition of "security," such as notes and bonds, could always be shown to be securities by showing that they possess the necessary attrib-

nection with novel devices that do not fit neatly into traditional categories commonly regarded as securities, but which pose the same dangers to investors as do traditional securities. To gather such devices into the regulatory scheme, the Securities Act definition of "security" incorporated the blue sky law concept of "investment contract."⁹¹

The United States Supreme Court construed this concept in *SEC v. W.J. Howey Co.*⁹² State law interpretations of "investment contract" frequently accepted the *Howey* formula.⁹³ In some instances, the *Howey* formula even served as a general definition of "security."⁹⁴ Courts in at least five jurisdictions, however, criticized the *Howey* formula as being too narrow in light of the perceived purposes of their state blue sky laws.⁹⁵ These decisions may reflect a state court perception that the *Howey* test is too conservative to suit paternalistic, merit regulation philosophy, or that the *Howey* formula is influenced by a general narrowing of federal court securities jurisdiction. In fact, if the *Howey* formula is too narrow, the fault lies not with the opinion itself, but with the courts that have construed the wording of the *Howey* formula as though it were a statute. This renders the

utes of their nominal character.

91. See, e.g., *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943).

92. 328 U.S. 293 (1946).

93. In *Howey* the Court construed "investment contract" to mean "a contract, transaction, or other scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party. . . ." *Id.* at 298; see also *id.* at 301 (restating the formula in slightly different words).

94. E.g., Long, *State Securities Regulation—An Overview*, 32 OKLA. L. REV. 541, 559-74 (1979). As Professor Long points out, there are other tests, but the *Howey* test is "by far . . . the most widely used [and] is the primary, if not the only, test for investment contracts in the federal courts and enjoys wide acceptance in the state courts and administrative agencies." *Id.* at 560.

95. According to the Hawaii Supreme Court, "The primary weakness of the *Howey* formula is that it has led courts to analyze investment projects mechanically, based on a narrow concept of investory participation." *State v. Hawaii Mkt. Center*, 52 Haw. 642, 647, 485 P.2d 105, 108 (1971). The Hawaii court propounded its own formula, emphasizing what it views as more flexible concepts of investment, benefit, and control by the investor. See *id.* at 648-49, 485 P.2d at 109. For similar cases, see *Securities Adm'r v. College Assistance Plan (Guam) Inc.*, 533 F. Supp. 118, 121-22 (D. Guam App. Div. 1981), *aff'd*, 700 F.2d 548 (9th Cir. 1983) (construing Guam's version of the Uniform Securities Act, GUAM GOV'T CODE §§ 45,101-45,420 (1970)); *Schultz v. Rector-Phillips-Morse, Inc.*, 261 Ark. 769, 780-81, 552 S.W.2d 4, 10 (1977) (en banc); *State v. Investors Sec. Corp.*, 297 Minn. 1, 11, 209 N.W.2d 405, 410 (1973); *Pratt v. Kross*, 276 Or. 483, 495-96, 555 P.2d 765, 772 (1976). See generally Annotation, *What Constitutes an "Investment Contract" Within the Meaning of State Blue Sky Laws*, 47 A.L.R.3d 1375 (1973).

Howey test the mechanical rule that the Supreme Court said in *Howey* was not wanted.⁹⁶ The Court has consistently emphasized the need for case-by-case analysis and flexibility, particularly when dealing with the sort of “unusual device” meant to be contemplated by “investment contract.”⁹⁷

Possibly perceiving this misapplication of *Howey*, the Supreme Court in *United Housing Foundation v. Forman*⁹⁸ reemphasized the flexibility of the term “investment contract.”⁹⁹ The Court implicitly endorsed standards articulated in cases decided under blue sky laws.¹⁰⁰ In so doing, the Supreme Court arguably has provided a recent example of borrowing from state law to inform the federal law.

D. South Carolina Jurisprudence

Courts applying the SCUSA have exhibited a uniform view that, in construing the SCUSA’s definition of “security,” courts may look to cases interpreting the federal statutory definition of “security.”¹⁰¹ This means that, in effect, as the federal law evolves, South Carolina law changes too. To know their own law, South Carolina lawyers must keep abreast of federal cases.

This gives South Carolina the considerable advantages of borrowing. It does not mean, however, that South Carolina courts are not free to depart from federal law constructions when analysis indicates that to do so would better serve subjec-

96. 328 U.S. at 299.

97. *See, e.g.,* Landreth Timber Co. v. Landreth, 471 U.S. 681, 688-89 (1985).

98. 421 U.S. 837 (1975).

99. *Id.* at 851-52.

100. *See id.* at 852 n.16. The Court in *Forman* referred to the holding in *SEC v. Glenn Turner Enters.*, 474 F.2d 476, 482, *cert. denied*, 414 U.S. 821 (1973), which stated that the “efforts of others” must be the “undeniably significant,” but not “sole” profit-producing efforts. The Court, however, found it unnecessary to address the issue to decide *Forman*. *See* 421 U.S. at 852 n.16; *see also* *SEC v. Aqua-Sonic Prods. Corp.*, 687 F.2d 577, 581-82 (2d Cir. 1982).

101. *See, e.g.,* Carver v. Blanford, 288 S.C. 309, 342 S.E.2d 406 (1986) (adopting *Landreth Timber* rule); O’Quinn v. Beach Assocs., 272 S.C. 95, 105-06, 249 S.E.2d 734, 739 (1978) (*Howey* is controlling on meaning of “investment contract”); McGaha v. Mosley, 283 S.C. 268, 273, 322 S.E.2d 461, 464 (Ct. App. 1984) (look to “cases interpreting the federal statute” concerning definition of “security”); *see also* Kosnoski v. Bruce, 669 F.2d 944, 946 (4th Cir. 1982) (“We assume . . . that the South Carolina Supreme Court would adopt the Federal judiciary concerning ‘investment contracts.’”). These opinions reflect acceptance by South Carolina of the *Howey* formula.

tive state interests perceived as underlying the SCUSA.¹⁰²

IV. INAPPROPRIATE BORROWING: PRIVATE STANDING AND IMPLIED RIGHTS OF ACTION

Modern securities markets, with their peculiar structure unlike anything known to the common law, give scope for activities perceived as wrongful. The common law, however, offers no redress to individuals harmed by these activities, largely because of the virtual impossibility of establishing any relationship between victim and perpetrator.¹⁰³ This makes these markets and their peculiar wrongs appropriate for government regulation. When designing their regulatory schemes, the drafters of securities regulation statutes invented a statutory wrong: employment of manipulative or deceptive practices in connection with the securities transactions ("securities fraud"). Congress made this activity unlawful precisely because it was not actionable at the common law. Therefore, it should not too hastily be assigned causes of action and remedies which developed in the common law.

Implied private rights of action patterned after common-law deceit have been found in the federal securities laws, but these have been construed as being in the nature of aids to public enforcement and not as providing comprehensive remedies to those who allege injury from securities fraud.¹⁰⁴ The federal statutes,

102. See, e.g., *State v. Hawaii Mkt. Center*, 52 Haw. 642, 647, 485 P.2d 105, 108 n.2 (1971); *Pratt v. Kross*, 276 Or. 483, 497, 555 P.2d 765, 773 (1976).

103. "[T]he doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as advice and securities." *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 194 (1963). In an anonymous auction market such as a national securities exchange, key elements of common-law deceit (e.g., reliance and causation) are virtually impossible to prove. These requirements have been substantially relaxed for purposes of stating an action under SEC rule 10b-5, 17 C.F.R. § 240.10b-5 (1986), but the degree and effect of such relaxation continue to be matters of confusion and debate. See, e.g., *FUNDAMENTALS*, *supra* note 5, at 808-18; *T. HAZEN*, *supra* note 28, at 461-70, and authority cited therein. See generally *PROSSER & KEETON*, *supra* note 66, § 108, at 751.

104. See, e.g., *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) (implied action under Exchange Act § 10(b) and SEC rule 10b-5); *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964) (implied action under Exchange Act § 14(a)); *Cramer v. General Tel. & Elecs.*, 443 F. Supp. 516 (E.D. Pa. 1977), *aff'd*, 582 F.2d 259 (3d Cir. 1978) (implied action under Exchange Act § 12(b)); *Kerber v. Kakos*, 383 F. Supp. 625 (N.D. Ill. 1974) (implied action under Exchange Act § 12(g)). But see, e.g., *In re Penn Cent. Sec. Litig.*, 494 F.2d 528 (3d Cir. 1974) (no implied action under Exchange Act § 13(a)); *Dyer v. Eastern*

in large part, leave the provision of comprehensive civil remedies for such injury to state law. The principal implied civil right of action under the federal securities laws derives from rule 10b-5 under the Securities Exchange Act of 1934.¹⁰⁵ This rule was the model for section 101 of the Uniform Act.¹⁰⁶ Commentators have noted that section 101 has the same purpose as rule 10b-5—the prevention of securities fraud.¹⁰⁷ Section 101 is codified at South Carolina Code section 35-1-1210.¹⁰⁸ In other words, South Carolina has a statutory provision that, like the definition of “security,” is modeled on federal law and arguably has the same general purpose as has its model. Does this mean that South Carolina should borrow the federal implied private action of rule 10b-5 when construing section 35-1-1210? To answer that question, we must first know with more particularity the purpose for which section 35-1-1210 was put into the SCUSA. Is it there for market regulatory purposes—to make wrongful certain conduct and thereby deter or punish it—or is it there to provide an avenue to redress the effects of such conduct? In other words, is section 35-1-1210 exclusively regulatory, or compensatory as well? It appears to be overwhelmingly regulatory, for reasons that are discussed herein.¹⁰⁹ Those who disagree with this conclusion should carefully consider whether the body of law which has developed under rule 10b-5 is what South Carolina needs to serve the purpose of section 35-1-1210, and whether it is appropriate for anyone other than the legislature to provide the answer. Subjective state interests are far too important in this area to be subjected to judicial borrowing.

Trust & Banking Co., 336 F. Supp. 890 (D. Me. 1971). *See generally* *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977) (discussion of Congressional purpose in Parts III and IV of the opinion).

105. 17 C.F.R. § 240.10b-5 (1986). This rule was promulgated pursuant to Exchange Act § 10(b), 15 U.S.C. § 78j(b) (1982).

106. UNIF. SEC. ACT § 101 7B U.L.A. 516 (1958).

107. *See* Farmer & Feldman, *Fraud in Securities Transactions: A Comparison of Remedies Under the Ohio Securities Act, the Uniform Securities Act, and the Federal Securities Acts*, 49 U. CIN. L. REV. 814, 821 (1980); Long, *supra* note 94, at 554; *see also* UNIF. SEC. ACT § 101 comment, 7B U.L.A. 516 (1958).

108. S.C. CODE ANN. § 35-1-1210 (1976).

109. *See infra* notes 121-24 and accompanying text.

A. *Compensatory Remedies Under Securities Fraud Statutes*

Whether the South Carolina securities market needs a compensatory securities fraud rule is beyond the scope of this Article. Should empirical study show that injury related to securities fraud is going unredressed, one might make a strong case in favor of such a rule. If securities fraud is a wrong, should there not be redress for those injured by the wrong? Technical difficulties arise in tailoring remedies to injury in a compensatory context because the conceptual scope of securities fraud is far broader than that of common-law fraud. Framing such a law requires empirical study of the markets, careful drafting, and a decision as to where in the law such a rule is to be found. All of these considerations must be addressed in terms of the perceived wrong to be redressed and the purpose of the new rule. The Legislature is best suited to address these considerations.

South Carolina Code section 35-1-1210 makes it “unlawful” to employ any fraudulent or deceptive device in connection with the offer, sale, or purchase of any security.¹¹⁰ It does not, by its terms, create any private right of action. This alone does not foreclose the possibility of an implied private action, however, because of “the general principle or [sic] of tort law that violation of a provision of a criminal statute can, unless expressly or impliedly negated by the statute itself, give rise to a civil remedy in tort.”¹¹¹ In the case of section 35-1-1210, however, the statute expressly and impliedly negates an implied civil remedy.

The implied negative lies in section 35-1-1490 of the Code,¹¹² which creates an explicit, although limited, civil remedy

110. S.C. CODE ANN. § 35-1-1210 (1976).

111. *Trussell v. United Underwriters, Ltd.*, 228 F. Supp. 757, 765 (D. Colo. 1964). The federal courts have developed a four-part inquiry in considering whether a federal statute implies a private right of action: (1) whether the plaintiff is a member of a class for whose especial benefit the statute was enacted; (2) whether there is any explicit or implicit indication of congressional intent to create or deny the particular remedy sought to the particular plaintiff seeking it; (3) whether the remedy sought, for the plaintiff seeking it, is consistent with the underlying purpose of the legislative scheme; and (4) whether the action is one traditionally relegated to state law, so that it would be inappropriate to infer a cause of action based solely on federal law. *See, e.g.*, *Cort v. Ash*, 422 U.S. 66 (1975); *Liberty Nat'l Ins. Holding Co. v. Charter Co.*, 734 F.2d 545 (11th Cir. 1984), and authority cited therein.

112. S.C. CODE ANN. § 35-1-1490 (1976).

for buyers whose sellers have violated the Code. The presence of this remedy implies legislative intent to exclude further private remedies.¹¹³ The express negative is found in South Carolina Code section 35-1-1560,¹¹⁴ the codification of Uniform Act section 410(h).¹¹⁵ Section 35-1-1560 provides in pertinent part:

The rights or remedies provided by this Chapter are in addition to any other rights or remedies that may exist at law or in equity, but this chapter does not create any cause of action not specified in this section or in [section] 35-1-510 [broker-dealer surety bonds in connection with registered offerings].¹¹⁶

The official comment to section 410(h) notes: “[M]ere presence of certain specific liability provisions in a statute is no assurance that other liabilities will not be implied by the courts under the doctrine which creates a common-law tort action for violation of certain criminal statutes.”¹¹⁷ Accordingly, the draftsmen of the Uniform Act inserted the last-quoted clause of section 410(h) “to assure that no comparable development [to the implied action under rule 10b-5] is based on violation of [section] 101 of this Act.”¹¹⁸ In addition, the commentary to section 101 of the Uniform Act notes that neither the borrowing of rule 10b-5 jurisprudence in particular nor the creation of a private action in general was intended under section 101.¹¹⁹ This commentary makes specific reference to section 410.¹²⁰

The intentions of the draftsmen of the Uniform Act are, therefore, clear, and the Legislature adopted their statutory structure virtually intact, without any indication that the Legislature’s views differed from the published views of the draftsmen. In the absence of any other expression of legislative intent, these circumstances may fairly be taken as an endorsement by the legislature of the draftsmen’s views.¹²¹

113. See *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 883, 864 (2d Cir. 1968) (Friendly, J., concurring).

114. S.C. CODE ANN. § 35-1-1560 (1976).

115. UNIF. SEC. ACT § 410(h), 7B U.L.A. 643 (1958).

116. S.C. CODE ANN. § 35-1-1560.

117. COMMENTARY, *supra* note 7, at 151.

118. *Id.*

119. See UNIF. SEC. ACT § 101 comment, 7B U.L.A. 516 (1958). Professor Loss considers the latter course preferable. See COMMENTARY, *supra* note 7, at 8.

120. See UNIF. SEC. ACT § 101 comment, 7B U.L.A. 516.

121. See *Goodman v. Poland*, 395 F. Supp. 660, 681-82 (D. Md. 1975). The district

The official comment to Uniform Act section 101 observes that the sanctions for securities fraud contemplated by that section are administrative proceedings, injunction, and criminal prosecution, except for the very limited private civil action of section 410(h).¹²² By putting the tools of enforcement of the Uniform Act almost solely into the hands of public regulatory authorities, the regulatory purpose of the Act is served without interference from the complex and diverse state laws on civil compensation and restitution. The intent of the Act is the regulation of the securities markets, not the superimposition of statutory civil actions upon existing state law. It is the ends and means of market regulation for which uniformity and coordination are sought, not the extent to which individual states choose to give their citizens relief once regulatory norms have been violated. The structure of the Act reflects a balance between predictability in interstate markets and interference with the civil remedies of the individual states. Most courts that have been asked to imply a private right of action under state law provisions based upon section 101 have declined to do so.¹²³ The prin-

court opined, "Inasmuch as the Maryland legislature certainly had the Commissioners' Notes and Draftsmen's Commentary before it during its deliberations on the adoption of sections 101 and 410 [the Uniform Securities Act bases for S.C. CODE ANN. § 35-1-1490 (1976)], its nearly verbatim acceptance of those sections must be deemed an expression of legislative intent against the development of an implied right of action on behalf of a defrauded seller." *Id.* at 681-82. There is no indication (other than the court's supposition) that the Legislature in fact considered the Notes and Commentary).

122. COMMENTARY, *supra* note 7, at 6. *But see* Cahill v. Ernst & Ernst, 625 F.2d 151 (7th Cir. 1980). In Cahill Judge Pell, dissenting from a decision that the Wisconsin analogue to § 101 does not imply a rule 10b-5 private action, argues that both laws are "intended to punish intentional wrongful conduct and make the perpetrators of such conduct liable for all the consequential damages caused by their acts." *Id.* at 157 (Pell, J., dissenting). Judge Pell's argument appeared to be that consequential damages are part of the punishment and their availability is a deterrent, but this begs the important question of how "consequent damages" are to be calculated in a securities fraud action. In matching relief to injury, courts administering state law must be conscious of an existing body of jurisprudence. *See infra* notes 126-31 and accompanying text. The tenor of Judge Pell's argument is that damages for securities fraud should be compensatory in effect (although penal in nature) but, in light of their remedial nature, should not be constrained by the limits of available state actions comprehending compensatory remedies. Similar arguments have been made in dissents in the United States Supreme Court. *See, e.g.,* Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (Blackmun, J., dissenting); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (Blackmun, J., dissenting).

123. *See, e.g.,* Diamond v. LaMotte, 709 F.2d 1419, 1423 (11th Cir. 1983) (construing Georgia's version of Uniform Securities Act, GA. CODE ANN. §§ 10-5-1 to -5-24 (1982 & Supp. 1986)); O'Hara v. Kovens, 625 F.2d 15, 17-18 (4th Cir. 1980), *cert. denied*, 449 U.S.

cial exception is based on a state legislature's failure to enact Uniform Act section 410(h).¹²⁴ South Carolina enacted section 410(h).¹²⁵ Thus, statutory purpose (insofar as we are able to ascertain it), the theory and design of the statute, and the weight of authority argue against implying any private civil action under section 35-1-1210. In addition to these factors, there are at least two further reasons why courts construing section 35-1-1210 should not borrow rule 10b-5 jurisprudence. One is the complexity and special nature of the state law of deceit and misrepresentation. The other is the peculiar body of precedent that has developed under rule 10b-5, which has itself taken on a strongly regulatory aspect.

1. Arguments Against Borrowing

a. Deceit and Misrepresentation

The action implied under rule 10b-5 is related to common-

1124 (1981); *Roberts v. Magnetic Metals Co.*, 611 F.2d 450, 453 (3rd Cir. 1979); *Dupuy v. Dupuy*, 551 F.2d 1005, 1023 n.31 (5th Cir. 1977), *cert. denied*, 434 U.S. 911 (1977); *IDS Progressive Fund, Inc. v. First of Michigan Corp.*, 533 F.2d 340, 343 (6th Cir. 1976); *Nichels v. Koehler Management Corp.*, 541 F.2d 611, 613 n.2 (6th Cir. 1976); *Friedlander v. Troutman, Sanders, Lockerman & Ashmore*, 595 F. Supp. 1442, 1452 (N.D. Ga. 1984); *Margaret Hall Found. v. Atlantic Fin. Management, Inc.*, 572 F. Supp. 1475 (D. Mass. 1983); *Colonial Bank & Trust Co. v. American Bankshares Corp.*, 478 F. Supp. 1186, 1189-90 (E.D. Wisc. 1979), *aff'd sub nom. Cahill v. Ernst & Ernst*, 625 F.2d 151 (7th Cir. 1980); *Goodman v. Poland*, 395 F. Supp. 660, 680-81 (D. Md. 1975); *Cabot Corp. v. Badouir*, 394 Mass. 720, 723 n.3, 477 N.E.2d 399, 401 n.3 (1985); *Ludwig v. Mutual Real Estate Investors*, 18 Wash. App. 33, 42-44, 567 P.2d 658, 663 (1977); *see also* *Eacho v. Bouvier*, Civ. A. No. 83-2903 (D.D.C. May 24, 1985) (asking counsel for briefs on results in other states and statutory history); *Foster v. Jessup & Lamont Sec.*, 482 So. 2d 1201 (Ala. 1986) (declining to decide the issue as unnecessary to disposition of dispute). *But see* *Carothers v. Rice*, 633 F.2d 7, 10-12 (6th Cir. 1980), *cert. denied*, 450 U.S. 998 (1981) (Kentucky did not adopt Uniform Securities Act § 410(h)); *Bailey v. Piper, Jaffray & Hopwood, Inc.*, 414 F. Supp. 475, 481 (D. Minn. 1976) ("likely" that § 101 analogue gives rise to an implied action).

Relatively few courts have faced the question as one dispositive of disputes. *But see* *Goodman*, 395 F. Supp. at 681-82; *Ludwig*, 18 Wash. App. at 42-44, 567 P.2d at 663-64. Most analysis of the question is in the context of seeking the most closely analogous state statute of limitations in 10b-5 actions. Of course, such analysis is dispositive of actions in many cases. For a brief discussion of this point, see Recent Decisions, *Statutes of Limitations in 10b-5 Actions*: *White v. Sanders*, 34 ALA. L. REV. 131 (1984).

124. *See* *Carothers v. Rice*, 633 F.2d 7, 10-11 (6th Cir. 1980) (failure to enact § 410(h), which proscribes implied remedies and limits plaintiffs' remedies to those expressly within § 410, indicates Kentucky Legislature's willingness to allow implied remedies under their blue sky law).

125. *See* S.C. CODE ANN. § 35-1-1560 (1976).

law doctrines of deceit, misrepresentation, and, in some respects, breach of fiduciary duty.¹²⁶ The federal wrong of securities fraud is “superimposed” on these doctrines and common law is borrowed to provide the elements of the wrong and the available remedies.¹²⁷ In view of the remedial purposes of the federal securities laws, “at the very least the most liberal common law views” are borrowed for rule 10b-5, and in fact, securities fraud is not limited to common law notions of fraud, in either federal or state securities law.¹²⁸

If construed to provide comprehensive compensatory and restitutionary remedies, this broadly interpreted federal cause of action, which carries with it a considerably complex and ill-understood common law,¹²⁹ would interfere considerably with related state-developed remedies. Adoption of this cause of action seems contrary to a state’s subjective interest in the consistency of its actions and remedies.¹³⁰ The United States Supreme Court has tried to avoid this result.¹³¹ Does South Carolina wish to impose upon itself the very interference from which the Supreme Court has attempted to spare it? Even if the answer might be “yes,” the Legislature is the appropriate body to resolve this question.

126. See generally D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES § 9.3, at 614-15; FUNDAMENTALS, *supra* note 5, at 799.

127. See, e.g., FUNDAMENTALS, *supra* note 5, at 812.

128. *Id.* at 813.

129. See T. HAZEN, *supra* note 28, at 449, and sources cited therein. As Professor Hazen notes, the elements authorities of a 10b-5 cause of action are “seriously in dispute today.” *Id.*

130. For example, the desired relationship between the elements of a South Carolina civil action in securities fraud and those of the South Carolina common-law action for deceit should be explored before the federal common law of deceit under rule 10b-5 is adopted. See UNIF. SEC. ACT § 401(d), 7B U.L.A. 578 (1958); S.C. CODE ANN. § 35-1-20(4) (1976) (“‘Fraud’, ‘deceit’ and ‘defraud’ are not limited to common-law deceit.”) (emphasis in original); COMMENTARY, *supra* note 7, at 93 (“Section 401(d) codifies the holdings that ‘fraud’ as used in federal and state securities statutes . . . is not limited to common-law deceit.”); see also, e.g., *Gold Kist, Inc. v. C & S Nat’l Bank*, 286 S.C. 272, 279, 333 S.E.2d 67, 72 (1985); *Elders v. Parker*, 286 S.C. 228, 233-34, 332 S.E.2d 563, 566 (Ct. App. 1985).

131. See *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977); cf. *Cort v. Ash*, 422 U.S. 66, 79-80 (1975) (criminal penalty for corporate malfeasance not necessarily preclude implied private cause of action, but must have statutory basis for implying civil action in favor of plaintiff); Warren, *supra* note 20, at 507-09, and authority cited therein.

b. Regulatory Versus Compensatory

The primary argument for borrowing federal jurisprudence under rule 10b-5 is the absence of a civil remedy for sellers under the SCUSA and the absence of any civil remedy for buyers other than rescission. If securities fraud is a wrong, should there not be a remedy for those who can show injury?

The strongest rebuttal to this argument is that the United States Supreme Court has held rule 10b-5 not to be principally compensatory or restitutionary; as interpreted, it does not provide a comprehensive range of remedies to those affected by securities fraud.¹³² The Court has permitted employment of the private action under the rule only insofar as necessary to fulfill the congressional purpose of complete and correct disclosure in securities transactions and not as a general avenue to redress for investors seeking to tie their injuries to securities fraud.¹³³ The Court adheres to this regulatory interpretation of the rule while acknowledging that substantial classes of injured investors are left without an action under the rule.¹³⁴ If a cause of action supporting comprehensive remedies for securities fraud is desired in addition to existing state law actions and remedies, the answer is not the body of law that has developed under rule 10b-5.

B. South Carolina Precedent

Two cases address the availability of an implied private civil action under South Carolina Code section 35-1-1210. One of these is unreported and in the other, the issue was not contested. In *Carver v. Blanford*,¹³⁵ an action brought under the SCUSA, a purchaser of 100% of the stock in the defendant's business sought rescission under the SCUSA and also alleged fraud. The supreme court thought it possible to interpret plaintiff/appellant Carver's complaint as alleging a private cause of

132. See, e.g., *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). The recent trend of United States Supreme Court decisions has been one of "limiting the remedies" available for implied civil actions under the federal securities laws. T. HAZEN, *supra* note 28, at 439.

133. See *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977), and authority cited therein.

134. See, e.g., *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 758-59 (1975) (Powell, J., concurring).

135. 288 S.C. 309, 342 S.E.2d 406 (1986).

action for securities fraud under the SCUSA. The court noted, however, that the appellant “admits that [Code section 35-1-1210] does not create a private cause of action.”¹³⁶ There was no further discussion of that issue in the opinion.

In the unreported decision of *Kitchens v. U.S. Shelter Corp.*,¹³⁷ a federal district judge declined to dismiss a complaint founded upon an implied action under section 35-1-1210. As for South Carolina Code section 35-1-1560 (South Carolina’s version of Uniform Act section 410(h))¹³⁸ and its provision that “this Chapter does not create any cause of action not specified in this section or [section] 35-1-510,”¹³⁹ the court determined, “There is no indication, under state law, that section 35-1-1560 was enacted to preclude private rights of action under the South Carolina Securities Act.”¹⁴⁰

The district court in *Kitchens* considered arguments based upon the commentary to the SCUSA as failing in light of South Carolina case law which, in the words of the court, “makes clear that the purpose of [section] 35-1-1560 was to insure that the civil remedies set forth in the South Carolina Uniform Act are properly joined with common law actions in fraud and deceit.”¹⁴¹

136. *Id.* at 311 n.2, 342 S.E.2d at 407 n.2.

137. 1984-85 Fed. Sec. L. Rep. (CCH) ¶ 91,838 (D.S.C. 1984). The complaint alleged material omissions and misstatements in a registration statement and prospectus relating to the defendants’ offer to the plaintiffs of an exchange of shares of stock in the defendants’ corporation for plaintiffs’ interests in limited partnerships, so that the plaintiff was in effect a seller. *See id.*

138. S.C. CODE ANN. § 35-1-1560 (1976).

139. *Id.*

140. *Kitchens*, 1984-85 Fed. Sec. L. Rep. at ¶¶ 90,203-90,204.

141. *Id.* at ¶ 90,204. For this proposition, the court cited *Bradley v. Hullander*, 266 S.C. 188, 222 S.E.2d 283 (1976). *Bradley* was an action by purchasers against sellers of shares of stock. The action was brought under the identical predecessor provision to S.C. CODE ANN. § 35-1-1490 (1976), i.e., S.C. CODE ANN. § 62-309 (1962) (express action for rescission for buyers of securities), and common-law fraud. The defendants demurred, arguing that the two causes could not properly be joined in a complaint because they sought inconsistent remedies. The order denying the demurrer was appealed to the South Carolina Supreme Court, which ruled that common-law fraud and a securities fraud action for rescission could properly be joined. 266 S.C. at 195, 222 S.E.2d at 287. In support of its ruling, the court quoted the following language from S.C. CODE ANN. § 62-316 (1962), the identical predecessor provision to § 35-1-1560: “The rights and remedies provided by this chapter are in addition to any other rights or remedies that may exist at law or in equity, but this chapter does not create any cause of action not specified in this section or § 62-111,” 266 S.C. at 194, 222 S.E.2d at 287.

The legislature’s purpose in enacting this provision, wrote the court, was “to provide that the civil remedies set forth in the Act are in addition to all other causes of action or

The opinion goes on to refer to the verbal similarities between Code section 35-1-1210 and rule 10b-5 and the possibility of the “development of implied remedies at the state level paralleling that [sic] available under [r]ule 10b-5.”¹⁴² The *Kitchens* opinion is correct that in light of section 35-1-1560 and the pronouncement of the South Carolina Supreme Court in *Bradley v. Hullander*,¹⁴³ the SCUSA does not preempt existing state law remedies. The further conclusions of the opinion, however, described as “clear” by the court are rather opaque since foreclosure of preemption cannot, in good sense, be read to be the only purpose of section 35-1-1560. In that case, what meaning are we to give to the words: “[t]his Chapter does not create any cause of action not specified . . .”?¹⁴⁴ The purpose of those words—to prevent the implication of actions—is clear from their plain meaning and from the draftsmen’s comments and has been generally recognized.¹⁴⁵

Alternatively, one can interpret the opinion to mean that existing actions are available to redress harm flowing from section 35-1-1210 violations. If this is the true meaning of *Kitchens*, then the references to rule 10b-5 are gratuitous. Reference to the rule is not necessary to determine that if the elements of an existing cause of action can be proven in a securities context, a plaintiff may maintain the action. The nonpreemption clause of section 35-1-1560 contains language to this effect. The “does not create” clause of section 35-1-1560 means that while existing actions are not preempted, new actions are not to be founded on section 35-1-1210 by implication.

Not only are the *Kitchens* ruling and its accompanying dicta on shaky ground under the statute, they seem inappropriate on grounds of comity. The issues involved in effectively altering a statutory scheme by implying actions, with the possibility of borrowing the complex law of rule 10b-5, are far more appropriate for resolution by the Legislature than by a federal district court in a motion hearing. In a recent federal district court case applying Georgia law, *Friedlander v. Troutman*,

remedies at law or in equity.” *Id.* at 195, 222 S.E.2d at 287.

142. *Kitchens*, 1984-85 Fed. Sec. L. Rep. at ¶¶ 90,203-90,204.

143. 266 S.C. 188, 222 S.E.2d 283 (1976).

144. S.C. CODE ANN. § 35-1-1560.

145. See authority cited *supra* note 123.

Sanders, Lockerman & Ashmore,¹⁴⁶ the court declined to imply a private right of action under Georgia's section 101 analogue¹⁴⁷ "[b]ecause a federal court should not determine so important an issue of state law as a matter of first impression"¹⁴⁸

V. CONCLUSION

Looking for guidance to the federal law in interpreting the South Carolina Uniform Securities Act has advantages for the State. It can also promote uniformity among the states and coordination with the federal scheme of securities regulation. State courts and securities regulators, however, should pursue these latter policies only insofar as they are not inconsistent with State interests. In any event, borrowing should be used only after consideration of the similarities and differences in function and purpose of the federal and State laws: "Looking for guidance" should not become borrowing without analysis. Finally, the federal laws are not the only ones to which South Carolina can look for guidance. Thirty-nine other jurisdictions have adopted versions of the Uniform Act.¹⁴⁹ Some of these adopting jurisdictions have numerous recorded decisions interpreting the Act.¹⁵⁰ The problems addressed in these decisions are often more similar to those faced in South Carolina than are the problems addressed under the federal securities laws, and their solutions are informed by doctrines more closely related to those of South Carolina.

If appropriate authorities determine that South Carolina needs a private civil action to provide restitutionary and com-

146. 595 F. Supp. 1442 (N.D. Ga. 1984); see also *Diamond v. Lamotte*, 709 F.2d 1419 (11th Cir. 1983). In *Diamond* the Eleventh Circuit was not faced with the issue of an implied action, but noted that the Georgia § 101 analogue created no express action in favor of sellers, when making a "most analogous action" analysis to determine a statute of limitation applicable to rule 10b-5. *Id.* at 423. Federal courts that have been willing to decide the issue have usually followed the wording of the statute and the intentions of the draftsmen and declined to imply a cause of action. See authority cited *supra* note 123.

147. GA. CODE ANN. § 10-5-12 (1982 & Supp. 1986).

148. *Friedlander*, 595 F. Supp. at 1452. The court added, "'Federal courts should not be overeager to hold on to the determination of issues that might be more appropriate to settlement in state court litigation.'" (quoting *Strachman v. Palmer*, 177 F.2d 427, 433 (1st Cir. 1949), quoted in *United Mine Workers v. Gibbs*, 383 U.S. 715 (1966)).

149. See authority cited *supra* note 58.

150. See *id.*

pensatory remedies for securities fraud injuries, such an action should be developed giving due consideration to the nature of causes of action and relationships between injury and relief under current South Carolina law. If there is a need, it should be addressed comprehensively with a view to complementing existing South Carolina jurisprudence, rather than reflexive borrowing and consequent superimposition of jurisprudence developed elsewhere.