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The South Carolina Uniform Securities Act of 2005: A Balancing Act under a New Blue Sky

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THE SOUTH CAROLINA UNIFORM SECURITIES ACT OF 2005: A BALANCING ACT UNDER A NEW BLUE SKY

I. INTRODUCTION

Corruption, manipulation, and false promises of easy money have plagued investors throughout the history of the securities markets. In the 1920s, Charles Ponzi scammed thousands of people out of millions of dollars in an international postal coupon scheme.[1] More recently, the disclosure of fraudulent financial statements by Enron cost investors billions of dollars.[2] The collapse of Carolina Investors and HomeGold revealed that South Carolina is not free from the reaches of securities fraud.[3] In addition to these headline-making scandals, other less notorious schemes have created equally damaging results. Several years ago, James Cowburn lost his life savings in a fraudulent investment scheme known as the "Cash 4 Titles Program."[4]

A goal of the securities laws is to protect investors from such fraudulent schemes.[5] In response to recent scandals, Congress and state legislatures have pushed to protect investors through more stringent securities regulation. Following the collapses of Enron and WorldCom, Congress passed the Sarbanes-Oxley Act of 2002[6] to enhance corporate accountability for fraudulent acts.[7] In South Carolina, the HomeGold and Carolina Investors financial debacle prompted the General

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1. This type of investment scheme eventually became known as a "Ponzi Scheme," defined as:
> A fraudulent investment scheme in which money contributed by later investors generates artificially high dividends for the original investors, whose example attracts even larger investments. Money from the new investors is used directly to repay or pay interest to earlier investors, usua[lly] without any operation or revenue-producing activity other than the continual raising of new funds.

BLACK'S LAW DICTIONARY 1198 (8th ed. 2004). For a brief discussion of Ponzi's famous investment scheme, see Cunningham v. Brown, 265 U.S. 1, 7–8 (1924).

2. For insight into the collapse of Enron and its effect on securities regulation, see John R. Kroger, *Enron, Fraud, and Securities Reform: An Enron Prosecutor's Perspective*, 76 U. COLO. L. REV. 57 (2005).

3. For a discussion of the collapse of Carolina Investors and HomeGold, see Jennifer L. Hess, Note, *Facing the Fear of Fraud: The Rise of Senate Bill 555 After the Fall of Carolina Investors*, 55 S.C. L. REV. 653, 653–55 (2004).

4. Cowburn v. Leventis, 366 S.C. 20, 28, 619 S.E.2d 437, 442 (Ct. App. 2005).

5. *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 849 (1975) ("The primary purpose of [the securities laws] was to eliminate serious abuses in a largely unregulated securities market."); *see also* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976) ("[The securities laws were] designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing.").

6. Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

7. *See* William S. Duffey, Jr., *Corporate Fraud and Accountability: A Primer on Sarbanes-Oxley Act of 2002*, 54 S.C. L. REV. 405, 406 (2002).

Assembly to increase the statute of limitations for securities fraud and to "empower[] a state grand jury to investigate and enforce state securities laws."[8]

Increasing investor protection does not come without cost. Stringent securities regulation imposes a substantial burden on businesses that seek to offer or make transactions in securities by raising the cost of capital formation.[9] The dual system of registration created by state and federal law further increases the burden of compliance with securities laws.[10] If the cost of capital formation becomes too high, businesses may relocate to other states, taking job opportunities and economic stimulation with them. The South Carolina General Assembly therefore must provide enhanced investor protection while also preserving the interests of state businesses.

The General Assembly may have struck a balance with the South Carolina Uniform Securities Act of 2005[11] (New Uniform Securities Act). The New Uniform Securities Act provides "for an enhanced role of the state in securities regulation and investor protection."[12] However, the New Uniform Securities Act also achieves greater coordination with the federal securities laws, providing for a more uniform system of regulation. This added uniformity decreases the complexities traditionally imposed by the dual system of regulation and alleviates the burdens securities laws place on state businesses. In this regard, the New Uniform Securities Act balances the interests of both state investors and state businesses, making South Carolina a more attractive place to invest and conduct business.

This Comment analyzes the impact of the South Carolina Uniform Securities Act of 2005 on South Carolina securities regulation. Part II sets forth the history of South Carolina securities regulation and discusses the adoption of the New Uniform Securities Act. Part III discusses the background and reasoning the South Carolina Court of Appeals employed in *Cowburn v. Leventis*.[13] Part IV analyzes the New Uniform Securities Act against the backdrop of *Cowburn* to determine the impact the New Uniform Securities Act has on the registration of securities, the registration of broker-dealers, and the methods used to enforce violations of the Act. Part V concludes that the New Uniform Securities Act attempts to balance the interests of state investors and state businesses by providing increased investor protection,

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8. *See* Hess, *supra* note 3, at 655.

9. *See* Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 DUKE L.J. 945, 948 (1993).

10. *See* Brian J. Fahrney, Comment, *State Blue Sky Laws: A Stronger Case for Federal Pre-Emption Due to Increasing Internationalization of Securities Markets*, 86 NW. U. L. REV. 753, 756-57 (1992). *But see* Stefania A. Di Trolio, Note, *Public Choice Theory, Federalism, and the Sunny Side to Blue-Sky Laws*, 30 WM. MITCHELL L. REV. 1279, 1307 (2004) (arguing that regulation of the securities market at both the state and federal levels "is efficient because federalism itself is efficient").

11. 2005 S.C. Acts 681 (codified at S.C. CODE ANN. §§ 35-1-101 to -703 (Supp. 2005)). This Comment cites specific sections of the South Carolina Uniform Securities Act of 2005 as "S.C. CODE ANN. § 35-1-___ (Supp. 2005)." The South Carolina Uniform Securities Act of 2005 amends earlier South Carolina law regulating securities. This Comment cites sections of the amended securities laws as: "S.C. CODE ANN. § 35-1-___ (Supp. 2004) (amended 2006)."

12. 2005 S.C. Acts 681, 681 (capitalization omitted).

13. 366 S.C. 20, 619 S.E.2d 437 (Ct. App. 2005).

while at the same time decreasing the complexity of South Carolina securities regulation through greater coordination with federal securities laws.

II. BACKGROUND OF SOUTH CAROLINA SECURITIES REGULATION

A. Federal Securities Regulation and State Blue Sky Laws

Securities regulation exists at both the state and the federal levels.[14] The main sources of federal securities regulation are the Securities Act of 1933[15] (Securities Act), which regulates the initial offering of securities,[16] and the Securities Exchange Act of 1934[17] (Exchange Act), which regulates the trading of securities subsequent to their initial issue.[18] These federal statutes constitute the backbone of most securities regulation in the United States.[19]

The laws promulgating the regulation of securities at the state level are generally known as blue sky laws.[20] The term "blue sky laws" originated in a comment made by Justice McKenna that the laws were aimed at "speculative schemes which have no more basis than so many feet of 'blue sky.'"[21] Kansas enacted the first blue sky law in 1911,[22] and every American jurisdiction has since followed suit.[23] Although commentators have developed several different theories explaining the sudden appearance of blue sky laws in the early part of the twentieth century,[24] most agree the main purpose behind blue sky laws is to protect the public from abuse in securities transactions.[25]

Prior to the 1930s, blue sky laws served as the only mechanism to protect investors from fraud.[26] Since that time, however, the federal government has provided for the regulation of securities under the Securities Act and the Exchange

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14. Richard B. Smith, *A New Uniform Securities Act*, WALLSTREETLAWYER.COM: SECURITIES IN THE ELECTRONIC AGE, Feb. 2003, *available at* WL 6 No. 9 GLWSLAW 8.

15. Ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aa (2000 & Supp. 2003)).

16. *See* 1 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 225 (3d ed. 1998).

17. Ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a-78nn (2000 & Supp. 2003)).

18. *See* 1 LOSS & SELIGMAN, *supra* note 16, at 226.

19. *See* THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION § 1.0[2] (4th ed. 2002).

20. *See id.* § 1.2[2].

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

22. *See* HAZEN, *supra* note 19, § 8.1.

23. *See* A.S. Goldmen & Co. v. N.J. Bureau of Sec., 163 F.3d 780, 781 (3d Cir. 1999) (citing LOSS & SELIGMAN, *supra* note 16, at 41).

24. *See* Paul G. Mahoney, *The Origins of the Blue-Sky Laws: A Test of Competing Hypotheses*, 46 J.L. & ECON. 229 (2003).

25. *See Hall*, 242 U.S. at 550 ("[T]he law is a regulation of business, constrains conduct only to that end, the purpose being to protect the public against the imposition of unsubstantial schemes and the securities based upon them."); *see also A.S. Goldmen & Co.*, 163 F.3d at 781 ("The purpose of these so-called 'blue sky' laws was to allow state authorities to prevent unknowing buyers from being defrauded into buying securities that appeared valuable but in fact were worthless." (citing Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347 (1991))).

26. The first state blue sky law was passed in 1911, twenty-two years prior to the passage of the Securities Act of 1933. *See supra* note 22.

Act. Why subject businesses to a dual system of securities regulation at both state and federal levels? Richard B. Smith, Chair of the Uniform Securities Act of 2002 drafting committee, suggested:

> [t]here is fraudulent activity at a level that eludes federal regulators, even when federal law applies. . . . Many schemes to defraud investors involve locally generated pyramid schemes, misrepresentation and scams. Without state regulation accompanied by civil and criminal enforcement of the law in state courts, there would be little hope of redress for many victimized investors.[27]

Furthermore, federal and state securities laws traditionally have embodied different theories of enforcement. The federal securities laws emphasize full disclosure, allowing investors to protect themselves by making informed decisions.[28] The paternalistic blue sky laws emphasize a system of "merit regulation" in which the securities administrator[29] reviews the terms of securities offers for the protection of the investor.[30] These two theories of enforcement are quite different. "[Blue sky laws] are directed toward the exercise of the judgment of the securities administrator. Investor self-protection is only a secondary goal."[31]

Regardless of the reasons for regulation at both the state and federal levels, blue sky laws play a significant role in regulating securities, and the securities practitioner must therefore be aware of the blue sky laws of each state that a securities transaction may reach. In this regard, the dual system of regulation dramatically increases the complexity of securities regulation and imposes substantial burdens on businesses engaging in securities transactions.

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27. Smith, *supra* note 14.

28. *See* Martin C. McWilliams, Jr., *Thoughts on Borrowing Federal Securities Jurisprudence under the Uniform Securities Act*, 38 S.C. L. REV. 243, 249 (1987).

29. In South Carolina, the securities administrator is the South Carolina Attorney General. S.C. CODE ANN. § 35-1-102(28) (Supp. 2005).

30. *See* McWilliams, *supra* note 28, at 249–50. The New Uniform Securities Act continues to permit "merit regulation." However, the New Uniform Securities Act is not particularly as focused on "merit" as past blue sky laws in large part because of the preemption of federal covered securities from "merit regulation" by the National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 and 29 U.S.C.). *See* Smith, *supra* note 14.

31. McWilliams, *supra* note 28, at 251.

B. *History of South Carolina Blue Sky Laws*

South Carolina enacted its first blue sky law in 1915.[32] In accordance with blue sky laws around the country, the purpose of the 1915 Act was to prevent fraud in the sale and disposition of securities.[33] By requiring the registration of securities[34] and broker-dealers,[35] and by prescribing the methods for enforcement,[36] the 1915 Act contained many of the methods of securities regulation South Carolina uses today.

In 1961, the South Carolina General Assembly passed the South Carolina Uniform Securities Act[37] (Old Uniform Securities Act). The General Assembly modeled the Old Uniform Securities Act on the Uniform Securities Act of 1956 promulgated by the Uniform Law Commissioners.[38] The Uniform Securities Act of 1956 served as the model for the blue sky laws of thirty-six other states,[39] representing the first step towards uniformity between state and federal securities laws.[40]

The Old Uniform Securities Act continued the primary methods of regulation used by South Carolina's first securities act: (1) the registration of securities,[41] (2) the registration of securities professionals,[42] and (3) the enforcement of regulations by the Securities Commissioner and private investors.[43] The Old Uniform Securities Act received a few modifications by amendment prior to 2006.[44] Significant amendments to the Old Uniform Securities Act occurred in 1997[45] to reflect the preemption provisions of the federal National Securities Markets Improvement Act

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32. Act of March 25, 1915, 1915 S.C. Acts 251.

33. *See id.* at 251.

34. *See, e.g., id.* § 12 (making it unlawful to sell securities unless the securities commissioner issues a certificate of approval).

35. *See, e.g., id.* § 9 (requiring the registration of dealers and agents desiring to sell securities within the state).

36. *See, e.g., id.* § 19 (making violation of the Act a misdemeanor offense).

37. Act of April 14, 1961, 1961 S.C. Acts 185.

38. *See* McWilliams, *supra* note 28, at 244.

39. Smith, *supra* note 14.

40. *Cf.* McWilliams, *supra* note 28, at 244 (discussing statements by the drafter of the Uniform Securities Act of 1956 expressing a desire to provide for the "'interchangeability' between state and federal precedent in certain areas.").

41. *See, e.g.*, S.C. CODE ANN. § 35-1-810 (Supp. 2004) (amended 2006) (making it unlawful for a person to offer or sell a security unless it is registered with the Securities Commissioner or exempt from registration under the act).

42. *See, e.g., id.* § 35-1-410 (making it unlawful for any person to transact business in South Carolina as a broker-dealer or agent unless registered with the Securities Commissioner or exempt from registration under the act).

43. *See, e.g., id.* § 35-1-1490 (providing a private cause of action to buyers of securities to enforce violations of the Act).

44. *See, e.g.*, Act of June 15, 1992, 1992 S.C. Acts 2404 (amending various provisions relating to broker-dealers, agents, investment advisers, and investment adviser representatives).

45. Act of June 13, 1997, 1997 S.C. Acts 638.

of 1996 (NSMIA)[46] and again in 2003[47] to provide enhanced investor protection in response to collapse of Carolina Investors and HomeGold.

C. *The South Carolina Uniform Securities Act of 2005*

The most recent change in South Carolina securities regulation occurred on June 1, 2005, when Governor Sanford signed the South Carolina Uniform Securities Act of 2005 into law.[48] The stated purpose of the New Uniform Securities Act is to

> provid[e] for an enhanced role of the state in securities regulation and investor protection including registration of initial public offerings by issuers and control persons; registration of broker-dealers and their agents and investment advisors and their representatives; expanded investigatory and enforcement powers through subpoena power, criminal penalties set by the state, and state civil and administrative liability; facilitation of electronic filing; and investor education.[49]

The General Assembly modeled the New Uniform Securities Act after the Uniform Securities Act of 2002, promulgated by the Uniform Law Commissioners. South Carolina was the tenth state to "adopt" the new model act.[50] The three overarching themes of the Uniform Securities Act of 2002 were (1) an "objective[] of uniformity [and] cooperation among relevant state and federal governments"; (2) "achieving consistency with NSMIA"; and (3) "facilitating electronic records, signatures, and filings."[51] Richard Smith, Chair of the Uniform Securities Act drafting committee, described the uniform act as a "carefully balanced result" reflecting "consensus support from most representatives of the broad array of government and private sector interests."[52] The structure of the New Uniform Securities Act is consistent with the structures of past acts, containing provisions dealing with (1) the registration of securities,[53] (2) the registration of securities

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46. Pub. L. No. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 and 29 U.S.C.).

47. For a discussion of the response of the South Carolina General Assembly to the collapse of Carolina Investors and HomeGold, see Hess, *supra* note 3, at 655–57.

48. 2005 S.C. Acts 681 (codified at S.C. CODE ANN. §§ 35-1-101 to -703 (Supp. 2005)).

49. *Id.* at 681 (capitalization omitted).

50. Uniform Securities Act, http://www.uniformsecuritiesact.org (follow "Enactments" hyperlink) (last visited March 7, 2006).

51. Joel Seligman, *The New Uniform Securities Act*, 81 WASH. U. L.Q. 243, 245–46 (2003).

52. Smith, *supra* note 14.

53. *See, e.g.*, S.C. CODE ANN. § 35-1-301 (Supp. 2005) (making it unlawful for a person to sell a security in South Carolina unless the security is registered with the Securities Commissioner, exempt from registration under the Act, or preempted from registration as a federal covered security).

professionals,[54] and (3) the enforcement of the regulations by the Securities Commissioner and private investors.[55]

III. BACKGROUND AND REASONING OF *COWBURN V. LEVENTIS*

The New Uniform Securities Act is extensive and complex. A complete understanding of its provisions and the effect on South Carolina securities regulation would require exhaustive study. *Cowburn v. Leventis,*[56] a case recently decided by the South Carolina Court of Appeals, addressed a few of the fundamental issues related to securities regulation. Significantly, *Cowburn* raised issues related to the three basic methods of securities regulation utilized by both the old and new securities acts: (1) the registration of securities, (2) the registration of broker-dealers, and (3) the enforcement of the regulations by the Securities Commissioner and private investors. Although the notes and bonds in *Cowburn* are not typical of the securities that practitioners regularly encounter, an analysis of the New Uniform Securities Act against the backdrop of *Cowburn* provides a mechanism to examine the effect the New Uniform Securities Act has on existing securities regulation.

A. Facts and Procedural Posture

Cowburn concerned the precise kind of fraudulent investment scheme that states designed blue sky laws to address. In *Cowburn*, James Cowburn lost a substantial amount of money he invested in an illegal Ponzi scheme known as the "Cash 4 Titles Program" (the Program).[57] After learning of the Program through a co-worker,[58] Cowburn met with Andrew Leventis, an attorney who "played an essential role in marketing and referring investors to the Program."[59] The promoters described the Program as being "engaged in the business of issuing short-term, high interest rate notes and bonds for the purpose of funding the automobile title lending industry."[60] Cowburn asserted he invested in the Program because of his discussions with Leventis and another promoter.[61]

In addition to Leventis's referral of Cowburn, Leventis referred numerous other investors to the Program and received fees for those referrals.[62] Leventis's 1998 tax

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54. *See, e.g., id.* § 35-1-401 (making it unlawful for a person to transact business in the state as a broker-dealer unless the person is registered with the Securities Commissioner or exempt from registration under the Act).

55. *See, e.g., id.* § 35-1-509 (providing a private right of action to buyers of securities for violations of certain provisions of the Act).

56. 366 S.C. 20, 619 S.E.2d 437 (Ct. App. 2005).

57. *Id.* at 28, 619 S.E.2d at 442.

58. *Id.* at 28, 619 S.E.2d at 442.

59. *Id.* at 34, 619 S.E.2d at 445.

60. *Id.* at 28, 619 S.E.2d at 442.

61. *Id.* at 29, 619 S.E.2d at 442.

62. Cowburn v. Leventis, 366 S.C. 20, 32, 619 S.E.2d 437, 444 (Ct. App. 2005).

return reflected that he received over $120,000 in referral fees.[63] Leventis was also the sole owner of Priority Advisors, a company "in the business of referring people to the Program."[64] Priority Advisors reported $297,367 in referral income for 1999 and received an ownership interest in Southwestern Holdings—an entity involved with the Program—without purchasing it.[65] Leventis also assisted investors by providing written information about the Program, supplying the appropriate forms, and, in some cases, even filling out the forms for the investors.[66]

Fidelity National Bank (Fidelity) served "as the conduit through which investors could contribute to the Program."[67] Cowburn transferred money from his individual retirement account (IRA) into a newly opened, self-directed IRA with Fidelity and completed the paperwork required for Fidelity to invest in the notes and bonds connected with the Program.[68] Cowburn's investments consisted of two 270-day promissory notes from Bellwether Holdings dated in 1998, three seven-year bonds from Southwestern Holdings dated in 1999, and two 270-day promissory notes from Southern Title Holdings dated in 1999.[69]

In October 1999, Leventis informed Cowburn that the Program was an illegal Ponzi scheme and that all of Cowburn's invested money was gone.[70] Cowburn then sued Leventis and Fidelity, alleging various causes of action, including a private civil action for violation of the Old Uniform Securities Act.[71] Leventis and Fidelity filed motions for summary judgment, which the trial court granted.[72] Cowburn then appealed to the South Carolina Court of Appeals.[73]

B. The South Carolina Court of Appeals' Holding and Analysis

The court of appeals upheld the trial court's grant of summary judgment to Leventis and Fidelity with respect to most of Cowburn's claims.[74] However, the court of appeals concluded that the trial court erred in granting summary judgment to Leventis with regard to Cowburn's claims for violations of the Old Uniform Securities Act.[75] In doing so, the court of appeals identified disputed, material questions of fact as to whether Cowburn's investments were exempt from the Act's registration requirements and whether Leventis failed to register as a broker-dealer or agent in violation of the Act.[76]

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63. *Id.* at 34, 619 S.E.2d at 445.
64. *Id.* at 34, 619 S.E.2d at 445.
65. *Id.* at 34, 619 S.E.2d at 445.
66. *Id.* at 32, 619 S.E.2d at 444.
67. *Id.* at 29, 619 S.E.2d at 442.
68. Cowburn v. Leventis, 366 S.C. 20, 29, 619 S.E.2d 437, 442 (Ct. App. 2005).
69. *Id.* at 29, 619 S.E.2d at 442.
70. *Id.* at 29, 619 S.E.2d at 442.
71. *Id.* at 29, 619 S.E.2d at 443.
72. *Id.* at 30, 619 S.E.2d at 443.
73. *Id.* at 30, 619 S.E.2d at 443.
74. Cowburn v. Leventis, 366 S.C. 20, 49–50, 619 S.E.2d 437, 453 (Ct. App. 2005).
75. *Id.* at 50, 619 S.E.2d at 453.
76. *Id.* at 50, 619 S.E.2d at 453.

1. Applicability of the Old Uniform Securities Act

In reaching its decision, the court of appeals first had to determine whether Cowburn's investments were securities governed by the Old Uniform Securities Act.[77] The Old Uniform Securities Act defined "security" to include "'any note, stock, treasury stock, bond, debenture, [or] evidence of indebtedness.'"[78] Because Cowburn's investments were promissory notes and bonds, the court concluded that the investments were securities regulated by the Old Uniform Securities Act.[79]

2. Private Right of Action

The court of appeals then determined whether the sale of the securities gave rise to a cause of action.[80] The Old Uniform Securities Act provided a private right of action for buyers of securities against any person who offered or sold securities in violation of the Act's security registration requirements or the broker-dealer registration requirements.[81] The remedy afforded to buyers of securities by the Old Uniform Act was "the consideration paid for the security, together with . . . interest, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security."[82] Cowburn relied on this private right of action in attempting to obtain relief for Leventis's alleged violations of the Act.

3. Registration of Securities

Under the Old Uniform Securities Act, it was unlawful for any person to offer or sell any security unless (1) the security was registered with the Securities Commissioner, (2) the security or transaction was statutorily exempt from registration, or (3) the security was a federal covered security.[83] Leventis's first argument for avoiding liability under the Old Uniform Securities Act was that he did not make an offer to sell securities.[84] The Old Uniform Securities Act defined "offer to sell" as "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value."[85] The court of appeals described Leventis's practices of introducing investors to the program, receiving referral fees,

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77. *Id.* at 30, 619 S.E.2d at 443.

78. *Id.* at 30, 619 S.E.2d at 443 (quoting S.C. CODE ANN. § 35-1-20(15) (Supp. 2004) (amended 2006) (alteration in original)).

79. *Id.* at 30, 619 S.E.2d at 443. In its opinion, the court of appeals stated, "[W]e find there is a genuine issue of material fact as to whether the securities were exempt." Cowburn v. Leventis, 366 S.C. 20, 32, 619 S.E.2d 437, 444 (Ct. App. 2005). This statement refers to whether the securities are exempt from the registration provisions of the Old Uniform Securities Act, not whether they meet the definition of a security. *See infra* text accompanying notes 86–95.

80. *See Cowburn*, 366 S.C. at 31, 619 S.E.2d at 443–44.

81. *See* S.C. CODE ANN. § 35-1-1490 (Supp. 2004) (amended 2006).

82. *Id.*

83. *See id.* § 35-1-810.

84. *See Cowburn*, 366 S.C. at 31, 619 S.E.2d at 444.

85. S.C. CODE ANN. § 35-1-20(13)(b).

providing written information to potential investors, arranging meetings between the principals of the Program and potential investors, and filling out the requisite forms to assist with the transactions as going "beyond simply recommending an investment to a friend."[86] The court of appeals viewed Leventis as "play[ing] an integral role in the Program" and concluded that a question of material fact existed as to whether Leventis made an offer to sell securities.[87]

Leventis further argued that he was not liable for failing to register the securities because they were exempt from registration as commercial paper under the Old Uniform Securities Act.[88] Former section 35-1-310(9) exempted:

> Any commercial paper which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions and which evidences an obligation to pay cash within nine months of the date of issuance, exclusive of days of grace, or any renewal of such paper which is likewise limited, or any guarantee of such paper or of any such renewal[.][89]

The court of appeals defined "commercial paper" to include any "short-term unsecured promissory note, usu[ally] issued and sold by one company to meet another company's immediate cash needs."[90] Because repayment of Cowburn's initial investments in the notes was due within nine months, the court concluded that the notes were exempt from registration as commercial paper.[91]

In analyzing Cowburn's subsequent investments, the court of appeals noted that they were made from the redemption proceeds of the original notes and included several seven-year bonds not exempt from registration as commercial paper.[92] Leventis argued that these subsequent investments were exempt from registration as "rollover transactions" under former section 35-1-320(11),[93] which exempted:

> Any transaction pursuant to an offer to existing security holders of the issuer, including persons who at the time of the transaction are holders of convertible securities, if (a) no commission or other remuneration, other than a standby commission, is paid or given directly or indirectly for soliciting any security holder in this State or (b) the issuer first files a notice specifying the terms of the offer

86. *Cowburn*, 366 S.C. at 31–32, 619 S.E.2d at 444.
87. *Id.* at 31–32, 619 S.E.2d at 444.
88. *Id.* at 31, 619 S.E.2d at 444.
89. S.C. CODE ANN. § 35-1-310(9) (Supp. 2004) (amended 2006).
90. Cowburn v. Leventis, 366 S.C. 20, 32 n.3, 619 S.E.2d 437, 444 n.3 (Ct. App. 2005) (quoting BLACK'S LAW DICTIONARY 1143 (8th ed. 2004)).
91. *Id.* at 32, 619 S.E.2d at 444.
92. *Id.* at 32–33, 619 S.E.2d at 444.
93. *Id.* at 32–33, 619 S.E.2d at 444.

> and the Securities Commissioner does not by order disallow the exemption within the next five full business days[.][94]

The court rejected Leventis's exemption argument, noting that "Cowburn did not invest with the same issuer for each transaction" and that Leventis received "referral fees" for the transactions.[95] The court of appeals held that those facts gave rise to a question of material fact as to whether the securities were exempt as "rollover transactions" under the Old Uniform Securities Act.[96]

4. Registration as a Broker-Dealer

Section 35-1-410 of the Old Uniform Securities Act made it unlawful for any person to transact business in South Carolina as a broker-dealer or agent unless registered pursuant to the Act.[97] The Old Uniform Securities Act defined "broker-dealer" as "any person engaged in the business of *effecting transactions in securities* for the account of others or for his own account"[98] and defined "agent" as "any individual, other than a broker-dealer, who represents a broker-dealer or issuer *in effecting or attempting to effect purchases or sales of securities*."[99] The court of appeals relied on Leventis's substantial role in referring investors to the program, his assistance with the transactions, his role as sole owner of Priority Advisors and the substantial referral fees he received in connection with the Program suggested Leventis was "effecting transactions in securities."[100] Therefore, the court of appeals found evidence indicating that Leventis acted as a broker-dealer or agent.[101]

Leventis did not dispute that he failed to register as a broker-dealer or agent, but instead argued he was exempt from registration under section 35-1-415(3)(b) of the Old Uniform Securities Act.[102] Section 35-1-415(3)(b) provided an exemption for "agent[s] acting for an issuer in effecting transactions in a security exempted" from registration.[103] Because the court concluded that a material question of fact existed as to whether the securities were exempt from registration, the court also concluded a material question of fact existed as to whether Leventis was exempt from registering as a broker-dealer or agent based on section 415(3)(b).[104]

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94. S.C. CODE ANN. § 35-1-320(11) (Supp. 2004) (amended 2006).
95. *Cowburn*, 366 S.C. at 33, 619 S.E.2d at 444–45.
96. *Id.* at 33, 619 S.E.2d at 444–45.
97. S.C. CODE ANN. § 35-1-410 (Supp. 2004) (amended 2006).
98. *Id.* § 35-1-20(3) (emphasis added).
99. *Id.* § 35-1-20(2) (emphasis added).
100. Cowburn v. Leventis, 366 S.C. 20, 34, 619 S.E.2d 437, 445 (Ct. App. 2005) (quoting S.C. CODE ANN. § 35-1-20).
101. *Id.* at 34, 619 S.E.2d at 445.
102. *Id.* at 34, 619 S.E.2d at 445.
103. S.C. CODE ANN. § 35-1-415(3) (Supp. 2004) (amended 2006).
104. *Cowburn*, 366 S.C. at 34, 619 S.E.2d at 445.

Leventis further argued he was exempt from registration as a broker-dealer under South Carolina Attorney General Order Number 97003 because he was an officer or director of Southwestern Holdings, an issuer of the securities.[105] Order Number 97003 exempts officers or directors of issuers from registration so long as they provide notice to the Securities Commissioner containing the

> names and corporate titles of each principal, partner, officer and director of the issuer along with a signed statement from each . . . indicating they: (1) perform . . . substantial duties for or on behalf of the issuer otherwise than in connection with transactions in securities . . . and (2) will not be compensated in connection with their participation . . . [in] transactions in securities.[106]

The court of appeals held that a genuine issue of material fact existed as to whether Order Number 97003 exempted Leventis from registration because he failed to file a statement with the Securities Commissioner stating he would perform other duties not in connection with transactions in securities or that he would not be compensated for his services.[107] Because material questions of fact existed as to whether Leventis sold securities in violation of the securities registration and broker-dealer registration requirements, the court of appeals reversed the trial court's summary judgment for Leventis on the alleged violations of the Old Uniform Securities Act.[108]

IV. ANALYSIS OF THE SOUTH CAROLINA UNIFORM SECURITIES ACT OF 2005 AGAINST THE BACKDROP OF *COWBURN V. LEVENTIS*

This Part analyzes the New Uniform Securities Act against the backdrop of *Cowburn* to determine the effect the New Uniform Securities Act has on South Carolina securities regulation. Section A discusses the applicability of the New Uniform Securities Act to the notes and bonds involved in *Cowburn* with emphasis on the changes to the definition of "security" in the new Act. Section B analyzes Leventis's liability under the New Uniform Securities Act for failure to register the notes and bonds and also discusses changes regarding proper methods of registration and the exemptions from registration, emphasizing the NSMIA's preemption of federal covered securities. Section C analyzes Leventis's liability under the New Uniform Securities Act for failure to register as a broker-dealer and includes discussions of changes made to the methods of and exemptions from broker-dealer registration. Section C analyzes the inclusion of banks in the expanded definition of broker-dealer as a possible source of a claim by Cowburn

105. *Id.* at 35, 619 S.E.2d at 445.
106. S.C. Att'y Gen. Order No. 97003 (1997).
107. *See Cowburn*, 366 S.C. at 35, 619 S.E.2d at 446.
108. Cowburn v. Leventis, 366 S.C. 20, 35, 619 S.E.2d 437, 446 (Ct. App. 2005).

against Fidelity. Section D discusses the New Uniform Securities Act's enforcement provisions, focusing on changes to the private civil action used in *Cowburn* and emphasizing the addition of a private civil action for sellers of securities as well as the addition of a private civil remedy for violation of South Carolina's general antifraud provision. Section D concludes with a brief discussion of the South Carolina Securities Commissioner's enhanced enforcement power.

A. Applicability of the New Uniform Securities Act

The 270-day notes and seven-year bonds involved in *Cowburn* fall within the scope of securities governed by the New Uniform Securities Act. Section 35-1-102(29) continues to include "any note; stock; treasury stock; . . . bond; debenture; [or] evidence of indebtedness" in the definition of security.[109] The notes and bonds involved in *Cowburn* satisfy that definition. On a basic level, the New Uniform Securities Act would continue to provide Cowburn some protection with respect to his investments in the Program.

Nonetheless, the definition of security in the New Uniform Securities Act does contain some relevant modifications. For example, the term "security" under the new Act expressly includes both certified and uncertified securities.[110] This modification clarifies that the term security is "intended to apply whether or not a security is evidenced by a writing."[111] The New Uniform Securities Act also clarifies that interests in limited partnerships and limited liability companies may be included in the definition of security as investment contracts.[112]

The drafters of the new Act strived to achieve a consistency between the definition of security in the federal acts and the definition in the New Uniform Securities Act.[113] To illustrate, consider the federal Commodity Futures Modernization Act of 2000,[114] which recently amended the definition of security in the Securities Act of 1933 to include security futures and security puts, calls, straddles, options, or privileges.[115] The New Uniform Securities Act mirrors that amendment by including security futures and security puts, calls, straddles, options,

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109. S.C. CODE ANN. § 35-1-102(29) (Supp. 2005).

110. *Id.* § 35-1-102(29)(A).

111. *Id.* § 35-1-102 cmt. 28.

112. *See id.* § 35-1-102(29)(E). In light of this provision, an interest in a limited liability company cannot be deemed a security under any other category in the Act's general definition of security. For a discussion of the treatment of membership interests in limited liability companies as securities under the Old Uniform Securities Act, see James J. Mayberry, Comment, *Should Limited Liability Company Membership Interests Be Treated as Securities in South Carolina?*, 52 S.C. L. REV. 827 (2001).

113. *See* S.C. CODE ANN. § 35-1-102 cmt. 28.

114. Pub. L. No. 106-554, 114 Stat. 2763A-365 (2000).

115. *Id.* § 208, 114 Stat. at 434–35. The Commodity Futures Modernization Act amended the Securities Act by subjecting security futures products to regulation as a securities. *See id.* The amendment defines security futures by reference to the Securities Exchange Act of 1934. *See id.*; *see also* 15 U.S.C. § 78c(a)(56) (2000) ("The term 'security futures product' means a security future or any put, call, straddle, option, or privilege on any security future.").

or privileges in its definition of security.[116] Consistency in the definition of security between the state and federal securities laws is an example of how the New Uniform Securities Act provides greater coordination with federal law. By allowing state businesses to depend on one uniform definition of security, the New Uniform Securities Act simplifies the complexities inherent in the dual system of regulation.

B. Registration of Securities

Like its predecessor, the New Uniform Securities Act imposes requirements for the registration of securities. Section 35-1-301 of the New Uniform Securities Act provides, "It is unlawful for a person to offer or sell a security in this State unless: (1) the security is a federal covered security; (2) the security, transaction, or offer is exempted from registration under [the Act]; or (3) the security is registered under this chapter."[117] This provision is substantively identical to the analogous provision in the Old Uniform Securities Act.[118] Leventis would therefore face liability for violation of the New Uniform Securities Act unless he could present evidence proving: (1) he properly registered the notes and bonds involved with Cowburn's investments; (2) the securities or transactions involved were explicitly exempt from registration; or (3) the notes and bonds were federal covered securities, which are preempted from state regulation.[119]

1. Proper Registration of Securities

Under the New Uniform Securities Act, issuers can register securities either by qualification[120] or by coordination.[121] Registration by qualification is ordinarily the method used when no other method of registration is available.[122] Registration by qualification requires the issuer to file a "full-fledged" registration statement analogous to a federal registration statement with the South Carolina Securities Commissioner.[123] "[S]maller issuers whose securities are either intrastate offerings

116. *See* S.C. CODE ANN. § 35-1-102(29) (Supp. 2005).

117. S.C. CODE ANN. § 35-1-301.

118. *Compare* S.C. CODE ANN. § 35-1-810 (Supp. 2004) (amended 2006) ("It is unlawful for any person to offer or sell any security in this State unless (a) it is registered under this chapter, (b) the security or transaction is exempted under [the Act], or (c) it is a federal covered security."), *with* S.C. CODE ANN. § 35-1-301 (Supp. 2005) ("It is unlawful for a person to offer or sell a security in this State unless: (1) the security is a federal covered security; (2) the security, transaction, or offer is exempted from registration under [the Act]; or (3) the security is registered under this chapter.").

119. *See* S.C. CODE ANN. § 35-1-301 (Supp. 2005).

120. *See* S.C. CODE ANN. § 35-1-304 (Supp. 2005).

121. *See id.* § 35-1-303.

122. *See id.* § 35-1-304 S.C. Reporter's cmt. 2.

123. *See id.* § 35-1-304 S.C. Reporter's cmt. 2.

or are exempt from SEC registration because of their small size" typically use registration by qualification.[124]

Registration by coordination is a method allows an issuer to register securities that are already registered with the Securities and Exchange Commission (SEC) pursuant to the federal Securities Act with the South Carolina Securities Commissioner.[125] Under this method, the latest prospectus filed with the SEC, along with a few additional documents and the registration statement specified in Section 35-1-305, must be submitted to the Securities Commissioner.[126] Under the New Uniform Securities Act, the Securities Commissioner retains the ability to require the filing of additional information, such as financial statements, with the registration application.[127] Registration by coordination is largely an innovation of the Old Uniform Securities Act.[128] However, the New Uniform Securities Act modernizes the provisions to permit electronic filing and electronic notification.[129] This modernization provides a platform for simultaneous electronic registration with the SEC and the South Carolina Securities Commissioner.[130] The ability to perform simultaneous registration can be a tremendous benefit to businesses that issue securities within the state.

Leventis did not register Cowburn's investments either by coordination or by qualification and therefore could not claim that he properly registered the securities under the New Uniform Securities Act. However, Leventis would be shielded from liability if the securities were exempt from registration. The Court of Appeals concluded that Cowburn's nine-month notes were exempt from registration under the Old Uniform Securities Act because they consisted of short-term commercial paper.[131] Does the New Uniform Securities Act provide a similar exemption for commercial paper?

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124. *Id.* § 35-1-304 S.C. Reporter's cmt. 2. Securities offerings that are exempt from federal registration because they are intrastate or because of their small size are not generally considered federal covered securities. *See infra* text accompanying notes 161–81.

125. *See* S.C. CODE ANN. § 35-1-303(a) (Supp. 2005).

126. *See id.* § 35-1-303(b). Section 35-1-305 requires the submission of a general registration statement specifying "the amount of securities to be offered" in South Carolina, other states in which a similar registration statement has been filed, and "any adverse order, judgment, or decree issued in connection with the offering." *Id.* § 35-1-305(c). This general registration statement is used in both registration by qualification and registration by coordination. *See id.* § 35-1-305 cmt. 2.

127. *See id.* § 35-1-303(b)(3); *see also id.* § 35-1-303 cmt. 4 ("Section 303(b) is not intended to limit the administrator to requiring only the information and records filed with the Securities and Exchange Commission."); *id.* § 35-1-303 S.C. Reporter's cmt. 1 (Supp. 2005) ("[U]nder prior law, the [s]ecurities [c]ommissioner issued S.C. Regs. 113–10 concerning the submission of financial statements with a registration application. Pursuant to Sections 605(a) and (c) the [Securities Commissioner] will have the authority to issue a similar regulation.").

128. *See* S.C. CODE ANN. § 35-1-303 cmt. 1 (Supp. 2005).

129. *See id.* § 35-1-303 cmt. 3.

130. *Id.*

131. *See* Cowburn v. Leventis, 366 S.C. 20, 32, 619 S.E.2d 437, 444 (Ct. App. 2005).

2. Exemptions under the New Uniform Securities Act

Article Two of the New Uniform Securities Act provides the registration exemptions.[132] The Act provides two types of registration exemptions: exempt securities[133] and exempt transactions.[134] Exempt securities retain their exemption as long as the securities maintain the required attributes.[135] In contrast, exempt transactions cover only specific transactions and must be established each time the securities are resold.[136] Short-term commercial paper was an exempt security under the Old Uniform Securities Act.[137]

The New Uniform Securities Act retains many of the exemptions for securities contained in the Old Uniform Securities Act. For example, the New Uniform Securities Act continues exemptions for federal, state, and municipal securities;[138] foreign government securities;[139] and common carrier and public utility securities.[140] Further, the New Uniform Securities Act combines three prior exemptions under the Old Uniform Securities Act—specified bank and depository institution securities,[141] savings and loan securities,[142] and credit union securities[143]—into a common exemption for depository institution and international banking institution securities.[144] The New Uniform Securities Act also retains exemptions for securities issued by nonprofit organizations[145] and for membership or ownership interests in nonprofit cooperatives if the security is not resold to a person who is not a member of the cooperative.[146]

The New Uniform Securities Act, however, modifies some of the Old Uniform Securities Act's provisions relating to exempt securities. The New Uniform Securities Act provides increased investor protection by allowing the Securities Commissioner to adopt rules regulating nonprofit debt offerings.[147] Thus, the Securities Commissioner can determine whether there is a need for investor protection from fraudulent debt offerings by alleged nonprofit companies. If so, the New Uniform Securities Act gives the Securities Commissioner the ability to adopt rules and regulations to limit fraudulent nonprofit debt offerings. Other modifications by the New Uniform Securities Act include the addition of

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132. *See* S.C. CODE ANN. §§ 35-1-201 to -204 (Supp. 2005).
133. *See id.* § 35-1-201.
134. *See id.* § 35-1-202.
135. HAZEN, *supra* note 19, § 4.1[5].
136. 3 LOSS & SELIGMAN, *supra* note 16, at 1231.
137. *See* S.C. CODE ANN. § 35-1-310 (Supp. 2004) (amended 2006) (including the exemption for short-term commercial paper in the list of exempt securities).
138. *See* S.C. CODE ANN. § 35-1-201(1) (Supp. 2005).
139. *See id.* § 35-1-201(2).
140. *See id.* § 35-1-201(5).
141. *See* S.C. CODE ANN. § 35-1-310(3) (Supp. 2004) (amended 2006).
142. *See id.* § 35-1-310(4).
143. *See id.* § 35-1-310(5).
144. *See* S.C. CODE ANN. § 35-1-201(3) (Supp. 2005).
145. *See id.* § 35-1-201(7).
146. *See id.* § 35-1-201(8).
147. *See id.*

exemptions for securities issued by insurance companies authorized to do business in South Carolina[148] and for equipment trust certificates issued to persons when used in connection with certain financing devices that are exempt under the state or federal securities laws.[149]

A modification relevant to *Cowburn* is the discontinuance of an explicit exemption for short-term commercial paper.[150] This modification indicates the New Uniform Securities Act would require Leventis to register Cowburn's initial investments in the 270-day promissory notes. However, Leventis could use another provision to avoid liability for failing to register Cowburn's investments—he could present evidence that Cowburn's initial investments were federal covered securities.

3. *Federal Covered Securities*

a. *Preemption of State Securities Regulation by the National Securities Markets Improvement Act*

Congress passed the National Securities Markets Improvement Act of 1996 (NSMIA)[151] in response to the redundant, costly, and inefficient hardships imposed on businesses as a result of the dual system of securities regulation.[152] The NSMIA "preempted significant parts of state power to duplicate federal regulation."[153] One facet of the NSMIA prevents states from regulating federal covered securities.[154] Accordingly, if a security falls within the preemption provisions of the NSMIA, then the New Uniform Securities Act cannot also require registration.[155]

To illustrate the preemption of federal covered securities, consider the following example. The NSMIA explicitly preempts from state regulation those securities that are exempt from federal registration pursuant to SEC rules or regulations promulgated under the nonpublic offering exemption of the Securities Act.[156] Congress designed the nonpublic offering exemption "to apply to specific or isolated sales as well as offerings to a very small number of securities holders so that the public interest is not involved."[157] In *SEC v. Ralston Purina Co.*,[158] the

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148. *See id.* § 35-1-201(4).

149. *See id.* § 35-1-201(9).

150. *Compare* S.C. CODE ANN. § 35-1-201 (Supp. 2005) (omitting an exemption for short-term commercial paper), *with* S.C. CODE ANN. § 35-1-310(a) (Supp. 2004) (amended 2006) (providing an exemption for short-term commercial paper).

151. Pub. L. No. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 and 29 U.S.C.).

152. *See* 1 LOSS & SELIGMAN, *supra* note 16, at 60-61.

153. Smith, *supra* note 14.

154. *See* 15 U.S.C. § 77r(a) (2000).

155. The South Carolina Securities Commissioner may, however, require a notice filing of federal covered securities that are not listed on national securities exchanges. *See infra* text accompanying notes 206–10.

156. *See* 15 U.S.C. § 77r(b)(4)(D).

157. HAZEN, *supra* note 19, § 4.24.

158. 346 U.S. 119 (1953).

United States Supreme Court stated, "[T]he applicability of [the nonpublic offering exemption] should turn on whether the particular class of persons affected needs the protection of the Act."[159] Arguably, offerings satisfying this definition of nonpublic offering are not exempt from state regulation as federal covered securities because the exemption does not derive from an SEC rule or regulation, but rather from a ruling of the Supreme Court.[160]

By contrast, securities exempt from registration pursuant to Regulation D may be preempted from state regulation. In 1982, the SEC provided a comprehensive scheme for the exemption of limited offerings through Regulation D.[161] Regulation D "is a series of six rules establishing three small issue or limited offering exemptions" under the Securities Act.[162] Rule 504 generally exempts offerings that do not exceed one million dollars within a twelve-month period;[163] Rule 505 generally exempts offerings that do not exceed five million dollars within a twelve-month period;[164] and Rule 506 generally exempts offerings to qualified purchasers.[165] Of these three exemptions, the SEC promulgated only Rule 506 pursuant to the nonpublic offering exemption of the Securities Act.[166] The Commission promulgated Rule 504 and Rule 505 pursuant to a statutory exemption for qualified small issues.[167] In this regard, the NSMIA preempts only those securities exempt under Rule 506 of Regulation D.[168] Securities exempt under Rule 504 or Rule 505 of Regulation D are still subject to state regulation.[169]

b. Argument for the Preemption of the Notes and Bonds Involved in Cowburn

Leventis could have avoided liability under the New Uniform Securities Act by proving the Program's notes and bonds are preempted from state regulation by the NSMIA. The New Uniform Securities Act accounts for the preemption provisions of the NSMIA by not requiring the registration of federal covered securities.[170] The New Uniform Securities Act defines "federal covered security" as "a security that is, or upon completion of a transaction will be, a covered security under Section 18(b) of the Securities Act of 1933 . . . or rules or regulations adopted

159. *Id.* at 125.
160. *See id.*
161. 17 C.F.R. §§ 230.501 to .508 (2005).
162. HAZEN, *supra* note 19, § 4.20[1].
163. 17 C.F.R. § 230.504.
164. 17 C.F.R. § 230.505.
165. 17 C.F.R. § 230.506.
166. *See* HAZEN, *supra* note 19, § 4.19.
167. *See id.*
168. *See* 15 U.S.C. § 77r(b)(4)(D) (2000); *see also* HAZEN, *supra* note 19, § 4.19 ("The only Regulation D exemption that carries a state law preemption is Rule 506—the safe harbor for nonpublic offerings.").
169. *See* HAZEN, *supra* note 19, § 4.19 ("[S]ince section 3(b) exemptions do not trigger preemption of state law, issuers relying on Rule 504 or 505 will need a parallel state law exemption.").
170. *See* S.C. CODE ANN. § 35-1-201(6) (Supp. 2005).

pursuant to that provision."[171] Section 18(b) of the Securities Act defines four types of covered securities: (1) securities listed on the New York Stock Exchange, the American Stock Exchange, the National Market System of the Nasdaq Stock Market, or other national securities exchanges;[172] (2) "securit[ies] issued by an investment company that is registered . . . under the Investment Company Act of 1940;"[173] (3) securities offered or sold to "qualified purchasers," as that term is defined by the SEC;[174] and (4) securities offered or sold in connection with an exempt transaction under the federal Securities Act.[175]

The category of federal covered securities most likely to benefit those in Leventis's situation is category four: securities offered or sold in connection with a transaction that is exempt from registration under the federal Securities Act. These securities include securities exempt from federal registration under § 3(a) of the Securities Act.[176] Section 3(a)(3) of the Securities Act—the federal commercial paper exemption—provides an exemption from registration for:

> [a]ny note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.[177]

This federal commercial paper exemption is substantially similar to the former state exemption for commercial paper Leventis relied on in *Cowburn*.[178] In this regard, Leventis could argue the Program's notes and bonds fall within the federal exemption for commercial paper. If successful, Leventis could avoid liability for failure to register the Program's notes and bonds—despite the absence of an explicit exemption for commercial paper at the state level—because the securities are preempted from registration as federal covered securities.

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171. *Id.* § 35-1-102(7).
172. *See* 15 U.S.C. § 77r(b)(1) (2000).
173. *See id.* § 77r(b)(2).
174. *See id.* § 77r(b)(3).
175. *See id.* § 77r(b)(4).
176. *See id.* § 77r(b)(4)(c).
177. 15 U.S.C. § 77c(a)(3) (2000).
178. *Compare id.* § 77c(a)(3) (providing an exemption for "[a]ny note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days grace, or any renewal thereof the maturity of which is likewise limited"), *with id.* § 35-1-310(9) (Supp. 2004) (amended 2006) (providing an exemption for "[a]ny commercial paper which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions and which evidences an obligation to pay cash within nine months of the date of issuance, exclusive of days grace, or any renewal of such paper which is likewise limited").

c. *The Preemption of Federal Covered Securities Provides Enhanced Conformity with Federal Securities Regulation*

Cowburn's commercial paper issue provides an example of how the preemption of federal covered securities under the New Uniform Securities Act provides enhanced uniformity with federal law.[179] In *Cowburn,* the court of appeals concluded the initial investments in the nine-month notes were exempt from registration pursuant to the Old Uniform Securities Act's short-term commercial paper exemption.[180] The court of appeal's analysis indicates that any note with a maturity of less than nine months would qualify for the old state commercial paper exemption.[181] Because of ambiguity regarding the scope of the federal commercial paper exemption, it is not certain that the same analysis would apply for the analogous commercial paper exemption at the federal level.

Whether the federal commercial paper exemption applies to all notes that have a maturity of less than nine months or whether the commercial paper exemption applies only to short-term commercial paper meeting a specified set of requirements is unclear. The most relevant United States Supreme Court opinion addressing the issue is *Reves v. Ernst & Young*,[182] in which the Court interpreted the scope of the commercial paper exemption as used in the Exchange Act.[183] In *Reves*, the holders of demand promissory notes issued by a farmers cooperative brought suit against an accounting firm, alleging the firm violated the antifraud provisions of the Exchange Act.[184] The Exchange Act contains an express exemption—substantially similar to the exemption in Section 3(a)(3) of the Securities Act[185]—from the definition of security for "any note . . . which has a maturity at the time of issuance of not exceeding nine months."[186] The accounting firm argued the Exchange Act exempted the demand notes from the definition of security and the firm thus could not be subject to the Exchange Act's antifraud provisions.[187] The firm relied on the statute's plain meaning, asserting that because the notes were payable upon

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179. Cowburn v. Leventis, 366 S.C. 20, 619 S.E.2d 437 (Ct. App. 2005).

180. *Id.* at 32, 619 S.E.2d at 444.

181. *Cf. id.* at 32, 619 S.E.2d at 444 ("In this case, Cowburn's initial investment consisted of short-term commercial paper exempted under [the Old Uniform Securities Act] because it was an investment in 270-day promissory notes, which were obligated to be paid within nine months." (footnote omitted)).

182. 494 U.S. 56 (1990).

183. *See id.* at 58, 70–73.

184. *Id.* at 58–59.

185. *Compare* 15 U.S.C. § 78c(a)(10) (2000) (The definition of security "shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."), *with id.* § 77c(a)(3) (The registration requirements "shall not apply to . . . [a]ny note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.").

186. *Id.* § 78c(a)(10).

187. *Reves*, 494 U.S at 70.

demand, their maturity was less than nine months and accordingly excluded by the Exchange Act.[188] In opposition, the holders of the demand notes relied on the legislative history of the analogous Section 3(a)(3) of the Securities Act to argue Congress intended to "except from the coverage of the Acts only commercial paper—short-term, high quality instruments issued to fund current operations and sold only to highly sophisticated investors."[189] The Court avoided deciding which interpretation was correct by holding the demand notes do not fall within the exemption's terms, even under the plain meaning interpretation of the exemption.[190]

Further complicating the issue, the SEC has promulgated six stringent requirements for notes to qualify for the Securities Act's commercial paper exemption: "(1) negotiability, (2) prime quality, (3) eligibility for discount at Federal Reserve Banks, (4) not ordinarily purchased by the general public, (5) used to facilitate current transactions, and (6) maturity of nine months or less with no automatic 'roll–over.'"[191] In a Securities Act release, the SEC acknowledged the exemption of commercial paper used to finance short-term loans by finance companies.[192] This authority indicates the federal commercial paper exemption applies only to securities meeting a specific set of requirements. Accordingly, Cowburn's investments, which qualified for the state commercial paper exemption under the Old Uniform Securities Act, may not have qualified for the analogous federal exemption. This discrepancy is an example of the complexities inherent in a dual system of regulation.

No such discrepancy exists under the New Uniform Securities Act. As discussed above, securities that fall within the federal commercial paper exemption are federal covered securities preempted from state regulation.[193] In this regard, if Cowburn's investments fall within the commercial paper exemption from registration at the federal level, the New Uniform Securities Act ensures the securities would also be exempt from registration at the state level.[194] If Cowburn's investments do not qualify for the commercial paper exemption under the federal Securities Act, then no provision in the New Uniform Securities Act would exempt the securities from registration at the state level because the New Uniform Securities Act no longer contains an express exemption for commercial paper.[195] Accordingly, state businesses can rely on a uniform application of the commercial

188. *Id.*

189. *Id.*

190. *Id.* at 71. The Court rejected the accounting firm's contention that the demand notes had a maturity of less than nine months because they were payable on demand. *Id.* at 72–73. Instead, the Court reasoned that demand notes may have an expiration date many years beyond nine months. *Id.* In concluding that the exemption did not apply to the demand notes in question, the Court relied on Congress's "broader purpose in the [Securities] Acts of ensuring that investments of all descriptions be regulated to prevent fraud and abuse." *Id.* at 73.

191. 3 LOSS & SELIGMAN, *supra* note 16, at 1211.

192. Interpretative Releases Relating to the Securities Act of 1933 and General Rules and Regulations Thereunder, Securities Act Release No. 33-4412, 26 Fed. Reg. 9158 (Sept. 29, 1961).

193. *See* 15 U.S.C. § 77r(b)(4)(C) (2000).

194. *See id.* § 77r(b)(4)(C); S.C. CODE ANN. § 35-1-201(6) (Supp. 2005).

195. *See* S.C. CODE ANN. § 35-1-201(6).

paper exemption at both the state and federal levels. This enhanced consistency benefits state businesses by eliminating confusion that can arise from the dual system of regulation and by lowering the costs of capital formation.

d. The New Uniform Securities Act Provides Enhanced Conformity with the NSMIA

The exemption of federal covered securities is not new to the New Uniform Securities Act. The 1997 amendments to the Old Uniform Securities Act incorporated the preemption of federal covered securities to ensure the Old Uniform Securities Act complied with the NSMIA.[196] So what benefit is the New Uniform Securities Act to businesses if the Old Uniform Securities Act already represented a step towards the uniformity of securities regulation? Some provisions in the Old Uniform Securities Act violated the preemption provisions of the NSMIA but were untouched by the 1997 amendments. The *Cowburn* case provides an example of such a provision.

Leventis argued Cowburn's subsequent investments in the seven-year bonds and 270-day promissory notes were exempt as "rollover transactions."[197] For rollover transactions to be exempt under the Old Uniform Securities Act, the party seeking the exemption had to show either: (1) "no commission or other remuneration, other than a standby commission, [was] paid or given directly or indirectly for soliciting any security holder" in the state or (2) "*the issuer first file[d] a notice specifying the terms of the offer and the Securities Commissioner [did] not by order disallow the exemption within the next five full business days.*"[198] The NSMIA preempts states from regulating rollover transactions because they are federal covered securities.[199] Accordingly, federal law preempts the regulation of the second category of rollover transactions, yet the 1997 amendments failed to change the provision. The New Uniform Securities Act avoids confusion by omitting the second category to reflect its preemption by the NSMIA.[200]

Another substantive change provided by the New Uniform Securities Act that reflects enhanced coordination with the NSMIA is the replacement of registration by notification with notice filing. Under the Old Uniform Securities Act, the issuer could register certain securities by notification,[201] which involved submission of a limited registration statement with the South Carolina Securities Commissioner.[202] Registration by notification was only available to (1) "issuers that ha[d] been in continuous operation for five years with no default on any senior security during the past three years and with a three-year average net earnings record of 5 percent

196. *See* Act of June 13, 1997, 1997 S.C. Acts 638.

197. Cowburn v. Leventis, 366 S.C. 20, 32–33, 619 S.E.2d 437, 444 (Ct. App. 2005).

198. S.C. CODE ANN. § 35-1-320(11) (Supp. 2004) (amended 2006) (emphasis added).

199. *See* 15 U.S.C. § 77r(b)(4)(C).

200. *See* S.C. CODE ANN. § 35-1-202(15) (Supp. 2005); *id.* § 35-1-202 S.C. Reporter's cmt. 15.

201. S.C. CODE ANN. § 35-1-820 (Supp. 2004) (amended 2006).

202. *See id.* § 35-1-830; *see also* 1 LOSS & SELIGMAN, *supra* note 16, at 53 ("The registration statement in a notification case is substantially limited to the information that is essential . . . .").

on their common stock"[203] or (2) for "nonissuer distribution[s] . . . [where] any security of the same class ha[d] ever been registered under" the Old Uniform Securities Act or the particular securities being registered were first issued under an exemption from registration under the Old Uniform Securities Act or a predecessor act.[204] With the NSMIA's passage, using registration by notification became a "deadletter" because most securities that qualified for registration by notification became exempt from registration as federal covered securities.[205]

The New Uniform Securities Act eliminates registration by notification altogether and replaces it with notice filing for certain federal covered securities[206] not listed on national stock exchanges.[207] Notice filing requires "consent to service of process, a filing fee, and . . . copies of material filed with the SEC" to be filed with the Securities Commissioner.[208] Notice filing differs from registration by coordination because it only applies to federal covered securities, whereas registration by coordination applies to securities registered at the federal level that are not preempted from state regulation. Just as with registration by coordination, the New Uniform Securities Act permits electronic filing of documents used in connection with notice filing,[209] allowing for more efficient registration with the Securities Commissioner.[210]

B. Registration of Broker-Dealers and Agents

Broker-dealer and agent registration "is intended to prevent dishonest or unqualified persons from entering the securities business, to supervise their activities within the state once registration has been achieved, and to remove them from registration if they fall below any of the statutory standards."[211] Broker-dealers are subject to regulation at several different levels. The federal securities laws require that broker-dealers register with the SEC.[212] Many broker-dealers are registered with the National Association of Securities Dealers and are subject to regulations imposed by that organization.[213] In addition, broker-dealers are subject

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203. 1 LOSS & SELIGMAN, *supra* note 16, at 53; *see* S.C. CODE ANN. § 35-1-820 (Supp. 2004) (amended 2006).

204. S.C. CODE ANN. § 35-1-820 (Supp. 2004) (amended 2006).

205. JOSEPH C. LONG, BLUE SKY LAW § 1:69 (West 2005).

206. *See* S.C. CODE ANN. § 35-1-302 (Supp. 2005).

207. *See id.* § 35-1-302(d) (allowing the Securities Commissioner to address deficiencies in notice filings except with respect to securities listed on a national securities exchange or on the National Market System of the Nasdaq Stock Market); *see also* Smith, *supra* note 14 ("Notice filing under the [New Uniform Securities Act] is for federal covered securities other than listed securities.").

208. Smith, *supra* note 14.

209. *See* S.C. CODE ANN. § 35-1-302 cmt. 3.

210. *See* Smith, *supra* note 14.

211. 1 LOSS & SELIGMAN, *supra* note 16, at 68–69.

212. 15 U.S.C. § 78o(a) (2000).

213. Smith, *supra* note 14.

to regulation by the state of South Carolina under the New Uniform Securities Act.[214]

The New Uniform Securities Act makes transacting business in the state as a broker-dealer or an agent unlawful "unless the person is registered . . . as a broker-dealer" or agent or the person is exempt from registration under the Act.[215] The New Uniform Securities Act defines a "broker-dealer" as "a person engaged in the business of effecting transactions in securities for the account of others or for the person's own account"[216] and an "agent" as "an individual, other than a broker-dealer, who represents a broker-dealer in effecting or attempting to effect purchases or sales of [the issuer's] securities."[217] These definitions are substantially similar to the definitions of broker-dealer and agent in the Old Uniform Securities Act.[218] Thus, Leventis's actions in *Cowburn* would likely create a material question of fact as to whether Leventis was acting as a broker-dealer or agent under the New Uniform Securities Act. Accordingly, for Leventis to avoid liability under the New Uniform Securities Act, he would have to present evidence indicating he was properly registered as a broker-dealer or agent, exempt from registration, or selling notes exempt from registration.

1. Proper Registration of Broker-Dealers

Under the New Uniform Securities Act, a broker-dealer or agent may register with the Securities Commissioner by completing the appropriate application, passing the required examinations, and paying the applicable registration fees.[219] This process is similar to broker-dealer registration under the Old Uniform Securities Act.[220] However, the New Uniform Securities Act implements a few changes that benefit broker-dealers. A noteworthy change is the removal of the list of information that broker-dealers must present to the Securities Commissioner.[221] This change gives the Securities Commissioner increased flexibility to accept standardized forms for the registration of broker-dealers.[222] The ability to use standardized registration forms provides greater uniformity in the registration

214. *See* S.C. CODE ANN. § 35-1-401 to -412 (Supp. 2005).

215. *Id.* § 35-1-401.

216. *Id.* § 35-1-102(4).

217. *Id.* § 35-1-102(2).

218. *Compare* S.C. CODE ANN. § 35-1-20 (Supp. 2004) (amended 2006) (defining "broker-dealer" as "any person engaged in the business of effecting transactions in securities for the account of others or for his own account" and "agent" as "any individual, other than a broker-dealer, who represents a broker–dealer or issuer in effecting or attempting to effect purchases or sales of securities"), *with* S.C. CODE ANN. § 35-1-102 (Supp. 2005) (defining "broker-dealer" as "a person engaged in the business of effecting transactions in securities for the account of others or for the person's own account" and "agent" as "an individual, other than a broker-dealer, who represents a broker-dealer in effecting or attempting to effect purchases or sales of [the issuer's] securities").

219. S.C. CODE ANN. § 35-1-406(a) (Supp. 2005).

220. See S.C. CODE ANN. § 35-1-440 (Supp. 2004) (amended 2006), for a description of the registration process under the Old Uniform Securities Act.

221. *See* S.C. CODE ANN. § 35-1-406 S.C. Reporter's cmt. 1 (Supp. 2005).

222. *Id.*

process across the multiple levels of regulation which broker-dealers face. Thus, the New Uniform Securities Act alleviates a burden typically imposed by multiple systems of regulation.

The New Uniform Securities Act also allows the Securities Commissioner to impose additional rules for broker-dealer registration, provided those rules are not inconsistent with the NSMIA.[223] That provision thus allows the Securities Commissioner to increase registration requirements to protect investors' interests while ensuring conformity with federal regulation by limiting the commissioner's power to that allowed under the NSMIA.

2. *Exemptions from Registration as Broker-Dealers or Agents*

The New Uniform Securities Act retains many of the Old Uniform Securities Act's registration exemptions for broker-dealers and agents. Broker-dealers exempt from registration under the New Uniform Securities Act include broker-dealers who are transacting business with certain customers in South Carolina but who do not have a place of business in the state[224] and broker-dealers that deal solely in United States government securities if certain governmental agencies supervise them.[225] The New Uniform Securities Act adds exemptions for agents "represent[ing] an issuer in connection with the purchase of the issuer's own securities"[226] and for agents who "represent[] an issuer and who restrict[] participation to performing clerical or ministerial acts."[227]

In *Cowburn,* Leventis relied unsuccessfully on an exemption for individuals effecting transactions in exempt securities.[228] The New Uniform Securities Act contains a similar exemption for "an individual who represents an issuer and who effects transactions in the issuer's securities exempted by [certain provisions of the New Uniform Securities Act]."[229] Because the provision offers no modification to the exemption relied on by Leventis under the Old Uniform Securities Act, the New Uniform Securities Act appears to provide little change in Cowburn's claim against Leventis for failing to register as a broker-dealer.

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223. *Id.* § 35-1-406(e).

224. *Id.* § 35-1-401(b)(1). These customers include: (1) "the issuer of the securities involved in the transactions"; (2) other broker-dealers; (3) institutional investors; (4) "nonaffiliated federal covered investment advis[ors] with investments under management in excess of one hundred million dollars"; (5) a bona fide preexisting customer not a resident of South Carolina; (6) a bona fide preexisting customer who is a resident of South Carolina but was not at the time the customer relationship was established; (7) a broker-dealer without more than three customers in South Carolina during the last twelve months; and (8) any other person exempted by rule adopted by the Securities Commissioner. *Id.*

225. *Id.* § 35-1-401(b)(2).

226. S.C. CODE ANN. § 35-1-402(b)(7) (Supp. 2005).

227. *Id.* § 35-1-402(b)(8).

228. Cowburn v. Leventis, 366 S.C. 20, 34, 619 S.E.2d 437, 445 (Ct. App. 2005).

229. S.C. CODE ANN. § 35-1-402(b)(4).

3. Scope of the Term Broker-Dealer

The New Uniform Securities Act significantly changes the definition of broker-dealer, which may have allowed Cowburn to bring a claim against Fidelity for violating the New Uniform Securities Act. Prior to the 1997 amendments, the Old Uniform Securities Act excluded banks from the definition of broker-dealer.[230] After the 1997 Amendments, the Old Uniform Securities Act made no reference to banks in the definition of broker-dealer.[231] However, the New Uniform Securities Act generally includes banks in the definition of broker-dealer, thereby subjecting them to regulation.[232]

Including banks in the definition of broker-dealer represents an effort to enhance conformity with the federal Gramm-Leach-Bliley Act.[233] Congress passed the Gramm-Leach-Bliley Act[234] in 1999 to increase the efficiency of the financial service industry by removing the restrictions placed on banks in the 1930s by the Glass-Steagall Act.[235] The Gramm-Leach-Bliley Act removed the blanket exclusion of banks from the definition of broker in the Exchange Act.[236] The Gramm-Leach-Bliley Act instead adopted a form of "functional regulation" in which the banks' securities affiliates would be subject to regulation by the SEC instead of bank regulators.[237] The Gramm-Leach-Bliley Act contains exceptions to the general inclusion of banks in the definition of broker, "allowing the bank to continue to effect transactions in certain 'identified banking products' without the risk of SEC regulation."[238] South Carolina chose to adopt the same functional approach by including provisions in the New Uniform Securities Act that "fully conform[] to the bank exceptions in the Graham-Leach-Bliley Act [sic]."[239]

The New Uniform Securities Act excludes banks from the definition of broker-dealer if they are excluded from the definition of broker or dealer under the federal Exchange Act.[240] The range of permissible bank activities under the Exchange Act is complex, and a complete analysis is beyond the scope of this Comment. Thus, it is unclear whether Cowburn would have a viable claim against Fidelity for

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230. *See* S.C. CODE ANN. § 35-1-102 S.C. Reporter's cmt. 4 (Supp. 2005).

231. *See* S.C. CODE ANN. § 35-1-20(3) (Supp. 2004) (amended 2006).

232. *Cf. id.* § 35-1-102(4)(C) (containing partial exclusions of banks and savings institutions from the definition of broker-dealer).

233. *Id.* § 35-1-102 cmt. 6.

234. Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified as amended in scattered sections of 12 and 15 U.S.C.).

235. *See* Paul J. Polking & Scott A. Cammarn, *Overview of the Gramm-Leach-Bliley Act*, 4 N.C. BANKING INST. 1, 1 (2000).

236. *See* Gramm-Leach-Bliley Act § 201.

237. HAZEN, *supra* note 19, § 14.4[1][B]. "Because it is impracticable in many cases for a bank itself to register as a broker-dealer, many of the securities activities traditionally conducted by banks—including certain derivative activities—must be 'pushed out' into an affiliated securities firm. . . ." Polking & Cammarn, *supra* note 234, at 16. These securities affiliates are considered "functionally regulated affiliates" with the SEC being the respective functional regulator. *Id.* at 14.

238. Polking & Cammarn, *supra* note 234, at 16.

239. S.C. CODE ANN. § 35-1-102 S.C. Reporter's cmt. 4 (Supp. 2005).

240. *See id.* § 35-1-102(4)(C).

violating the New Uniform Securities Act. Nonetheless, removing the blanket exclusion of banks from the definition of broker-dealer illustrates the balancing act that the New Uniform Securities Act performs. Subjecting banks to regulation as broker-dealers increases investor protection. At the same time, including banks in the regulatory scheme enhances coordination with the federal securities laws, simplifying the complexities traditionally imposed by the dual system of regulation.

C. Enforcement Provisions

The New Uniform Securities Act's registration and antifraud provisions are useless in providing protection for investors unless the Act has effective enforcement mechanisms. The New Uniform Securities Act provides four methods of enforcement: (1) criminal prosecution for willfully violating the Act;[241] (2) private civil suit against the person or entity violating the Act;[242] (3) civil suit brought by the Securities Commissioner to enjoin threatened violations of the Act;[243] and (4) administrative proceedings brought by the Securities Commissioner directly against the person or entity violating the Act.[244]

1. Private Civil Action

The enforcement method utilized in *Cowburn* was a private civil action against an alleged violator of the Old Uniform Securities Act.[245] The New Uniform Securities Act would provide Cowburn with a similar private cause of action as a purchaser of securities.[246] Cowburn would generally receive the same relief, if successful, under the New Uniform Securities Act as under the Old Uniform Securities Act.[247] However, despite a few similarities, the New Uniform Securities Act provides some significant modifications to the private civil action relevant in *Cowburn*.

The New Uniform Securities Act allows purchasers and sellers of securities to bring private civil actions to enforce the Act.[248] The Old Uniform Securities Act limited standing in private civil actions to purchasers only.[249] In this regard, if a

241. *Id.* § 35-1-508.
242. *Id.* § 35-1-509.
243. *Id.* § 35-1-603.
244. *Id.* § 35-1-604.
245. Cowburn v. Leventis, 366 S.C. 20, 29–30, 619 S.E.2d 437, 443 (Ct. App. 2005).
246. *See* S.C. CODE ANN. § 35-1-509(b) (Supp. 2005).
247. Similar to the private civil suit under the Old Uniform Securities Act, the New Uniform Securities Act allows a plaintiff to seek the consideration paid for the security with interest, costs, and reasonable attorneys' fees, less any income received on the security. *Id.* § 35-1-509(b)(1). If the plaintiff has already sold the security, the plaintiff may seek actual damages—"the amount that would be recoverable upon a tender less the value of the security when the purchaser disposed of it, and interest at the legal rate of interest from the date of the purchase, costs, and reasonable attorneys' fees." *Id.* § 35-1-509(b)(1) to -509(b)(3).
248. *See id.* § 35-1-509(b)–(c).
249. S.C. CODE ANN. § 35-1-1490 (Supp. 2004) (amended 2006).

buyer defrauded a seller of securities, the defrauded seller had no means of redress. The New Uniform Securities Act protects purchasers and sellers by making the private civil action remedy available to both. This change significantly enhances investor protection compared to the Old Uniform Securities Act.

Another significant modification involves the New Uniform Securities Act's antifraud provision.[250] The New Uniform Securities Act creates a private civil action for violation of section 35-1-501,[251] which provides:

> It is unlawful for a person, in connection with the offer, sale, or purchase of a security, directly or indirectly:
> (1) to employ a device, scheme, or artifice to defraud;
> (2) to make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
> (3) to engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person.[252]

The Old Uniform Securities Act contained a similar provision in former section 35-1-1210[253] but did not create a private cause of action for its violation.[254] Rather, a plaintiff who wished to bring a private cause of action for securities fraud under the Old Uniform Securities Act had to rely on former section 35-1-1490.[255] Although

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250. Regardless of whether subject to the New Uniform Securities Act's registration requirements, all securities—including federal covered securities—are subject to the anti-fraud provisions of the New Uniform Securities Act. Smith, *supra* note 14.

251. *See* S.C. CODE ANN. § 35-1-509 (Supp. 2005) (imposing civil liability on both purchasers and sellers for violating section 35-1-501, the general fraud provision).

252. *Id.* § 35-1-501. This provision "was modeled [in part] on Rule 10b-5 adopted under the Securities Exchange Act of 1934." *Id.* § 35-1-501 cmt. 1. For the language of Rule 10b-5, see 17 C.F.R. § 240.10b-5 (2005).

253. *See* S.C. CODE ANN. § 35-1-1210 (Supp. 2004) (amended 2006).

254. *See* Atlanta Skin & Cancer Clinic, P.C. v. Hallmark Gen. Partners, Inc., 320 S.C. 113, 120, 463 S.E.2d 600, 604 (1995) ("Section 35-1-1560 is indicative of the Legislature's intention that the only private remedies for securities fraud *predicated on* the Act are those specifically created by the Act itself."); *see also* McWilliams, *supra* note 28, at 270 ("Thus, statutory purpose . . . , the theory and design of the statute, and the weight of authority argue against implying any private civil action under section 35-1-1210.").

255. *See* S.C. CODE ANN. § 35-1-1490(2) (Supp. 2004) (amended 2006). This provision provided a cause of action against any person who

> [o]ffers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, the buyer not knowing of the untruth or omission, and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.

Id.; *see also* McWilliams, *supra* note 28, at 267–68 ("[S]ection 35-1-1490 . . . creates an explicit, although limited, civil remedy for buyers whose sellers have violated the Code.").

failing to provide defrauded sellers any form of redress,[256] former section 35-1-1490 provided significant advantages to defrauded buyers. For example, buyers bringing a cause of action for securities fraud under former section 35-1-1490 or its predecessor did not have to show causation,[257] reliance,[258] or scienter.[259] Accordingly, plaintiffs did not encounter great difficulty in recovering for securities fraud under section 35-1-1490 of the Old Uniform Securities Act.

By providing a private cause of action for violating section 35-1-501,[260] the New Uniform Securities Act opens the door to arguments that this private right of action should be construed in accordance with the current standards for implied rights of action under federal Rule 10b-5. Unlike private rights of action under former section 35-1-1490, implied rights of action under Rule 10b-5 require plaintiffs to show causation,[261] reliance,[262] and scienter.[263] Requiring plaintiffs to prove those elements would make it substantially more difficult for a plaintiff to establish a cause of action for fraud under the New Uniform Securities Act.

The New Uniform Securities Act permits both a private cause of action for violating section 35-1-501 and a private cause of action analogous to that exemplified by former section 35-1-1490.[264] Therefore, a plaintiff may have the ability to elect to pursue a claim under "new" section 35-1-1490—now codified in section 35-1-509(b) and (c)—or under section 35-1-501.[265] Whether adding a private cause of action for violations of section 35-1-501 brings in scienter, reliance, and causation concepts to a cause of action brought pursuant to "new"

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256. *See supra* text accompanying note 247.

257. *See* Bradley v. Hullander, 272 S.C. 6, 24, 249 S.E.2d 486, 495 (1978) ("[M]ateriality does not require a showing of reliance, causation or that the sale would not have occurred absent the misstatement or omission.").

258. *See id.* at 24, 249 S.E.2d at 495.

259. *See id.* at 35, 249 S.E.2d at 500 (noting scienter is not a required element in a private cause of action brought pursuant to the predecessor to former section 35-1-1490). Scienter is defined as a

> mental state consisting in an intent to deceive, manipulate, or defraud. In this sense, the term is used most often in the context of securities fraud. The Supreme Court has held that to establish a claim for damages under Rule 10b-5, a plaintiff must prove that the defendant acted with scienter.

BLACK'S LAW DICTIONARY 1373 (8th ed. 2004) (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976)).

260. S.C. CODE ANN. § 35-1-509(b)–(c) (Supp. 2005).

261. HAZEN, *supra* note 19, § 12.4[2] ("[I]n addition to scienter, materiality, and reliance, causation is an element of a Rule 10b-5 action.").

262. *Id.* ("Following the basic requirements for proving common law fraud, reliance is an element of any Rule 10b-5 claim.").

263. *See Ernst*, 425 U.S. at 193.

264. *See* S.C. CODE ANN. § 35-1-509(b)–(c).

265. *Cf. id.* § 35-1-509(b) ("A person is liable to the purchaser if the person sells a security in violation of Section[] . . . 35-1-501 *or*, by means of an untrue statement of a material fact or an omission to state a material fact necessary in order to make the statement made . . . not misleading. . . ." (emphasis added)); S.C. CODE ANN. § 35-1-509(c) (Supp. 2005) ("A person is liable to the seller if the person buys a security in violation of Section 35-1-501 *or* by means of an untrue statement of a material fact or omission to state a material fact necessary in order to make the statement made . . . not misleading. . . ." (emphasis added)).

section 35-1-1490 is unclear. However, the new Act presumably does not require those additional concepts for proving fraud under new section 35-1-1490. If this is the case, a plaintiff should be wary of bringing a private cause of action for a violation of section 35-1-501 because it may impose the additional burdens of proving causation, reliance, and scienter.

Another difference between the private civil suit in *Cowburn* and the private civil suit under the New Uniform Securities Act is that "[e]nforcement of civil liability under [the New Uniform Securities Act] is subject to the Securities Litigation Uniform Standards Act of 1998" (SLUSA).[266] Congress passed the Private Securities Litigation Reform Act of 1995,[267] and a major purpose of that Act was to impose class action reforms designed to discourage frivolous lawsuits.[268] However, plaintiffs' lawyers would get around the reforms by bringing class actions under state blue sky laws.[269] In response, Congress passed SLUSA "to prevent state private securities class actions lawsuits 'from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995.'"[270]

The effect of SLUSA is that states are preempted from entertaining certain class actions for securities fraud. The New Uniform Securities Act ensures conformity with SLUSA by inserting a reminder in section 35-1-509(a) that private civil actions are subject to the limitations of SLUSA.[271] This coordination with SLUSA is attractive to state businesses for two reasons: (1) state businesses do not have to worry about being subjected to securities fraud class actions at the state level, and (2) coordination with SLUSA provides uniformity between state and federal securities regulation.

2. *The Securities Commissioner's Enhanced Enforcement Power*

The New Uniform Securities Act's primary purpose, as stated by the General Assembly, is to "enhance [the] role of the state in securities regulation and investor protection."[272] Several provisions in the New Uniform Securities Act provide for this enhanced role. Significantly, the New Uniform Securities Act "amplifies the investigation, administrative, and civil enforcement" powers granted to the Securities Commissioner.[273]

The New Uniform Securities Act gives the Securities Commissioner authority to issue cease and desist orders for violations or threatened violations.[274] Under the Old Uniform Securities Act, the Securities Commissioner had to initiate

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266. *Id.* § 35-1-509(a).
267. Pub. L. No. 104-67, 109 Stat. 737 (1995).
268. HAZEN, *supra* note 19, § 12.15[1].
269. *See* 4 LOSS & SELIGMAN, *supra* note 16, at 4166–67 & n.117.
270. *Id.* at 4166–67.
271. S.C. CODE ANN. § 35-1-509(a) (Supp. 2005).
272. South Carolina Uniform Securities Act of 2005, 2005 S.C. Acts 681, 681 (capitalization omitted).
273. Seligman, *supra* note 50, at 298.
274. S.C. CODE ANN. § 35-1-604.

proceedings in state court to obtain injunctive relief against threatened violations of the state securities laws.[275] Accordingly, the Securities Commissioner's ability to issue cease and desist orders without first initiating court proceedings represents a significant enhancement of enforcement power. Although subject to some restrictions to preserve due process protections,[276] the enhanced enforcement power significantly increases the Securities Commissioner's ability to aid investors if the commissioner suspects a state business of engaging in wrongful activity.

The New Uniform Securities Act grants the Securities Commissioner other powers which enhance the ability to protect investors. One such power is the ability to "develop and implement investor education initiatives to inform the public about investing in securities."[277] By arming investors with knowledge of the securities transactions, the Securities Commissioner increases investors' ability to protect themselves. The New Uniform Securities Act also gives the Securities Commissioner the authority to conduct investigations, issue subpoenas, and otherwise provide general assistance to the securities administrators of other states.[278] This authority not only provides a mechanism for increasing investor protection for South Carolina investors but also enhances investor protection for other states' investors.

V. CONCLUSION

Analyzing the New Uniform Securities Act against the backdrop of *Cowburn* reveals numerous provisions designed to augment investor protection. By providing a private civil action for securities fraud to both buyers and sellers of securities, and by tying in a private civil action for violating the state Rule 10b-5 equivalent, the New Uniform Securities Act ensures there are no gaps in investor protection.[279] The Securities Commissioner's enhanced power to issue cease and desist orders without initiating prior court proceedings and to utilize necessary measures to protect investors of other states further protects investors. The New Uniform Securities Act even specifically enables the Securities Commissioner to adopt investor education programs to ensure investors can learn to protect themselves. In this regard, the New Uniform Securities Act unquestionably provides "an enhanced role of the state in securities regulation and investor protection"[280] and is an adequate response to the recent scandals that have already spurred sweeping changes to the securities laws.

Unlike past changes to the securities laws, the New Uniform Securities Act does not substantially increase the cost of capital formation. Analyzing the New Uniform Securities Act against the backdrop of *Cowburn* reveals specific instances

275. *See* S.C. CODE ANN. § 35-1-1480 (Supp. 2004) (amended 2006).
276. *See* S.C. CODE ANN. § 35-1-604(b) (Supp. 2005).
277. *Id.* § 35-1-601(d).
278. *See id.* § 35-1-602.
279. *Id.* § 35-1-509 S.C. Reporter's cmt. 3.
280. South Carolina Uniform Securities Act of 2005, 2005 S.C. Acts 681, 681 (capitalization omitted).

of enhanced consistency with the National Securities Markets Improvement Act, the Gramm-Leach-Bliley Act, and the Securities Litigation Uniform Standards Act of 1998. Conformity with these federal laws not only provides uniformity across a complex dual system of regulation but also ensures the efficiency-driven purposes of those federal laws are preserved at the state level. Along with establishing a platform for simultaneous registration of securities at the state and federal levels by permitting electronic filing, the enhanced conformity with federal law should facilitate the process of issuing securities and making securities transactions while lowering the costs of capital formation.

By increasing investor protection without significantly raising the costs of capital formation, the New Uniform Securities Act balances the interests of both investors and businesses. Nothing exemplifies this balance better than the orders given to the Securities Commissioner in section 35-1-608(b) of the New Uniform Securities Act:

> In cooperating, coordinating, consulting, and sharing records and information under this section and in acting by rule, order, or waiver under this chapter, the Securities Commissioner shall, in its discretion, take into consideration in carrying out the public interest the following general policies:
>
> (1) maximizing effectiveness of regulation for the protection of investors; and
>
> (2) maximizing uniformity in federal and state regulatory standards; and
>
> (3) minimizing burdens on the business of capital formation, without adversely affecting essentials of investor protection.[281]

The true effects of the New Uniform Securities Act will only be revealed with time, but the Act presently represents a positive effort by the South Carolina General Assembly to balance the interests of both investors and businesses, leading to an overall improved system of securities regulation.

J. Parks Workman

281. S.C. CODE ANN. § 35-1-608(b).