

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM RICHLAND COUNTY
Court of Common Pleas

The Honorable Tanya A. Gee
Circuit Court Judge

Case No. 2014-CP-40-07917

Appellate Case No. 2015-001845

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SC Court of Appeals

John M. McIntyre and Silver Oak Land
Management LLC,.....

Appellants,

v.

Securities Commissioner of South Carolina,.....

Respondent.

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Statement of Issues on Appeal

- I. The circuit court failed to properly review to the factual findings of the Securities Commissioner under the standard mandated by section 35-1-609 of the South Carolina Code.
- II. The membership interests in the LLCs do not qualify as securities because the members retained ultimate control over the LLCs.
- III. Even if the membership interest qualified as a security, the evidence relied upon by the Securities Commissioner does not support a violation of section 35-1-501 because the conduct did not occur at the time of the offer, sale, or purchase of the LLC interests.
- IV. The Securities Commissioner violated Appellants' due process rights by initiating an enforcement action prior to promulgating the rules applicable for such an action.
- V. No substantial evidence exists in the record because the evidence relied on by the Securities Commissioner and circuit court was inadmissible.

Statement of the Case

This cases centers on a determination by the Securities Commissioner that membership interests in seven South Carolina limited liability companies (LLC) constituted securities under the South Carolina Uniform Securities Act of 2005, Sections 35-1-101, et seq. (the “Securities Act”). {Circuit Court Order, R. ____}. The LLCs were formed between 2005 and 2009, and the membership interests were offered during that time frame. {See respective Operating Agreement for each LLC, R. ____}.

Some three-plus years after the initial offer, sale, and purchase of the membership interests in the last-formed LLCs, the Attorney General, acting as the South Carolina Securities Commissioner (the “Securities Commissioner”), issued a cease and desist order to Appellants John M. McIntyre and Silver Oak Land Management, LLC. {Cease and Desist Order dated April 9, 2013, R. ____}. The Securities Commissioner alleged at least 39 violations of the anti-fraud provision of the Securities Act, section 35-1-501 of the South Carolina Code. {Id., R. ____}.

A hearing officer appointed by the Securities Commissioner took testimony and recommend findings of facts as to the matters alleged in the cease and desist order. {Hearing Officer Recommendation dated May 6, 2014, R. ____}. After a four-day trial, the hearing officer recommended that the Securities Commissioner dismiss the case and desist order because the membership interests in the LLCs were not securities under the Securities Act. {Id. at ____, R. ____}.

The Securities Commissioner, however, rejected the recommendation and issued an order finding the membership interests constituted securities. {Remand Order dated September 12,

2014, R. ____}. As a result, Securities Commissioner remanded the matter to the hearing officer for a determination as to whether violations of the Securities Act occurred. {Id., R. ____}.

On remand, the hearing officer found violations of the Securities Act had occurred with respect to 78 investors. {Recommendation dated October 22, 2014, R. ____}. The hearing officer based those violations on findings that McIntyre misappropriated investor money without the members' knowledge or permission. {Id., R. ____}. However, the hearing officer did not find that such violations related to the time of any offer, sale, or purchase of membership interests in any LLC. {Id., R. ____}.

The Securities Commissioner accepted the recommendation in the final order. {Final Order dated November 20, 2014, R. ____}. Notably, Securities Commissioner also did not find that any of the violations related to the time of any offer, sale, or purchase of membership interests in any LLC. {Id., R. ____}. The Securities Commissioner reduced the number of violations based on the time the violations allegedly occurred. {Id., R. ____}. The Securities Commissioner found that McIntyre and Silver Oak Land Management began to misappropriate investor money by mid-2007. {Id., R. ____}. Based on that date, the Securities Commissioner reduced the number of investors to 54. {Id., R. ____}. The Securities Commissioner imposed a fine of \$540,000, ordered McIntyre and Silver Oak Land Management to cease and desist from transacting business in South Carolina, revoked any Security Act exemptions, and ordered payment for the costs of the investigation and proceedings. {Id., R. ____}.

McIntyre and Silver Oak Land Management petitioned for judicial review by the circuit court pursuant to section 35-1-609 of the South Carolina Code. {Petition for Review dated ____, R. ____}. The circuit court affirmed the final order issued by the Securities Commissioner. {Order of Circuit Court dated ____, R. ____}. Just like the hearing officer and the Securities

Commissioner, the circuit court did not find that any violation related to the time of any offer, sale, or purchase of membership interests in any LLC. {Id., R. ____}. McIntyre and Silver Oak Land Management moved for reconsideration of that order, which was denied. {Motion for Reconsideration, R. ____; Order denying Motion for Reconsideration, R. ____}. McIntyre and Silver Oak Land Management timely appealed to this Court. {Notice of Appeal; R. ____}.

Statement of Facts

In the early to mid-2000s, Appellant John M. McIntyre identified the timber industry as a business opportunity. {Trans. p. ____, R. ____}. McIntyre located a 349-acre tract of land in Hilton Head Island, South Carolina that had the potential for harvesting timber and then future development. {Id., R. ____}. McIntyre and four others¹ formed Silver Oak Land Trust LLC (“Silver Oak I”). {Silver Oak I Operating Agreement, R. ____}. Thereafter, McIntyre formed five² other Silver Oak LLCs to purchase additional tracts of land:

- Silver Oak II purchased land in Fairfield County, South Carolina. Eight persons acquired membership interests in Silver Oak II in addition to the five members from Silver Oak I. {Silver Oak II Operating Agreement, R. ____}.
- Silver Oak III bought property in Prosperity, South Carolina, with the five Silver Oak I members being the sole members of Silver Oak III. {Silver Oak III Operating Agreement, R. ____}. Silver Oak IV acquired land in Edenton, North Carolina, and it had 24 total members. {Silver Oak IV Operating Agreement, R. ____}.

¹ The four other members were Jim Paris, Murray Reed, Martin Rehder, and Susan Vitek (Ms. Vitek acquired her membership interest via Dave Jeff, LLC).

² The circuit court order referred to the LLCs as SOLT and then the appropriate number. This brief refers to each LLC as Silver Oak and then the appropriate number for clarity and ease of reference.

- Silver Oak V had 13 members and held 131 acres in Winton, North Carolina. {Silver Oak V Operating Agreement, R. ____}.
- Silver Oak VII³ purchased 258 acres in Ridgeland, South Carolina, and it had 13 members. {Silver Oak VII Operating Agreement, R. ____}. The final LLC, Silver Oak VII, was created in November 2009. {Silver Oak VII Operating Agreement, R. ____}.

The primary intention for those six LLCs was “tree farming coupled with potential opportunities of long-term real estate holdings.” {See respective Operating Agreement for each LLC, R. ____}. All of six of the Silver Oak LLCs are manager-managed per paragraph 6.1 of their respective operating agreements. {Id., R. ____}. McIntyre managed Silver Oak I, II, and III. {Id., R. ____}. Silver Oak Land Management acted as the manager of Silver Oak IV, V, and VII. {Id., R. ____}.

In late 2009, McIntyre decided to pursue the biomass renewable energy industry as another business interest. {Silver Oak Energy Operating Agreement, R. ____}. McIntyre and five other investors became members of Silver Oak Energy LLC to develop that business. {Id., R. ____}. Silver Oak Land Management acted as the manager of Silver Oak Energy. {Silver Oak Energy Operating Agreement, R. ____}.

More than three years after the offer, sale, or purchase of the final membership interests in the LLCs, the Attorney General, in his role as Securities Commissioner, acted upon the request of several members of the LLCs and investigated the management of the LLCs. {Trans. p. ____, R. ____}. The Securities Division of the Attorney General’s Office initiated a civil enforcement action by issuing a cease and desist order to McIntyre and Silver Oak Land Management. {Cease

³ No Silver Oak VI exists.

and Desist Order dated April 9, 2013, R. ____}. The Securities Commissioner alleged at least 39 violations of the anti-fraud provision of the Securities Act, section 35-1-501 of the South Carolina Code, related to the management of the LLCs. {Id., R. ____}.

A hearing officer, after a four-day trial, recommended that the Securities Commissioner dismiss the cease and desist order because the membership interests in the LLCs were not securities under the Securities Act. {Hearing Officer Recommendation dated May 6, 2014, R. ____}. The Securities Commissioner rejected the recommendation and issued an order declaring that the membership interests constituted securities and remanded the matter to the hearing officer for a determination as to whether violations of the Securities Act occurred. {Remand Order dated September 12, 2014, R. ____}.

On remand, the hearing officer found violations of the Securities Act had occurred with respect to 78 investors. {Recommendation dated October 22, 2014, R. ____}. The hearing officer based those violations on findings that McIntyre misappropriated investor money without the members' knowledge or permission. {Id., R. ____}. Critically, the hearing officer did not find that such violations related to the time of any offer, sale, or purchase of membership interests in any LLC. {Id., R. ____}.

The Securities Commissioner accepted the recommendation after remand to the hearing officer. {Final Order dated November 20, 2014, R. ____}. The Securities Commissioner ultimately reduced the number of violations based on the time the violations allegedly occurred. {Id., R. ____}. The Securities Commissioner found that McIntyre and Silver Oak Land Management began to misappropriate investor money by mid-2007. {Id., R. ____}. Relying on that date, the Securities Commissioner reduced the number of investors to 54. {Id., R. ____}. Notably, the Securities Commissioner failed to find that any violations by Appellants related to

the time of any offer, sale, or purchase of membership interests in any LLC; rather, the Securities Commissioner based such violations on post-sale management activities by Appellants. {Id., R. ____}. The Securities Commissioner imposed a fine of \$540,000, ordered McIntyre and Silver Oak Land Management to cease and desist from transacting business in South Carolina, revoked any Security Act exemptions, and ordered payment for the costs of the investigation and proceedings. {Id., R. ____}.

McIntyre and Silver Oak Land Management petitioned for judicial review by the circuit court pursuant to section 35-1-609 of the South Carolina Code. {Petition for Review dated ____, R. ____}. The circuit court affirmed the final order issued by the Securities Commissioner. {Order of Circuit Court dated ____, R. ____}. The circuit court, like the hearing officer and Securities Commissioner, did not find that any violation related to the time of any offer, sale, or purchase of membership interests in any LLC. {Id., R. ____}. McIntyre and Silver Oak Land Management moved for reconsideration of that order, which was denied. {Motion for Reconsideration, R. ____; Order denying Motion for Reconsideration, R. ____}. McIntyre and Silver Oak Land Management timely appealed to this Court. {Notice of Appeal; R. ____}.

Argument

I. The circuit court failed to properly review to the factual findings of the Securities Commissioner under the standard mandated by section 35-1-609 of the South Carolina Code.

In a securities matter, the circuit court performs a judicial review of the final order issued by the Securities Commissioner.⁴ This initial judicial review requires the circuit court to review the evidence introduced before the Securities Commissioner and determine whether the Securities Commissioner supported his factual findings with “competent evidence.” In this matter, the circuit court failed to review the record to first determine whether competent evidence supported the Securities Commissioner’s factual findings.

The General Assembly mandated this review of the factual record by the circuit court, providing in full that:

A person aggrieved by a final order of the Securities Commissioner may obtain a review of the order in the Richland County Court of Common Pleas by filing in the court, within thirty days after entry of the order, a written petition praying that the order may be modified or set aside in whole or in part. The aggrieved person, upon filing a petition, may move before the court in which the petition is filed to stay the effectiveness of the Securities Commissioner’s final order until such time as the court has reviewed the order. If the court orders a stay, the aggrieved person must post any bond set by the court in which a petition is filed. A copy of the petition must be served upon the Securities Commissioner, and the Securities Commissioner shall certify and file in court a copy of the filing and evidence upon which the order was entered. When these have been filed, the court has exclusive jurisdiction to affirm, modify, enforce or set aside the order, in

⁴ Administration of the South Carolina Uniform Securities Act (the “Securities Act”) does not fall under the Administrative Procedures Act or other administrative tribunal. Rather, the Attorney General, in his role as Securities Commissioner, administers the enforcement of the Securities Act, unbridled by the procedural protections contained in the Administrative Procedures Act. See S.C. Code Ann. § 35-1-601. Thus, the first level of review by a judicial body occurs when the circuit court performs the judicial review under section 35-1-609.

whole or in part. **The findings of the Securities Commissioner as to the facts, if supported by competent, material, and substantial evidence, are conclusive.**

S.C. Code Ann. § 35-1-609 (2005) (emphasis added). The emphasized language establishes a two-part review by the circuit court of a final order from the Securities Commissioner. First, the circuit court, in its role as the judicial reviewer of the administration of the Securities Act, has been tasked with determining “if” the Securities Commissioner found facts “supported by competent . . . evidence.” Id. Second, after making that threshold determination as to whether competent evidence exists, the circuit court then determines whether substantial evidence supports the factual findings of the Securities Commissioner. Id.

In this matter, the circuit court failed to perform its threshold determination as to the competency of the evidence before the Securities Commissioners. The circuit court relied on the testimony of Sandra Matthews, Phil Hartman, Paul Finn, and James Paris in addition to the bank records of each LLC to find evidence existed to support the violations of section 35-1-501 found by the Securities Commissioner.⁵ {Circuit Court Order p. 13, R. ____}. However, Appellants objected to the admissibility of each item listed by the circuit court and, specifically, those portions of testimony or evidence related to the purported violations of section 35-1-501 as follows:

- Bank records:

⁵ Phil Hartman and James Paris offered no testimony relating to the specific factual scenarios identified by the circuit court as grounds for a finding of a violation of section 35-1-501 on page 13 of the order. Thus, their testimony cannot support the findings of the Securities Commissioners as set forth in Section V, infra.

- The hearing officer admitted the LLC bank records through Mr. Silver. Appellants objected to the admission of those records in that manner based on authentication issues, hearsay, and improper admission of Mr. Silver's notes on the records. {Oct. Trans. p. 148-150, 150, 157, R. ____}.
- Moreover, Appellants objected to the decision to allow Mr. Silver to testify as an expert witness in regards to the bank statements. {Oct. Trans. p. 148-150, 150-151, 152, 154-55, 155-56, 157, 161-162, 164, 167, 172, 173, 177, R. ____}.
- Sandra Matthews:
 - The hearing officer admitted investor questionnaires through the testimony of Ms. Matthews. {Oct. Trans. p. 438-439, R. ____}. Appellants objected to the admission and testimony related thereto on hearsay and authentication grounds. {Oct. Trans. p. 440-442, 442, 444, 445, 446-47, 457-460, 525-26, R. ____}.
- Richard Silver:
 - The hearing officer allowed Mr. Silver to testify as to the management of the LLCs or purported violations of the securities act through hearsay. Appellants objected to the admission of such hearsay testimony. {Oct. Trans. p. 130-131, 132, 141, 148-150, R. ____}.
- Paul Finn:

- Appellants objected to the hearing officer allowing Mr. Finn to base testimony off the improperly admitted bank records of the LLCs. {Oct. Trans. p. 148-150, 219, R. ____}.

Despite these objections, the circuit court did not determine whether such evidence was properly admitted by the hearing officer. By failing to adhere to section 35-1-609 and verify whether the Securities Commissioner relied upon competent evidence, the circuit court erred as a matter of law. Therefore, this Court should reverse because the Securities Commissioner's factual findings are not supported by competent evidence as set forth in section V, infra. At a minimum, this Court should remand the matter to allow the circuit court to perform its threshold review of whether the record before the Securities Commissioner contained competent evidence as required by section 35-1-609.

II. The membership interests in the LLCs do not qualify as securities because the members retained ultimate control over the LLCs.

The circuit court found that the LLC membership interests constituted securities because the members lacked control over the operations of the LLCs based on the LLC operating agreements. {Circuit Court Order p. 11-12, R. ____}. The circuit court then found that such lack of control established that the members expected profits as a result of the efforts of Appellants. {Id. at 13, R. ____}. Such findings misapprehended the application of the test to determine whether the LLC membership interests qualified as securities.

An investment contract qualifies as a security when there has been (1) an investment of money, (2) in a common enterprise, and (3) with an expectation of profits to be derived primarily from the efforts of a person other than the investor. Majors v. S.C. Securities Com'n, 373 S.C.

153, 163-67, 644 S.E.2d 710, 716-18 (2007) (relying upon Securities & Exchange Com'n. v. J.W. Howey Co., 328 U.S. 293 (1946)).

As the circuit court noted, this case hinged on the third factor of the test. The Securities Commissioner and circuit court found the third factor satisfied based on the LLC operating agreements and testimony (over the objection of Appellants) to find that the members lacked control over the management of the LLCs, and as a result, expected profit from the efforts of Appellants. However, this finding failed to account for the fact that the members possessed the ultimate control over the LLC by operation of law that allowed the members to remove any manager with or without cause and to dissolve the LLC without manager consent. See S.C. Code Ann. § 33-44-404(b)(3)(i) (setting forth the power of the members to remove the manager of an LLC by simple majority vote); S.C. Code Ann. § 3344-801 (allowing the members to dissolve the LLC by vote).

Courts recognize that when members of manager-managed LLC possesses such ultimate power over the manager and the LLC then the membership interests do not qualify as securities. Great Lakes Chem. Corp v. Monsanto Co., 96 F.Supp.2d 376 (D. Del. 2000). In that analogous matter, the court addressed whether membership interests in an LLC constituted a security by applying the Howey test. Great Lakes, 96 F.Supp.2d at 389. As is the case in this matter, the matter hinged on the third Howey factor. Id. at 391-92. In analyzing the issue, the court noted that “the members of [the LLC] had no authority to directly manage [the LLC’s] business and affairs” pursuant to the operating agreement. Id. at 392. The analysis, however, did not stop there. Rather, the court recognized that the members “had the power to remove any [m]anager with or without cause, and to dissolve the company.” Id. The court found that such power meant the each member “was not a passive investor.” Id. The court then held that:

[The member's] authority to remove managers gave it the power to directly **affect the profits it received from [the LLC]**. Thus, the court finds that [the member's] profits from [the LLC] did not come solely from the efforts of others.

Id. (emphasis added). The court concluded that as a result the membership interests did not qualify as an investment contract under the securities act. Id.

In this matter, the members of each Silver Oak LLC possessed the same power to remove Appellants as manager and dissolve the LLC as the member in Great Lakes. That power vested each member with the authority to “affect the profits that [each] received” from the LLCs. Thus, the membership interests in the LLC could not qualify as securities under the South Carolina test. The Securities Commissioner and the circuit court erred in finding to the contrary. This Court should reverse and enter judgment in favor of Appellants.

III. Even if the membership interest qualified as a security, the evidence relied upon by the Securities Commissioner does not support a violation of section 35-1-501 because the conduct did not occur at the time of the offer, sale, or purchase of the LLC interests.

The circuit court upheld the Securities Commissioner's findings of violations of the general fraud provision of the Securities Act codified as section 35-1-501 of the South Carolina Code. {Circuit Court Order p. 13, R. ____}. Specifically, the circuit court found that management activities occurring after the offer, sale, or purchase of the LLC membership interests supported a finding that Appellants violated section 35-1-501. {Id., R. ____ (listing facts in form of bullet points)}. This finding constituted error. Section 35-1-501 requires a finding that the conduct occur “in connection with the offer, sale, or purchase of a security” in order to violate the statute. The Securities Commissioner and the circuit court failed to make any finding that that the conduct was connected to the time of any offer, sale, or purchase of a membership

interests in any of the LLCs at issue. Imposing penalties without such a finding violates our rules of statutory construction. Thus, this Court should reverse.

The cardinal rule of statutory interpretation is to determine the intent of the legislature above all else. Gordon v. Phillips Utils., Inc., 362 S.C. 403, 406, 608 S.E.2d 425, 427 (2005). “All rules of statutory construction are subservient to the maxim that legislative intent must prevail if it can be reasonably discovered in the language used” McClanahan v. Richland County Council, 350 S.C. 433, 438, 567 S.E.2d 240, 242 (2002); Ray Bell Constr. Co. v. School Dist. of Greenville County, 331 S.C. 19, 26, 501 S.E.2d 725, 729 (1998). Moreover, “if a statute’s language is plain, unambiguous, and conveys a clear meaning, the rules of statutory interpretation are not needed and the court has no right to impose another meaning.” Buist v. Huggins, 367 S.C. 268, 276, 625 S.E.2d 636, 640 (2006) (internal quotes and citation omitted). Words of a statute must be given their plain and ordinary meaning without resorting to subtle or forced construction to limit or expand the statute’s operation. Id. Courts will reject an interpretation leading to an absurd result clearly unintended by the legislature. Unisun Ins. Co. v. Schmidt, 339 S.C. 362, 368, 529 S.E.2d 280, 283 (2000). Further, it is beyond a court’s “power to effect a change in the statutes enacted by the Legislature.” State v. Corey D., 339 S.C. 107, 120, 529 S.E.2d 20, 27 (2000).

Courts should seek a construction of a statute that gives meaning to every word of a statute rather than one that renders a portion meaningless. Hinton v. S. Carolina Dep’t of Prob., Parole & Pardon Servs., 357 S.C. 327, 342, 592 S.E.2d 335, 343 (Ct. App. 2004); Steinke v. S. Carolina Dep’t of Labor, Licensing & Regulation, 336 S.C. 373, 396, 520 S.E.2d 142, 154 (1999) (stating that courts should “avoid a construction that would read a provision out of a statute”). “Every word, clause, and sentence must be given some meaning, force, and effect, if

it can be done by any reasonable construction.” Breeden v. TCW, Inc./Tennessee Exp., 355 S.C. 112, 120, 584 S.E.2d 379, 383 (2003). “It is never to be supposed that a single word was inserted in the law of this state without the intention of thereby conveying some meaning.” Davenport v. City of Rock Hill, 315 S.C. 114, 117, 432 S.E.2d 451, 453 (1993). “A statute should be so construed that no word, clause, sentence, provision or part shall be rendered surplusage, or superfluous.” CFRE, LLC v. Greenville Cnty. Assessor, 395 S.C. 67, 74, 716 S.E.2d 877, 881 (2011); Matter of Decker, 322 S.C. 215, 219, 471 S.E.2d 462, 463 (1995) (citations omitted).

The general fraud statute in the Securities Act provides that:

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.

S.C. Code Ann. § 35-1-501 (2005) (emphasis added). The plain language establishes that the statute limits its application to conduct occurring in connection with the offer, sale, or purchase of a security. This is evident by the manner in which the General Assembly drafted the statute.

The placing of the “in connection with the offer, sale, or purchase of a security” language immediately after the “[i]t is unlawful for a person” signifies the General Assembly’s intent to modify, qualify, or limit violations to conduct occurring with the offer, sale, or purchase of a security. See, e.g., Total Environmental Solutions, Inc. v. S.C. Pub. Servs. Comm’n, 351 S.C.

175, 181-82, 568 S.E.2d 365, 369 (2002) (finding a subsequent phrase in the statute modified a preceding phrase and defined the scope of the statute). Such a grammatical construction demonstrates the limited scope of section 35-1-501.

The Securities Commissioner and circuit court's decision to find post-offer, sale, or purchase conduct in the management of the LLCs violated the statute improperly ignored the plain temporal limitation included by the General Assembly. In order to support the Securities Commissioner and circuit court's interpretation of section 35-1-501, this Court would have to ignore the language "in connection with the offer, sale, or purchase of a security" that qualifies the scope of the statute. Moreover, the Securities Commissioner and circuit court's interpretation would render that phrase as surplusage or superfluous. Such a reading violates our rules of statutory construction. In contrast, Appellants' interpretation offers a construction of the statute "that gives meaning to every word" of section 35-1-501. When the plain language of section 35-1-501 is read as a whole, the conclusion is inescapable—the purpose of the statute is to prevent fraud occurring at the time of or in connection with the offer, sale, or purchase of a security.⁶

Therefore, section 35-1-501 requires a finding that the conduct occur "in connection with the offer, sale, or purchase of a security" in order to violate the statute. The Securities Commissioner and circuit court made no finding linking the conduct at issue to the offer, sale, or purchase of the LLC membership interest at issue in this matter. Rather, the Securities Commissioner and circuit court imposed liability under section 35-1-501 based on conduct

⁶ The circuit court noted the purpose was "to prevent fraud in the sale and disposition of securities." {Circuit Court Order p. 5, R. ____ (emphasis added)}. However, the circuit court ignored the recognition of that temporal limitation in affirming the Securities Commissioner.

occurring after the sale and purchase and related to the management of the LLCs. Such a finding contradicts the plain language of section 35-1-501.

Moreover, our Securities Act was modeled after the Uniform Securities Act of 2002. See S.C. Code Ann. § 35-1-101. The Uniform Act codified the general fraud provision as Rule 10b-5. See 17 C.F.R. 240.10b-5. That section provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

17 C.F.R. 240.10b-5. Subsections (a), (b), and (c) of Rule 10b-5 are identical to subsections (1), (2), and (3) of section 35-1-501. Rule 10b-5 further states that those subsections apply “in connection with the purchase or sale of any security.” Id. Federal courts have recognized this temporal limitation and construed this language to require that “[i]n order to establish a claim under Rule 10b-5, [the party] must prove fraud in connection with the purchase of securities. See, e.g., Robinson v. Glynn, 349 F.3d 166, 169 (4th Cir. 2003). Because section 35-1-501 includes the same temporal limitation, the Securities Commissioner and circuit court should likewise have construed it as Rule 10b-5 has been construed.

The Securities Commissioner and the circuit court failed to make any finding that that the conduct was connected to the time of any offer, sale, or purchase of a membership interests

in any of the LLCs at issue. Imposing penalties without such a finding violates our rules of statutory construction. Thus, this Court should reverse and enter judgment in favor of Appellants.

IV. The Securities Commissioner violated Appellants' due process rights by initiating an enforcement action prior to promulgating the rules applicable for such an action.

With the adoption of the Securities Act in 2005, the General Assembly authorized possible methods⁷ for the Securities Commissioner to utilize in order to regulate securities. Once such possible option would allow the Securities Commissioner to pursue civil relief. See S.C. Code Ann. §§ 35-1-603 and 604 (2005). The General Assembly did not, however, provide for the rules to implement such civil proceedings. Instead, the General Assembly allowed the Securities Commissioner to create the rules of a civil proceeding in the event the Securities Commissioner elected to implement such a proceeding. See S.C. Code Ann. § 35-1-605. Stated differently, the General Assembly provided for the possibility of a civil proceeding but such proceeding would only exist once the Securities Commissioner promulgated the rules applicable to such a proceeding. In this matter, the Securities Commissioner never promulgated such rules but nevertheless pursued civil relief against the Appellants. That decision violated Appellants' procedural due process rights. As a result, this Court should reverse the circuit court's order upholding the Securities Commissioner's final order.

The General Assembly created the possibility of a civil enforcement action but conditioned the implementation of that process on the Securities Commissioner's creation and promulgation of the rules governing such an action in Section 35-1-605:

⁷ The Securities Commissioner could pursue criminal relief or civil relief. Only civil relief is at issue in this action.

(a) The Securities Commissioner may:

(1) issue forms and orders and, after notice and comment, may adopt and amend rules necessary or appropriate to carry out this chapter and may repeal rules, including rules and forms governing registration statements, applications, notice filings, reports, and other records. . . .

S.C. Code Ann. § 35-1-605(a)(1) (emphasis added).

The plain language of section 35-1-605(a)(1) established that the Securities Commissioner could not initiate a civil relief action under the Securities Act until the Securities Commissioner promulgated the rules for such proceedings. Such an interpretation has been recognized by the leading South Carolina scholars addressing the civil enforcement process. Those scholars recognized that rules were need to implement the Securities Act's civil enforcement process, noting:

As of July 2005, the Securities Commissioner has not proposed new regulations in anticipation of the January 1, 2006 effective date of the S.C. Securities Act. The writer understands that the present intention of the Commissioner is to propose new regulations to implement the new Act

Gregory B. Adams, James R. Burkhard, et al., South Carolina Corp. Practice Manual, 2d., Ch. 16, p. 366 n. 8 (2005).

The permissive “may” in section 35-1-605(a)(1) does not alter this result. The circuit court found that the inclusion of “may” meant that the Securities Commissioner did not have to promulgate rules for a civil enforcement action, and, as a result, the action did not violate Appellants’ due process rights. {Circuit Court Order p. ____, R. ____}. This was error. The inclusion of “may” in section 35-1-605(a)(1) actually supports Appellants’ position and that of the leading scholars.

The use of “may” in the statute does not excuse a failure to promulgate rules. Rather, the inclusion of “may” must be read in conjunction with the “to carry out this chapter” language also included in section 35-1-605(a)(1) and leads to one conclusion—the General Assembly allowed the Securities Commissioner to create the rules of a civil proceeding in the event the Securities Commissioner elected to implement such a proceeding. As a result, the permissive “may” referred to the condition precedent necessary for the Securities Commissioner to implement the entire civil proceedings not just whether the Securities Commissioner will circulate rules after implementation. Thus, the circuit court’s finding misapprehended section 35-1-605(a)(1). The statute required rules to exist before the Securities Commissioner could pursue civil relief against Appellants.

The Securities Commissioner has never created such rules to allow him to begin any civil enforcement action under the Securities Act. Therefore, the Securities Commissioner has failed to implement the civil relief process. Despite the civil relief process not being operational, the Securities Commissioner pursued such relief against Appellants to deprive Appellants of \$540,000, plus costs, of their property. That decision of the Securities Commissioner violated Appellants’ due process rights.

Procedural due process “imposes constraints on governmental decisions that deprive individuals of liberty or property interests within the meaning of the Due Process Clause of the Fifth or Fourteenth Amendment of the United States Constitution.” See, e.g., Harbit v. City of Charleston, 382 S.C. 383, 393, 675 S.E.2d 776, 781 (Ct. App. 2009). “The fundamental requirements of due process under the United States Constitution and the South Carolina

Constitution include notice, an opportunity to be heard in a meaningful way, and judicial review.” Id. (emphasis added).

Our Supreme Court recognized that due process requires:

[A]t a minimum certain elements must be present. These include (1) adequate notice; (2) adequate opportunity for a hearing; (3) the right to introduce evidence; and (4) the right to confront and cross-examine witnesses.

In re Dickey, 395 S.C. 336, 360, 718 S.E.2d 739, 751 (2011) (quoting In re Vora, 354 S.C. 590, 595, 582 S.E.2d 413, 416 (2003)). Moreover, defects existing in the process itself cannot be rendered harmless error and must be reversed. State v. Mouzon, 326 S.C. 199, 204, 485 S.E.2d 918, 921 (1997) (distinguishing between “trial errors, which are subject to harmless error analysis,” and “structural defects in the constitution of the trial mechanism, which defy analysis by harmless error standards”).

The Securities Commissioner’s decision to pursue relief via a unimplemented process violated these settled principles. Specifically, the Securities Commissioner denied Appellants an opportunity to be heard in a meaningful way by forcing them to participate in a process without the benefit of any rules. Without prior knowledge of the proverbial “rules of the game,” Appellants were precluded from adequately presenting its case or defending the claims. Appellants were left to grope in the dark as to the rules governing the admission of evidence, whether the rules of civil procedure applied, the scope of testimony and cross examination, the burden of proof, and scope of review after the initial determination. Those “structural defects in the constitution of the trial mechanism” deprived Appellants of their property interests as protected by our state and federal constitutions. Thus, this Court should reverse the circuit court

order upholding the order of the Securities Commissioner and enter judgment in favor of Appellants.

V. No substantial evidence exists in the record because the evidence relied on by the Securities Commissioner and circuit court was inadmissible.

The factual findings of the Securities Commissioner will only be upheld by the circuit court when substantial evidence supports such findings. S.C. Code Ann. § 35-1-609 (“The findings of the Securities Commissioner as to the facts, if supported by competent, material, and substantial evidence, are conclusive”). Here, the evidence cited by the Securities Commission and circuit court was inadmissible on various grounds or did not have any relevance to establish a violation of section 35-1-501:

- The bank records should have been excluded based on the fact the records were (1) not properly authenticated, (2) hearsay, and (3) included the admission of Mr. Silver’s handwritten notes on the records. {Oct. Trans. p. 148-150, 150, 157, R. ____}. In addition, the hearing officer erred in allowing Mr. Silver to testify as an expert witness in regards to the bank statements. {Oct. Trans. p. 148-150, 150-151, 152, 154-55, 155-56, 157, 161-162, 164, 167, 172, 173, 177, R. ____}.
- The hearing officer erred in allowing admission of investor questionnaires though the testimony of Ms. Matthews. {Oct. Trans. p. 438-439, R. ____}. The hearing officer further erred in allowing the admission of the QuickBooks records and allowing Ms. Matthews to testify as to the contents of those documents because the documents were hearsay and not properly authenticated. {Oct. Trans. p. 440-442; 442, 444, 445, 446-47, 457-460, 525-26, R. ____}.
- Mr. Silver’s testimony regarding the management of the LLCs or purported violations of the securities act was inadmissible hearsay. {Oct. Trans. p. 130-131, 132, 141, 148-150, R. ____}.
- Mr. Finn based his testimony on these issues on the improperly admitted bank records of the LLCs. {Oct. Trans. p. 148-150; 219, R. ____}.
- Phil Hartman and James Paris offered no testimony relating to the specific factual scenarios identified by the circuit court as grounds for a finding of a violation of section 35-1-501 on page 13 of the order. Rather, each testified

in generalities regarding the management of the LLC. {Oct. Trans. p. 22, 49-50, R. ____}.

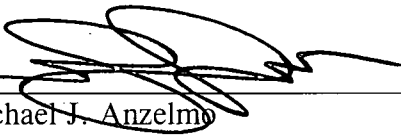
As a result, the testimony and evidence should have been excluded, and, once excluded, there was no competent evidence to prove a violation of section 35-1-501. This Court should reverse the circuit court order upholding the order of the Securities Commissioner and enter judgment in favor of Appellants.

Conclusion

Based on the foregoing, this Court should reverse the circuit court order upholding the order of the Securities Commissioner and enter judgment in favor of Appellants. In the alternative, this Court should remand this action to the circuit court as set forth in Section I, supra.

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