

INTEGRATION OF SECURITIES OFFERINGS—THE ABA'S "INDISCREET" PROPOSAL

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I. INTRODUCTION

Federal and almost all state laws generally provide that, before securities¹ may be offered or sold,² the issuer must first comply with a registration process.³ Federal law specifically prohibits the use of the facilities of interstate commerce or the mails⁴ to offer⁵ any securities for sale unless a

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1. "Security" is defined in Section 2(1) of the Securities Act of 1933 (Securities Act of 1933), Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77z (1982)). Section 2(1), 15 U.S.C. § 77b(1), covers such common financial instruments as stocks, bonds, and debentures. It also includes, *inter alia*, any "investment contract," "evidence of indebtedness" or "certificate of interest or participation in any profit sharing agreement." *Id.* In particular, the term "investment contract" has been broadly interpreted to include certain transactions which purport to be the sale of realty or commodities coupled with other arrangements. The Supreme Court has stated: "The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946). This standard, however, does not apply when the possibility of participating in asset earnings is peripheral to the transaction. International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979). Likewise, not every interest called a "stock" is considered a security where the economic realities of the transaction indicate otherwise. United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1957). *See generally* 3 H. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW §§ 2.01 to .24 (1982).

2. Section 2(3) of the Securities Act defines "offer" and "sale" broadly: "The term 'sale' or 'sell' shall include every contract of sale or disposition of a security or interest in a security for value. The term 'offer to sell,' 'offer for sale,' or 'offer,' shall include every attempt or offer to dispose of, or solicitation of an offer to buy a security or interest in a security for value." 15 U.S.C. § 77b(3) (1982). *See* L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 263-77 (1983).

As used in this Article, a single "offer" may constitute an "offering" and an "offer" or "sale" of securities should be considered a "transaction."

3. Section 5 of the Securities Act, 15 U.S.C. § 77e (1982).

As to state registration requirements, *see generally* L. LOSS, *supra* note 2, at 8-29 and L. LOSS & E. COWETT, BLUE SKY LAW 283-331 (1958); UNIF. SECURITIES ACT §§ 301-306, 7A U.L.A. 596-624 (1978).

4. All violations of the Securities Act are premised upon "the use of any means or instru-

registration statement⁶ pertaining to them has been filed with the Securities and Exchange Commission ("Commission" or "SEC").⁷ It further forbids any such sales until that statement has become effective.⁸

As is the case with most entities facing government regulation, issuers of securities typically regard registration as an unwelcome event subjecting their prospective financing arrangements to additional costs, delays, and unwanted bureaucratic scrutiny.⁹ The federal securities laws and analogous state statutes provide exemptions from their registration requirements

ments of transportation or communication in interstate commerce or of the mails." *See* Section 5(c) of the Securities Act, 15 U.S.C. § 77e(c) (1982). Courts have found this prerequisite easy to satisfy. *E.g.*, *Hill York Corp. v. American Int'l Franchises, Inc.* 448 F.2d 680, 693 (5th Cir. 1971). *See generally* H. BLOOMENTHAL, *supra* note 1, at § 2.27.

5. Section 5(c) of the Securities Act, 15 U.S.C. § 77e(c) (1982).

Since the term "offer" is defined broadly in Section 2(3) of the Securities Act to include, among other things, solicitation of offers to buy securities, various types of pre-filing publicity that would condition the market for the securities are also forbidden by this provision. *In re Carl M. Loeb, Rhoades & Co.*, 38 S.E.C. 843 (1959). *See* L. Loss, *supra* note 2, at 101-06.

6. For a discussion of the contents of a registration statement and the various forms prescribed for it by the Securities and Exchange Commission, see H. BLOOMENTHAL, *supra* note 1, at §§ 7.097.19.

7. The Securities and Exchange Commission is an independent federal regulatory agency established by Section 4 of the Securities Exchange Act of 1934 (Exchange Act), Pub. L. No. 73-291, 48 Stat. 881 (currently codified at 15 U.S.C. §§ 78a-78jj (1982)). For a more detailed self-description of the SEC, *see generally* SEC, THE WORK OF THE SECURITIES AND EXCHANGE COMMISSION (1980).

8. Section 5(a)(1) of the Securities Act, 15 U.S.C. § 77e(a)(1) (1982).

A registration statement becomes effective pursuant to Section 8(a) of the Securities Act, 15 U.S.C. § 77h(a), which states in part:

Except as herein provided, the effective date of a registration statement shall be the twentieth day after the filing thereof or such earlier date as the Commission may determine, having due regards to the adequacy of the information respecting the issuer theretofore available to the public, to the facility with which the nature of the securities to be registered, their relationship to the capital structure of the issuer and the rights of holders thereof can be understood, and to the public interest and the protection of investors.

In practice, issuers never permit their registration statements to become automatically effective 20 days after filing but always seek to have the SEC declare them so at a time that meets the issuers' convenience. This process, which is called "acceleration," allows an issuer to begin selling its securities immediately after it determines their price. If an issuer were to forego acceleration, it would have to wait 20 days after setting its price before commencing sales. It then would most likely not be able to obtain the optimum amount which a fluctuating market might pay for its securities. To secure the cooperation of the Securities and Exchange Commission in granting acceleration, the issuer may have to comply with certain requests for additions and modifications to the registration statement which the Commission's examiners may demand pursuant to Securities Act Rule 461, 17 C.F.R. § 230.461 (1982). For a full discussion of this process, see L. Loss, *supra* note 2, at 125-36.

9. The completion of a successful registered offering is generally a complicated task requiring the skills of attorneys, accountants, and investment bankers and the active cooperation of many of the issuer's officials. The time which these professionals devote to registration can be substantial. Much of the effort entails the preparation of a document that will ultimately meet the approval of the Commission's staff so that it will accelerate the effective date of the statement. *See supra* note 8. The staff typically reviews the registration statement and then notifies the issuer by letter or telephone of any deficiencies it perceives. The issuer and its counsel, seeking to satisfy the SEC officials, then amend the registration statement. Fluctuation in the securities market may adversely interact with that process and cause the issuer to get a less favorable price for its securities than it might desire. *See generally* Schneider, Manko & Kant, *Going Public: Practice, Procedure and Consequences*, 27 VILL. L. REV. 1 (1981). For an older but interesting hypothetical description of this process, see Wheat & Blackstone, *Guideposts for a First Public Offering*, 15 BUS. LAW. 539 (1960).

Two relatively new procedures of the Commission expedite this process and grant established companies relief from its attendant uncertainties. The Commission now reviews the registration

when the costs outweigh the protection that registration is likely to afford investors.¹⁰ Two of the most widely claimed federal exemptions are for transactions by an issuer not involving any public offering, the private placement exemption,¹¹ and for securities offered under certain conditions only to residents of a single state, the intrastate exemption.¹²

The private placement exemption is designed for offerings made to wealthy or financially sophisticated individuals who purchase the securities for their own portfolios.¹³ At least in theory, these investors can fend for themselves and do not need the safeguards provided by registration.¹⁴ This exemption is often claimed by those offering interests in limited partnerships formed for oil and gas exploration¹⁵ or the purchase of real estate.¹⁶ The promoters of these ventures typically organize a number of them within a relatively short time span and maintain that interests in each of the limited partnership offerings are specifically exempt from registration as distinct private placements.¹⁷ The concept of integration, however, safeguards the integrity of the registration process by examining these purportedly separate issues to determine if they should realistically be viewed together as one transaction.¹⁸ If, in such combined form, these offerings do not qualify as a valid private placement, the issuer and any individuals

statements of experienced issuers only on a selective basis. SEC Press Release No. 80-60, Nov. 17, 1980.

The Commission has also done much to harmonize the contents of registration statements under the Securities Act with the separate reporting requirements mandated of "exchange-listed" and other "publicly-held" corporations by Sections 12(b) and 12(g) of the Exchange Act, 15 U.S.C. §§ 78l(b), (g) (1982). Among such required disclosure is an annual report to shareholders pursuant to Exchange Act Rule 14a-3, 17 C.F.R. § 240.14a-3 (1982). The "integrated disclosure" system, adopted by the Commission in Securities Act Release No. 33-6383, Mar. 3, 1982, 956 Fed. Sec. L. Rep. (CCH) (March 11, 1982), allows many of these "reporting" issuers to use their annual reports to shareholders to comply with much of the disclosure requirements of a Securities Act registration statement. *See* H. BLOOMENTHAL, *supra* note 1, at ch. 2A.

10. Section 3 of the Securities Act, 15 U.S.C. § 77c (1982), exempts certain securities from registration, and Section 4 of the Act, 15 U.S.C. 77d (1982) exempts certain transactions. *See infra* notes 60-61 and accompanying text. UNIF. SECURITIES ACT § 402, 7A U.L.A. 638-42 (1962) details the state equivalents of these provisions. *See also* L. LOSS & E. COWETT, *supra* note 3, at 352-81.

11. Section 4(2) of the Securities Act, 15 U.S.C. § 77d(2) (1982); Securities Act Rule 146, 17 C.F.R. § 230.146 (1982) (repealed at 47 Fed. Reg. 11,261 (June 30, 1982)) and Securities Act Rule 506, 17 C.F.R. § 230.506 (1982). *See infra* notes 62-81, 97-117 and accompanying text.

12. Section 3(a)(11) of the Securities Act, 15 U.S.C. § 77c(a)(11) (1982); Securities Act Rule 147, 17 C.F.R. § 230.147 (1982). *See infra* notes 118-125 and accompanying text.

Recent changes in SEC regulations have also expanded exemptions for limited issues of securities to the general public. Section 3(b) of the Securities Act, 15 U.S.C. § 77c(b); Regulation A, Securities Act Rules 251 to 264, 17 C.F.R. §§ 230.251-264 (1982); Securities Act Rules 504 and 505, 17 C.F.R. §§ 230.504-505 (1982); Securities Act Rule 240, 17 C.F.R. § 230.240 (1982) (repealed at 47 Fed. Reg. 11, 262 (1982)); and Securities Act Rule 242, 17 C.F.R. § 230.242 (1982) (repealed at 47 Fed. Reg. 11,262 (1982)). *See infra* notes 82-117 and accompanying text.

13. *See SEC v. Ralston Purina*, 346 U.S. 119 (1953); L. LOSS, *supra* note 2, at 349-96. *See infra* notes 65-69 and accompanying text.

14. SEC v. Ralston Purina, 346 U.S. at 125.

15. *See generally* INSTITUTE FOR ENERGY DEVELOPMENT, PRIVATE PLACEMENTS IN OIL UNDER SEC REGULATION D (L. Mosburg ed. 1982).

16. *See* S. FRESHMAN, PRINCIPLES OF REAL ESTATE SYNDICATION (1973).

17. *See, e.g.*, the requests for no-action letters in JIC Drilling Cos. and Martin Exploration Co. discussed at note 180 *infra* and accompanying text.

18. Securities Act Release No. 33-4552, Nov. 6, 1962, 1 Fed. Sec. L. Rep. (CCH) ¶ 2770. *See infra* note 149 and accompanying text.

who have materially participated in the transactions have violated the registration requirement¹⁹ and are subject to criminal prosecution²⁰ and civil liability.²¹ Integration applies similarly to unite certain intrastate²² or limited public issues²³ with other offerings so that the total issuance might be considered as one potentially non-exempt transaction.

The SEC has publicly stated several criteria for determining whether a purportedly exempt issuance should be integrated with other registered or non-registered offerings.²⁴ The Commission's staff has also responded to inquiries about particular situations indicating whether it would integrate those specific offerings.²⁵ These "no-action letters," as they are called, were generally interpreted as affording promoters of limited partnership ventures some qualified assurance that their relatively contemporaneous offerings would not be deemed integrated if they were organized to fund distinct projects, such as the drilling for oil on geographically varied prospects let from separate lessors.²⁶ Recent judicial decisions, however, give expansive interpretation to the SEC's traditional criteria for integration.²⁷ Under these rulings, a sponsor of a number of limited partnerships may be considered their common issuer despite their separate legal structures.²⁸ The courts take a broad view of the purpose for which these partnerships are organized and considered them as a single plan of financing for an ongoing business operation despite their different undertakings.²⁹

The American Bar Association's Section of Corporation, Banking, and Business Law has viewed these recent opinions with alarm. Its subcommittee on Partnerships, Trusts, and Unincorporated Associations has issued a position paper³⁰ describing at least one of them as a product of

19. SEC v. Murphy, 626 F.2d 633, 648-52 (9th Cir. 1980). *See infra* notes 216-236 and accompanying text.

20. Section 24 of the Securities Act, 15 U.S.C. § 77x (1982), provides in part: "Any person who willfully violates any of the provisions of this subchapter . . . shall upon conviction be fined not more than \$10,000 or imprisoned for not more than five years or both." *See* United States v. Wolfson, 405 F.2d 779 (2d Cir. 1968), *cert. denied*, 394 U.S. 946 (1969) (defendant convicted for sale of unregistered securities pursuant to Section Five of the Securities Act, 15 U.S.C. § 77e).

21. Section 12(1) of the Securities Act, provides: "Any person who offers or sells a security in violation of Section 5 . . . shall be liable to the person purchasing such security from him . . . to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon." 15 U.S.C. § 77l(l) (1982). The purchaser may so recover from the issuer and all those who directly participated in such sales. Lewis v. Walston & Co., 487 F.2d 617, 621-22 (5th Cir. 1972); Lennerth v. Mendenhall, 243 F. Supp. 59, 65 (N.D. Ohio 1964).

22. Securities Act Release No. 33-4434 (Dec. 6, 1961), I Fed. Sec. L. Rep. (CCH) ¶ 2270 at 2607. *See infra* note 148 and accompanying text.

23. *In re* Unity Gold Corp., 3 S.E.C. 618 (1938). *See infra* notes 134-44 and accompanying text.

24. Securities Act Release Nos. 33-4434, *supra* note 22, at 33-4552, *supra* note 18. *See infra* notes 148-50 and accompanying text.

25. *See infra* notes 175-76 and accompanying text.

26. E.g., Churchill & Hoskins, available Oct. 24, 1978, SEC No-Action Letters (CCH) file 49, frame H1; Martin Exploration Co., [1976-1977 transfer binder] Fed. Sec. L. Rep. ¶ 80,794 (Sept. 7, 1976). *See infra* notes 180-81 & 184 and accompanying text.

27. *Murphy*, 626 F.2d at 645, SEC. v. Holschuh, 694 F.2d 130 (7th Cir. 1982). *See infra* notes 216-45 and accompanying text for a complete discussion of these cases.

28. *Murphy*, 626 F.2d at 644; *Holschuh*, 694 F.2d at 138-39.

29. *Murphy*, 625 F.2d at 646; *Holschuh*, 694 F.2d at 133.

30. ABA Subcommittee on Partnerships, Trusts, and Unincorporated Associations, *Integra-*

result-oriented analysis³¹ and putting forth its own standards for the integration of limited partnership offerings.³² In its proposal the subcommittee identifies "discrete offerings" which it would not integrate with other contemporaneous financing endeavors by the same sponsor. It also calls for a new three-prong test for integration which would not combine commonly sponsored partnership offerings which (1) are structured as separate legal entities, (2) are in substance economically independent from one another, and (3) have the material portions of their proceeds applied to the development of distinct properties.³³

Although the subcommittee has correctly pointed out that the recent appellate opinions on integration involved egregious frauds,³⁴ its arguments do not invalidate the reasoning underlying the rulings. Investors in commonly sponsored offerings may be subject to some different financial risks because of the varied properties owned by the separate limited partnerships making those offerings.³⁵ The investors' ultimate decisions, however, are to place their funds with a given individual running an on-going business, such as drilling for oil or acquiring real estate.³⁶ The promotor's entrepreneurial skills are what attract investors,³⁷ and it is from their mon-

tion of Partnership Offerings: A Proposal For Identifying a Discrete Offering, 37 Bus. Law. 1591 (1982) (hereinafter cited as ABA Proposal).

31. *Id.* at 1603.

32. *Id.* at 1610-12.

33. *Id.* at 1611.

34. *Murphy*, 626 F.2d at 653; *Holschuh*, 694 F.2d at 142.

35. REV. UNIF. LIMITED PARTNERSHIP ACT §§ 503-504, 804, 6 U.L.A. 206-207, 216 (West. Supp. 1983).

36. *Murphy*, 626 F.2d at 643-44.

37. An oil driller's record of success is consistently mentioned as a prime motive for investment with him. The following statements well illustrate this pervasive outlook. Lewis G. Mosburg, Jr. is an Oklahoma City attorney and former general counsel for the Oil Investment Institute in Washington, D.C. Hunter Yarborough is a geologist from Houston.

Investor: When you pick up a prospectus or offering memorandum, what's the first thing you look at?

Mosburg: Prior activities.

Investor: Why?

Mosburg: Because the first thing I'm trying to determine is whether a guy is trying to hide his track record. I'm not anywhere near as worried about somebody with a track record that may not be spectacular and is admitting it. If it's a public program, it's going to be in there because the SEC makes him put it in. Even then, he can put in the data in some way that is non-uniform, or less standard, to sort of cloud over a poor performance record for his investor.

* * *

Investor: What are other areas you consider most important in a prospectus?

Mosburg: Well, the first nine most important areas are track record, track record, and so on.

* * *

Interview, *Mosburg on the Record*, OIL AND GAS INVESTOR March, 1982, at 28-29.

* * *

Investor: You talk of oilfinders. How would, say, the almost apocryphal dentist from Peoria go about finding out whether the outfit pitching him truly possessed oilfinders?

Yarborough: The same way any other businessman would, Mr. Cooper. You would go around and look at the individuals. Most oil is found by individuals. You find a consulting geologist, someone like that who won't give you a lot of overhead, whose track record you know, and you work with him. Through him you meet other people that are successful. All he would do

ies that he or she receives compensation. The subcommittee's proposal has overlooked these and other key nuances of such multi-offering situations.

This Article will examine the subcommittee's proposed new standards for integration in the light of the doctrine's historical development and application. Before doing so, the Article will place the issue in context by examining the reasons for registration and the various exemptions which provide measured relief from that requirement. The Article will then conclude by urging rejection of the subcommittee's new test and continued use of the integration criteria articulated in recent judicial opinions. These steps are necessary to safeguard that prime tool of investor protection, the registration process.

II. REGISTRATION

The Securities Act, which became law in 1933, contains two key substantive provisions, both of which are rooted in its underlying philosophy of disclosure.³⁸ Section 17 makes it unlawful to offer or sell securities by means of fraud or misrepresentation while using the facilities of interstate commerce or the mails.³⁹ Section 5 requires that securities to be offered by such federal jurisdictional means must first be registered with the SEC⁴⁰ and prohibits sales of those securities until that registration statement becomes effective.⁴¹ The offer or sale of unregistered securities in violation of Section 5 gives investors a right to rescind any such purchases.⁴²

Registration is effected by the filing of a registration statement⁴³ the contents of which are prescribed by the Securities Act.⁴⁴ The law requires, among other things, that a registration statement contain the issuer's prospectus,⁴⁵ which must provide specific items of factual disclosure to investors.⁴⁶ Most importantly, the prospectus must include all information that an investor would consider important in making a decision whether to

is fundamental research and try to find who are good individuals or small groups to put your monies with.

* * *

Interview, *Realities, Reflections of a Geologist*, OIL AND GAS INVESTOR, March, 1983.

38. The stock market crash of 1929 and the resulting Great Depression provided the impetus for enactment of the first federal laws comprehensively regulating the offer and sale of securities. President Franklin D. Roosevelt recommended legislation to Congress premised on this stated belief: "There is . . . an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public." S. REP. No. 47, 73d Cong., 1st Sess. 67 (1933) and H.R. REP. No. 85, 73d Cong., 1st Sess. (1933). See L. Loss, *supra* note 2, at 29-38.

39. Section 17 of the Securities Act, 15 U.S.C. § 77q (1982).

40. Section 5(c) of the Securities Act, 15 U.S.C. § 77e (1982). As to the definition of "offer," see *supra* note 2.

41. Section 5(a)(1) of the Securities Act, 15 U.S.C. § 77e(a)(1) (1982). As to the definition of "sale," see *supra* note 2.

42. Section 12(1) of the Securities Act, 15 U.S.C. § 77l(1) (1982); *see supra* note 21.

43. Section 6 of the Securities Act, 15 U.S.C. § 77f (1982).

44. *See supra* note 6.

45. "Prospectus" is defined at § 2(10) of the Securities Act, 15 U.S.C. § 77b(10) (1982).

46. Section 10 of the Securities Act, 15 U.S.C. § 77j (1982).

purchase the securities.⁴⁷ The SEC has promulgated specific regulations and forms to that effect.⁴⁸

The purpose for compelling this disclosure is to require an issuer to lay all important elements of a securities offering open to its prospective investors.⁴⁹ In addition to protecting investors, the registration requirement is also intended to aid the economy by bolstering public confidence in business and directing financing to its most productive uses.⁵⁰

The goal of fair and honest securities dealings is furthered by the potential criminal penalties⁵¹ and civil liabilities⁵² which federal law attaches

47. Failure to make such disclosure would give rise to criminal and civil liability under the anti-fraud provisions of the Securities Act. *See infra* notes 51-52.

48. The Securities Act empowers the SEC to prescribe further information for a registration statement. Section 7 of the Securities Act, 15 U.S.C. § 77g (1982) (last sentence). Section 10(c) of the Securities Act also gives the Commission such power in regard to the prospectus. 15 U.S.C. § 77j(c) (1982). For regulations, *see, e.g.*, Regulation S-K, 17 C.F.R. §§ 229.10-.800 (1982); Regulation S-X, 17 C.F.R. §§ 210.1-01 to .12-27 (1982); and Regulation C, 17 C.F.R. §§ 230.400-.494 (1982). For forms, *see, e.g.*, 17 C.F.R. §§ 239.0-1 to .50 (1982) (forms prescribed under the Securities Act). *See also* 2 Fed. Sec. L. Rep. (CCH) ¶ 6011 (list of Securities Act forms). For an apt summary of the standard items of disclosure that are applicable to all registration statements, *see* H. BLOOMENTHAL, *supra* note 1, at § 7.09.

49. "The type of information required to be disclosed is of a character comparable to that demanded by competent banks from their borrowers . . . [and is], in the judgment of your Committee, adequate to bring into the full glare of publicity those elements of real and unreal values which may lie behind the security." H.R. REP. NO. 85, 73d Cong., 1st Sess. 4 (1933).

50. "[The Act is] . . . to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public by crooked promotion; to restore the confidence of a prospective investor in his ability to select sound securities; to bring into productive channels of industry and development capital which has grown timid to the point of hoarding; and to aid in providing employment and restoring buying and consummating power." S. REP. NO. 47, 73d Cong., 1st Sess. 1 (1933).

Frank E. Marley, Jr., a recent administrator of the Oklahoma Securities Commission, commented publicly on how the process of governmental review serves to weed out fraudulent or improvident investment opportunities. Marley noted that enforcement cases brought by his small office against fraudulent, unregistered offerings in 1981 totalled nearly \$100,000,000 in losses. The administrator reflected that if those funds had been directed into investments subject to acceptable risks, our society would have been able to progress more swiftly to economic recovery. Letter from Frank E. Marley, Jr. to Linda A. Wertheimer (July 1, 1982) (available from Oklahoma Securities Commission).

51. Section 24 of the Securities Act and Section 32 of the Exchange Act, 15 U.S.C. § 77x and 15 U.S.C. § 78ff, respectively, make violators of the anti-fraud provisions of Section 17 of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5 (1982), subject to criminal penalties.

52. Two sections of the Securities Act specifically provide such civil liability. Section 11, 15 U.S.C. § 77k, sets forth a detailed scheme listing those individuals who may be liable to purchasers for any material misstatements or omissions in an effective registration statement. The statute also enumerates certain affirmative defenses which those individuals may maintain, most importantly the "due diligence" defense. Such provisions allow certain individuals to avoid liability if they can show that they met a specific standard of knowledge or conduct with respect to the material misstatements or omissions. *See* Feit v. Leasco Data Processing Equipment Corp., 332 F. Supp. 544 (E.D.N.Y. 1971); Escott v. BarChris Constr. Corp., 283 F. Supp. 643 (S.D.N.Y. 1968).

Section 12(2) of the Securities Act, 15 U.S.C. § 77l(2), more broadly imposes civil liability on any person who offers or sells securities by means of any written or oral communication containing material misstatements or omissions. Section 12(2) applies to such transactions whether or not made pursuant to registration statements. It allows suit only against those who actually sold the securities to the plaintiff. It contains a "due diligence" defense similar to that of Section 11. Sanders v. John Nuveen & Co., 619 F.2d 1222 (7th Cir. 1980).

Considerable controversy exists as to whether or not an implied civil right of action exists under Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), because such a right would conflict with the express rights of Sections 11 and 12(2), 15 U.S.C. §§ 77k, 77l(2). *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 n.6 (1975), where the Supreme Court specifically declined to

to materially⁵³ false or misleading statements made in a registration statement. As an additional aid, the Commission's staff frequently reviews the registration statement before it becomes effective.⁵⁴ In most jurisdictions, state officials make similar reviews.⁵⁵

Consistent with the philosophy of the Securities Act, the SEC's review process is conducted under a disclosure standard which requires only that a registration statement and prospectus accurately reflect all important information about the issue before it may be sold.⁵⁶ Most state agencies, however, condition clearance of securities for sale in their jurisdictions upon an issue's intrinsic value to investors.⁵⁷ State examiners thus pass upon the fairness of certain elements of an offering, such as the underwriter's commission, the dilution which new investors face in the worth of their investments, and the issuer's plans for the proceeds of the offering.⁵⁸ In practice the federal process may also be said to contain certain elements of this merit review.⁵⁹

III. EXEMPTIONS FROM REGISTRATION

The Securities Act exempts the offer and sale of securities from its registration requirement in two general areas. Certain classes of securities are deemed "exempt securities" in Section 3,⁶⁰ and certain specific transactions are freed from the registration mandate by Section 4.⁶¹ The integration doctrine tests the validity of these exemptions when they are claimed individually for related offerings made in close temporal sequence.

rule on that point. An implied right of action has long been recognized under Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. *Blue Chip Stamps*, 421 U.S. at 729-30. The Supreme Court has recently ruled that such an action may be maintained despite the express remedies under Section 11 of the Securities Act, 15 U.S.C. § 77k. *Herman & MacLean v. Huddleston*, 103 S. Ct. 683 (1983).

53. Since civil or criminal liability under the Securities Act or the Exchange Act depends on a "material" misrepresentation or omission, an understanding of that concept is essential. The Supreme Court's most recent comment about that term arose in the context of a suit charging violations of Section 14(a) of the Exchange Act, 15 U.S.C. § 78n(a) and Rule 14a-9 thereunder, 17 C.F.R. § 240.14a-9 (1982), the anti-fraud provision pertaining to statements made in proxy solicitation materials. The Court said an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to act upon such solicitation. *TSC Industries, Inc. v. Northway*, 426 U.S. 438, 449 (1976).

54. *See supra* note 9.

55. L. Loss & E. Cowett, *supra* note 3, at 34-38, 67-80. *See generally* Shapiro & Sachs, *Blue Sky Law and Practice: An Overview*, 4 U. BALT. L. REV. 1 (1974) (practical guide to Blue Sky Laws).

56. *See* L. Loss, *supra* note 2, at 29-38; Anderson, *The Disclosure Process in Federal Securities Regulation: A Brief Review*, 25 HASTINGS L.J. 311 (1974). The preamble to the Securities Act states: "An Act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof. . . ." Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-z (1982)) (preamble).

57. L. Loss, *supra* note 2, at 8-16.

58. L. Loss & E. Cowett, *supra* note 3, at 67-80.

59. For example, the SEC may inform an issuer that its registration statement presents such serious problems that the staff will not review it. This notice is informally called a "bed-bug" letter. SEC Release No. 33-5231, Feb. 3, 1972, 1 Fed. Sec. L. Rep. (CCH) ¶ 3057.

60. 15 U.S.C. § 77c (1982). *See generally* L. Loss, *supra* note 2, at 297-349.

61. 15 U.S.C. § 77d (1982). *See generally* L. Loss, *supra* note 2, at 349-429.

A. Early Private Placement Rulings

Looming large in this field of potentially integrable offerings are so-called private placements⁶²—offerings alleged to be exempt under Section 4(2) as “transactions by an issuer not involving any public offering.”⁶³ In describing this provision, the House Committee stated that it would exempt situations “where there is no practical need for [the Act’s] application . . . [or] where the public benefits are too remote.”⁶⁴

This terse statement of legislative policy was given an expanded judicial interpretation in *SEC v. Ralston Purina Company*.⁶⁵ In that case, the United States Supreme Court stated that the exemption applies only when the offerees of securities are able to “fend for themselves.”⁶⁶ More specifically, the Court ruled that the corporate offeror was not able to control the exemption’s applicability simply by defining offerees of its stock as “key employees” when some of those individuals were not high level executives having access to the kind of information provided in a registration statement.⁶⁷ The issuer, therefore, could not validly claim that its potential investors did not need the protection of a registration statement.

Although the offering in *Ralston Purina* was made to hundreds of individuals, the Court declined to find that fact dispositive of a public offering. It did indicate, however, that the number of offerees could be a factor in determining whether a Section 4(2) exemption was appropriate.⁶⁸ Those remarks liberalized the SEC’s earlier position which appeared to restrict the number of offerees that a valid private placement might contain.⁶⁹

Certain judicial opinions following *Ralston Purina* interpreted it narrowly, implying that it was virtually impossible for an outside investor in an unregistered offering to be given access to all material information about an issuer.⁷⁰ The commission, in response, used its rulemaking authority⁷¹ to create an administrative “safe harbor,” Rule 146, which more clearly and liberally defined a nonpublic offering.⁷² Pursuant to this rule,

62. Securities Act Release No. 33-4552, Nov. 6, 1962, 1 Fed. Sec. L. Rep. (CCH) ¶ 2770 at 2918. *Murphy*, 626 F.2d at 641.

63. 15 U.S.C. § 77d(2) (1982). *See* H. BLOOMENTHAL, *supra* note 1, at § 4.05.

64. H.R. REP. NO. 85, 73d Cong., 1st Sess. 5 (1933).

65. 346 U.S. 119 (1953).

66. *Id.* at 124-25.

67. *Id.* at 126-27. In *Ralston Purina*, the issuing company made an offering of its treasury stock over a five-year period to certain of its “key employees.” It was estimated that in one year alone the offering was made to 500 such persons, many of whom held rather low-level positions in the company. *Id.* at 121.

68. *Id.* at 125. Subsequent cases have cited the number of offerees as a factor to be used in determining the validity of a statutory private placement. *Doran v. Petroleum Management Corp.*, 545 F.2d 893, 901 (5th Cir. 1977); *Murphy*, 626 F.2d at 645. *See infra* notes 215-36 and accompanying text.

69. Securities Act Release No. 33-285, Jan. 24, 1935, 1 Fed. Sec. L. Rep. (CCH) ¶ 2740.

70. *Hill York Corp.*, 448 F.2d at 689; *SEC v. Continental Tobacco Co.*, 463 F.2d 137, 158 (5th Cir. 1972).

71. Section 19(a) of the Securities Act empowers the Commission to prescribe rules and regulations to carry out provisions of the Act and makes good faith compliance with those administrative pronouncements a defense to any liability imposed by the Act. 15 U.S.C. § 77s(a) (1982).

72. Securities Act Rule 146, 17 C.F.R. § 230.146 (1982) (repealed, 47 Fed. Reg. 11,261 (1982)); Securities Act Release No. 33-5487, April 23, 1974, 1 Fed. Sec. L. Rep. (CCH) ¶ 2710.

an offering would not be considered public if: a) the issuer reasonably believed that the securities were not purchased by more than thirty-five persons (not counting purchasers of more than \$150,000);⁷³ b) there was no general soliciting or advertising;⁷⁴ c) the issuer reasonably believed that the securities were offered and sold only to certain suitable persons having either the requisite investment expertise or the ability to bear financial risks and the services of a counselor possessing adequate business acumen;⁷⁵ d) the offerees had access to or were furnished with information comparable to that in a registration statement;⁷⁶ and e) steps were taken to assure that the securities could not be resold except in accordance with certain rules.⁷⁷

Rule 146 was a nonexclusive safe harbor that allowed an issuer to qualify for a private placement exemption by either meeting its specific requirements or coming within Section 4(2) itself as judicially interpreted.⁷⁸ After Rule 146's adoption, debate therefore continued about the essential elements of a statutory private placement.⁷⁹ In an important judicial opinion, the construction of Section 4(2) was modified so that offerees did not have to be "insiders" of the issuer to fulfill the *Ralston Purina* requirement that they have access to its material information.⁸⁰ Such disclosure, it was held, could be made available to investors by documents similar to those permitted under Rule 146.⁸¹

B. Early Limited Offering Provisions

In addition to the exemption for nonpublic offerings, the Securities Act contains a specific provision excluding from registration certain small or limited offerings. Section 3(b)⁸² authorizes the SEC "by its rules and regulations" to exempt offerings up to \$5 million⁸³ when the Commission finds that registration is not necessary "by reason of the small amount involved or the limited character of the public offering."⁸⁴

Early in its history, the Commission acted on that authorization by adopting Regulation A,⁸⁵ which now exempts up to \$1.5 million of securities sold by an issuer during a twelve month period.⁸⁶ The Regulation A exemption is available only if the issuer complies with certain specific pro-

73. Securities Act Rule 146(g), 17 C.F.R. § 230.146(g) (1982).

74. Securities Act Rule 146(c), 17 C.F.R. § 230.146(c) (1982).

75. Securities Act Rule 146(d), 17 C.F.R. § 230.146(d) (1982).

76. Securities Act Rule 146(e), 17 C.F.R. § 230.146(e) (1982).

77. Securities Act Rule 146(h), 17 C.F.R. § 230.146(h) (1982).

78. Securities Act Rule 146, 17 C.F.R. § 230.146 (1982) (preliminary note). *See also* Securities Act Release No. 33-5487, April 23, 1974, 1 Fed. Sec. L. Rep. (CCH) ¶ 2710.

79. ABA Committee on Federal Regulation of Securities, *Position Paper on Section 4(2) and Statutory Law*, 31 BUS. LAW. 485 (1975).

80. *Doran v. Petroleum Management Corp.*, 545 F.2d at 905-06.

81. *Id.* at 906.

82. Section 3(b) of the Securities Act, 15 U.S.C. 77c(b). *See* H.R. REP. NO. 85, 73d CONG., 1st Sess. 6 (1933). *See also* L. LOSS, *supra* note 2, at 337-49.

83. In 1980, Congress raised this ceiling to \$5 million. Pub. L. No. 96-477, § 301, 94 Stat. 2275, 2291 (1980).

84. Section 3(b) of the Securities Act, 15 U.S.C. § 77c(b).

85. Regulation A, Securities Act Rules 251-264, 17 C.F.R. §§ 230.251 to 264 (1982).

86. Securities Act Rule 254, 17 C.F.R. § 230.254 (1982).

cedures similar to the registration process itself. A simplified registration statement called an "offering statement" must be filed at an appropriate SEC regional office.⁸⁷ This offering statement must contain an offering circular, which is similar to the prospectus of a registration statement.⁸⁸ Commission staff members review the offering circular, and sales of the securities are customarily made only after the issuer has satisfactorily responded to any disclosure deficiencies noted by SEC examiners.⁸⁹

In the recent past, the Commission adopted two additional exemptions under Section 4(b). Rule 240⁹⁰ made it possible for an issuer to sell up to \$100,000 of securities in any twelve-month period as long as not more than 100 beneficial owners of those securities existed at the completion of the offering.⁹¹ Rule 242⁹² allowed an issuer to sell up to \$2 million of securities in any six month period to an unlimited number of "accredited persons" without providing them with any disclosure documents. Certain types of institutional investors, directors, or executive officers of the issuer, and any person buying at least \$100,000 of securities were defined as "accredited persons."⁹³ The offering could also be sold to thirty-five non-accredited persons provided that they were given written information similar to that contained in an appropriate registration statement.⁹⁴

In a related development, Congress added a new transactional exemption to the Securities Act, Section 4(6), which freed offerings under \$5 million from the requirement of registration if they were made only to "accredited investors."⁹⁵ Congress defined that term to include certain financial organizations and other persons which the Commission might designate.⁹⁶

C. Regulation D

Responding to criticism that the administratively prescribed exemp-

87. Securities Act Rule 255, 17 C.F.R. § 230.255 (1982).

88. Securities Act Rule 256(a)(1), 17 C.F.R. § 230.256(a)(1) (1982).

89. The circulation requirements for the offering statement are likewise quite similar to those prescribed for a prospectus in a registration statement. Securities Act Rule 256(a)(2) 17 C.F.R. § 230.256(a)(2). Cf. Section 5(b)(1) of the Securities Act 15 U.S.C. § 77e(b)(1) and Securities Act Release No. 33-4968, Apr. 24, 1968, 1 Fed. Sec. L. Rep. (CCH) ¶ 3929.

90. For the classic, but somewhat dated study of Regulation A, see Weiss, *Regulation A Under the Securities Act of 1933—Highways and Byways*, 8 N.Y.L.F. 3 (1962).

91. Securities Act Rule 240, 17 C.F.R. § 230.240 (effective March 15, 1975). Securities Act Release No. 33-5565 (repealed, 47 Fed. Reg. 11,262 (June 30, 1982)).

92. Under Rule 240, "the issuer shall, after reasonable inquiry, have reasonable grounds to believe, and shall believe, that the securities of the issuer . . . are beneficially owned by 100 or fewer persons." 17 C.F.R. § 230.240(f) (1982). The rule then specifically lists certain relationships that are not within the "beneficial owner" restriction. *See id.* at § 230.240(f)(1) to (3).

93. Securities Act Rule 242, 17 C.F.R. § 230.242 (1982); Securities Act Release No. 33-6180, Jan. 17, 1980 [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,426 (repealed, 47 Fed. Reg. 11,262 (effective June 30, 1982)).

94. Accredited person included, *inter alia*, "any person who purchases \$100,000 or more of securities of the issue per issue sold . . . for any combination of: (A) cash, or (B) an obligation to pay . . . [with] . . . full recourse against the purchaser . . . and for discharge of the obligation within 60 days of the first issuance of the securities, or (C) the cancellation of any indebtedness owed by the issuer to the purchaser. . . ." 17 C.F.R. § 230.242(a)(1)(ii) (1982).

95. Securities Act Rule 242(e), 17 C.F.R. § 230.242(e) (1982).

96. Section 4(6) of the Securities Act, 15 U.S.C. § 77d(6).

97. Section 2(15) of the Securities Act, 15 U.S.C. § 77b(15).

tions for private placements and small offerings were overly technical and unduly burdensome to small businesses,⁹⁷ in 1982 the Commission acted to consolidate and liberalize them by adopting Regulation D.⁹⁸ The three substantive rules of Regulation D—Rules 504, 505, and 506—revised and replaced respectively Rules 240, 242, and 146.⁹⁹ Rule 504 allows an issuer to sell \$500,000 of securities to any number of purchasers in a twelve-month period.¹⁰⁰ No written information need be supplied to investors under that rule,¹⁰¹ and no restrictions on resales are required if the offering is made only in states which require registration and the furnishing of disclosure documents to purchasers before sale.¹⁰²

Rule 505, promulgated (as was Rule 504) under the Section 3(b) exemption, expanded the use of the accredited investor theory begun in Rule 242.¹⁰³ Rule 505 provides that \$5 million may be raised in a twelve-month period from an unlimited number of such purchasers¹⁰⁴ and from thirty-five other persons.¹⁰⁵ Accredited investors are defined in Rule 501 to include certain classes of institutions and individuals with substantial financial resources.¹⁰⁶ Continuing the precedent set in Rule 242, no disclosure documents need be provided to those investors.¹⁰⁷ Nonaccredited purchasers in a Rule 505 offering, however, must be supplied with certain written information similar to that which would be required in an appropriate registration statement of a non-exempt offering.¹⁰⁸

Rule 506 replaced the rather limited safe harbor of Rule 146.¹⁰⁹ It allows sales of an unlimited dollar amount of securities to any number of accredited investors and to thirty-five other purchasers.¹¹⁰ Its disclosure requirements are the same as those for Rule 505 offerings.¹¹¹ Because

97. See Campbell, *The Plight of Small Issuers Under the Securities Act of 1933: Practical Foreclosure from the Capital Market*, 1977 DUKE L.J. 1139, 1143, 1168-69; Heumann, *Is SEC Rule 146 Too Subjective to Provide the Needed Predictability in Private Offerings?*, 55 NEB. L. REV. 1, 9 (1975); Weinberg & McMannis, *The Private Placement Exemption Under the Securities and Exchange [sic] Act of 1933 Revisited, and Rule 146*, 27 BAYLOR L. REV. 201 (1975).

98. Regulation D, Securities Act Rules 501-506, 17 C.F.R. §§ 230.501 to .506 (1982). Securities Act Release No. 6389, Mar. 8, 1982 [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,106.

99. See generally H. BLOOMENTHAL, *supra* note 1, at § 4.05.

100. Securities Act Rule 504(b)(2)(i), 17 C.F.R. § 230.504(b)(2)(i) (1982).

101. Securities Act Rule 502(b)(1)(i), 17 C.F.R. § 230.502(b)(1)(i) (1982).

102. Securities Act Rule 504(b)(1), 17 C.F.R. § 230.504(b)(1) (1982).

103. Securities Act Rule 242, 17 C.F.R. § 230.242 (1982). See *supra* notes 92-93 and accompanying text.

104. Securities Act Rule 501(e)(1)(iv), 17 C.F.R. § 230.501(e)(1)(iv) (1982).

105. Securities Act Rule 505(b)(2)(ii), 17 C.F.R. § 230.505(b)(2)(ii) (1982).

106. Securities Act Rule 501(a)(1)-(8), 17 C.F.R. §§ 230.501(a)(1)-(8) (1982). "Accredited investor" is defined to include, among others, any natural person with a net worth of over \$1 million (Rule 501(a)(6) or one with an individual income in the two most recent years of \$200,000 who reasonably expects such income in the current year (Rule 501(a)(7).

107. Securities Act Rule 502(b)(1)(i), 17 C.F.R. § 230.502(b)(1)(i) (1982).

108. Securities Act Rule 502(b)(2)(i), 17 C.F.R. §§ 230.502(b)(2)(i) (1982). If the issuer is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, Sections 502(b)(2)(ii)-(iii), 17 C.F.R. 230.502(b)(2)(ii)-(iii) require that certain of those documents be provided to prospective investors.

109. See *supra* notes 72-78 and accompanying text.

110. Securities Act Rule 506(b)(2)(i), 17 C.F.R. § 230.506(b)(2)(i) (1982); and Securities Act Rule 501(e)(iv), 17 C.F.R. § 230.501(e)(iv) (1982).

111. See *supra* notes 107-08 and accompanying text.

Rule 506 is based on Section 4(2), the issuer must have reason to believe that all non-accredited purchasers or their "purchaser representatives" are financially sophisticated so that the offering may be safeguarded from being public.¹¹² As was the case with its predecessor, Rule 146, Rule 506 is a nonexclusive exemption permitting the issuer the option of bypassing it and claiming that its offering is exempt directly under the statute.¹¹³

To comply fully with any of these Regulation D exemptions, the issuer must also observe certain technical conditions, such as exercising the reasonable care concerning resales of the securities outlined in Rule 502¹¹⁴ and filing a notice with the Commission as required by Rule 503.¹¹⁵ Rule 502 also contains a specific section on the application of the integration doctrine to Regulation D offerings,¹¹⁶ which will be discussed in detail later in this Article.¹¹⁷

D. *Intrastate Offerings*

Securities which are "part of an issue offered and sold only to persons resident within a single State or Territory" are classified as exempted securities pursuant to Section 3(a)(11).¹¹⁸ To qualify, the issuer, if a corporation, must be incorporated by and doing business in the state where its securities are offered and sold.¹¹⁹ Judicial opinions have interpreted the "doing business" provision as meaning substantial business.¹²⁰ The SEC has additionally commented that the exemption was designed for "local financing by local industries, carried out through local investment."¹²¹

The Commission has refined this exemption with another nonexclusive safe harbor provision, Rule 147.¹²² That rule defines an issuer as do-

112. Securities Act Rule 506(b)(2)(ii), 17 C.F.R. § 230.506(b)(2)(ii) (1982).

113. Regulation D, 17 C.F.R. § 230.501-506 (1982) (Preliminary Note 3).

114. Securities Act Rule 502(d), 17 C.F.R. § 230.502(d) (1982). The provision cautions against resale of those securities that might make such sellers statutory underwriters pursuant to Section 2(11) of the Securities Act, 15 U.S.C. § 77b(11). It lists certain steps which the issuer should take to guard against that possibility.

115. Securities Act Rule 503, 17 C.F.R. § 230.503 (1982).

116. Securities Act Rule 502(a), 17 C.F.R. § 230.502(a) (1982).

117. *See infra* notes 170-72 and accompanying text.

118. Section 3(a)(11), 15 U.S.C. § 77c(a)(11). The exemption is not based upon a lack of federal jurisdiction since the instrumentalities of intrastate commerce may be used to sell these securities. Rather, it reflects Congress' decision to allow these securities to be regulated by state authorities only. *See* S. REP. NO. 47, 73d Cong., 1st Sess. 4 (1933); H.R. REP. NO. 85, 73d Cong., 1st sess. 5 (1933); L. LOSS, *supra* note 2, at 319-25. *See also* Securities Act Release No. 33-1459, May 29, 1937, 1 Fed. Sec. L. Rep. (CCH) ¶ 2261. The exemption applies only to the registration requirement of the Act, not to the anti-fraud provisions. The SEC has stated that the term "resident" has the same meaning as domiciliary. Securities Act Release No. 33-4386, July 12, 1961, [1957-1961 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,774.

119. To qualify for that exemption, a natural person who is an issuer must also be a resident and doing business in the same state where his or her securities are offered or sold. 15 U.S.C. § 77c(a)(11).

120. *Chapman v. Dunn*, 414 F.2d 153 (6th Cir. 1969); *SEC v. Truckee Showboat*, 157 F. Supp. 824 (S.D. Cal. 1957).

121. Securities Act Release No. 33-4434, Dec. 6, 1961, 1 Fed. Sec. L. Rep. (CCH) ¶ 2270 at 2611.

122. Securities Act Rule 147, 17 C.F.R. § 230.147; Securities Act Release No. 33-5450, January 7, 1974, 1 Fed. Sec. L. Rep. (CCH) ¶ 2340. *See generally* Hicks, *Intrastate Offerings Under Rule 147*, 72 MICH. L. REV. 463 (1974).

ing business in a state if it has its principal office there¹²³ and conducts at least eighty percent of various financial aspects of its enterprise within that state.¹²⁴ If Rule 147 is to be applicable, no interstate resales of securities issued pursuant to the rule may be made for at least nine months after the initial distribution is completed so that the offering may be said to have "come to rest" in the state where it was sold.¹²⁵

IV. INTEGRATION

By their diction, the exemptions detailed in Sections 3 and 4 of the Securities Act accept the notion that a business can offer or issue its securities in distinct batches constituting segregable financing arrangements.¹²⁶ Section 4(2) exempts "transactions by an issuer not involving any public offering,"¹²⁷ and both the small offering and intrastate exemptions of Sections 3(b)¹²⁸ and 3(a)(11)¹²⁹ speak of *issues*, thereby connoting separate money raising endeavors. Problems arise when an issuer engineers a series of these unregistered offerings which, when considered together, do not conform to the requirements of any exemption. The issuer then exceeds the carefully prescribed boundaries of those exemptions and deprives its investors of the legally mandated protection afforded by registration.¹³⁰

A. Early SEC Rulings on Integration

The first such combining of a firm's purportedly separate issuances was made in 1933, the initial year of the Securities Act's existence, by the Federal Trade Commission ("FTC"), the agency then charged with its administration.¹³¹ Responding to an inquiry by an issuer planning an intrastate offering while a registration statement for interstate sales of the same class of its securities was pending, the FTC declared that a Section 3(a)(11) exemption would not be available for the purported intrastate offering.¹³² The FTC stated that the two offerings were in reality one issue; therefore, registered sales to individuals not resident in the issuer's home state would

123. Securities Act Rule 147(c)(2)(iv), 17 C.F.R. § 230.147(c)(2)(iv) (1982).

124. Securities Act Rule 147(c)(2)(i)-(iii), 17 C.F.R. §§ 230.147(c)(2)(i)-(iii) (1982) provides, in summary, that this requirement is fulfilled only if an issuer is deriving at least 80% of its gross revenues from the state where the offering is made, has at least 80% of its assets in that state, and intends to use at least 80% of the proceeds of the offering in that state.

125. Securities Act Rule 147(e), 17 C.F.R. § 230.147(e) (1982).

126. L. Loss, *supra* note 2, at 304-05, discusses this doctrine principally in connection with the exemption under Section 3(a)(9) of the Securities Act, 15 U.S.C. § 77c(a)(9), for any security exchanged by the issuer with its existing security holders under certain conditions. Professor Loss also notes that the principle applies to other exempt securities, *id.* at 341-42, and to exempt transactions under § 4(2) of the Act. *Id.* at 374. See also Deaktor, *Integration of Securities Offerings*, 31 U. FLA. L. REV. 465 (1979), and *ABA Proposal*, *supra* note 30, at 1591.

127. Section 4(2) of the Securities Act, 15 U.S.C. § 77d(2).

128. Section 3(b) of the Securities Act, 15 U.S.C. § 77c(b).

129. Section 3(a)(11) of the Securities Act, 15 U.S.C. § 77(c)(a)(11).

130. L. Loss, *supra* note 2, at 304-05, 319-20, 341-42, 374; Deaktor, *supra* note 126, at 492.

131. Section 4 of the Exchange Act, 15 U.S.C. § 78d, created the SEC and gave it the authority to oversee and enforce the federal securities laws. Public Law Number 73-291, section 210, 48 Stat. 881 (1934) amended Section 2(5) of the Securities Act, which had originally granted that power to the FTC.

132. Securities Act Release No. 33-97, Dec. 28, 1933, 1 Fed. Sec. L. Rep. (CCH) ¶ 1021.

taint any exemption claimed for the unregistered shares.¹³³

The Securities and Exchange Commission gave its first reasoned statement of this integration doctrine in the administrative proceeding, *In re Unity Gold Corp.*¹³⁴ *Unity Gold* involved an unregistered offering made shortly before sale of the same class of the issuer's securities was planned pursuant to a registration statement.¹³⁵ The unregistered offering was made under a Section 3(b) exemption, Rule 202,¹³⁶ the predecessor of the current Regulation A exemption.¹³⁷ Two months later, the issuer filed a registration statement for its other offering in which it mentioned the earlier issuance and stated that it had been made pursuant to the Rule 202 exemption.¹³⁸ The SEC integrated the two offerings and ruled that the securities were of the same class and had been offered in an uninterrupted program of distribution.¹³⁹ It then found that the aggregate amount raised by the two offerings exceeded the \$100,000 ceiling in effect for Rule 202 offerings.¹⁴⁰ The Commission consequently issued a stop order¹⁴¹ to halt the effectiveness of the registration statement because of its misleading representation regarding the compliance of the earlier offering with Rule 202.¹⁴²

In *Unity Gold*, the Commission articulated six factors indicative of whether a series of offerings were in effect a single issuance of securities: (1) whether the plan to distribute the securities included, in addition, the distribution of other securities; (2) the methods of sale and distribution; (3) the classes of securities offered; (4) the general terms on which the securities were offered; (5) the timing of the offering; and (6) the use of the proceeds of the offering.¹⁴³ The Commission was careful to point out that its reason for applying the doctrine of integration was to prevent misuse of valid statutory exemptions from registration. The Commission noted, "[t]he proviso [the small issue exemption] cannot be construed to permit the exemption of small portions of large financing operations. This would defeat its very purpose."¹⁴⁴

Several years later, the SEC's general counsel applied the *Unity Gold* criteria to a series of offerings for which the Section 4(2) exemption was claimed.¹⁴⁵ His opinion focused on the language in the statute exempting

133. *Id. In re Brooklyn Manhattan Transit Corp.*, 1 S.E.C. 147 (1935), was the SEC's first application of the integration doctrine to intrastate offerings. The Commission reaffirmed the policy in Securities Act Release No. 33-1459, May 29, 1937, 1 Fed. Sec. L. Rep. (CCH) ¶ 2261.

134. 3 S.E.C. 618 (1938).

135. *Id.* at 623.

136. Securities Act Rule 202, Securities Act Release No. 33-182, pt. III, March 15, 1936 (repealed) (available from SEC).

137. Securities Act Rules 251-264, 17 C.F.R. §§ 230.251 to .264 (1982). *See supra* notes 85-89 and accompanying text.

138. 3 S.E.C. at 624.

139. *Id.* at 625.

140. *See supra* note 136.

141. Section 8(d) of the Securities Act empowers the Commission to suspend the effectiveness of a registration statement when it finds, after appropriate notice and hearing, that the statement contains material misrepresentations or omissions. 15 U.S.C. § 77h(d) (1982).

142. 3 S.E.C. at 634.

143. *Id.* at 625.

144. *Id.*

145. Securities Act Release No. 33-2029, Aug. 8, 1939, 1 Fed. Sec. L. Rep. (CCH) ¶ 2140. The

transactions "not involving any public offering" and stated: "Accordingly I am of the opinion that the exemption is not available to securities privately offered if any other securities comprised within the same issue are made the subject of a public offering."¹⁴⁶

Little judicial or administrative development of the integration doctrine occurred until the early 1960's. At that time, the Commission, under aggressive leadership,¹⁴⁷ published releases reaffirming the applicability of integration to both intrastate issues¹⁴⁸ and private placements.¹⁴⁹ In Securities Act Release Number 4434, the Commission restated the principles underlying the Section 3(a)(11) exemption and made this comment about the relationship of integration to intrastate issues:

Any one or more of the following factors may be determinative of the question of integration: (1) are the offerings part of a single plan of financing; (2) do the offerings involve issuance of the same class of securities; (3) are the offerings made at about the same time; (4) is the same type of consideration to be received; and (5) are the offerings made for the same general purpose.¹⁵⁰

This five-factor test contained all of the previously announced criteria of *Unity Gold*, except that similarities in sales and distribution methods were no longer listed.¹⁵¹ Importantly, however, the SEC stated that any one of these indicia alone could be conclusive of the matter.¹⁵²

Shortly after that pronouncement, the Commission repeated these same five factors in a discussion of integration as it related to the private placement exemption.¹⁵³ The Commission's introductory comments stated: "The following factors are *relevant* to the question of integration: . . ."¹⁵⁴ The intrastate integration release, however, had begun, "[a]ny one or more of the following factors may be *determinative* of the question of integration: . . ."¹⁵⁵ Since the Commission did not comment on this disparity in language, it is uncertain whether it was favoring a flexible ap-

opinion affirmed the validity of a Section 3(a)(9) exemption for the exchange of one series of bonds for another and the application of the private placement exemption for a sale of a third series of bonds for cash. The general counsel found that the bonds exchanged with the issuer's then current security holders and those sold in the private placement were substantially different, so as to justify their treatment as separate classes of securities. If this were not the case, the offerings would have been deemed integrable.

146. *Id.* at 2585.

147. Commissioner Roberta Karmel recounts how William L. Cary, President Kennedy's appointee as SEC Chairman, revitalized the Commission. She also expresses some misgivings about that turn of events. R. KARMEL, REGULATION BY PROSECUTION 52-59 (1982).

148. Securities Act Release No. 33-4434, Dec. 6, 1961, 1 Fed. Sec. L. Rep. (CCH) ¶ 2270.

149. Securities Act Release No. 33-4552, Nov. 6, 1962, 1 Fed. Sec. L. Rep. (CCH) ¶ 2770.

150. 1 Fed. Sec. L. Rep. (CCH) ¶ 2270 at 2608.

151. *But see* Smith v. Jackson Tool & Die, Inc. 419 F.2d 152 (5th Cir. 1969), where the court declined to integrate a statutory private placement with an intrastate issue, citing a broker's commission and a stock subscription agreement which were present only in the intrastate offering.

152. Securities Act Release No. 33-4434, Dec. 6, 1961, 1 Fed. Sec. L. Rep. (CCH) ¶ 2270 at 2608.

153. Securities Act Release No. 33-4552, Nov. 6, 1962, 1 Fed. Sec. L. Rep. (CCH) ¶ 2770 at 2918.

154. *Id.* (emphasis added).

155. *See supra* note 152 (emphasis added).

plication of these factors when applied to private placements while making any one of them dispositive in the context of intrastate issues.

In neither of the releases did the SEC expand on the meaning of the five factors, nor did it indicate how they should be weighed when applied to a series of offerings where some but not all the factors were present. Issuers concerned about integration, however, have received some additional guidance from the Commission in its safe harbor rulings and no-action letters discussed in the following subsections of this Article.

B. *Safe Harbors*

The Commission has balanced the vague nature of the integration criteria in its releases with various straightforward "safe harbor" provisions.¹⁵⁶ These rules give issuers assurance that financing arrangements structured in certain ways will not be integrated.

In the second year of its existence, the Commission published a regulation stating that it would not integrate certain transactions in a valid non-public offering with later offers or sales of the same offering made pursuant to a registration statement.¹⁵⁷ The purpose of this rule, which remains in force today, is to permit "those who have contemplated or begun to undertake a public offering to register the securities without incurring any risk of liability as a consequence of having first contemplated or begun to undertake a private offering."¹⁵⁸ The rule precludes integration of aborted private financing with a later registered offering, but it is unclear if such protection also applies to successfully completed private placements.¹⁵⁹

When the Commission promulgated Rules 146¹⁶⁰ and 147¹⁶¹ providing nonexclusive safe harbors for private placements and intrastate offerings, it included this section on integration in both rules:

For purposes of this rule only, an offering [issue]¹⁶² shall be deemed not to include offers, offers to sell, offers for sale or sales of securities of the issuer pursuant to the exemptions provided by section 3 or section 4(2) of the Act or pursuant to a registration statement filed under the Act, that take place prior to the six month period immediately preceding or after the six month period immediately following any offers, offers for sale or sales pursuant to this rule, *Provided*, That there are during neither of said six month periods any offers, offers for sale or sales of securities by or for the issuer of the same or similar

156. See *supra* note 71.

157. See Securities Act Rule 152, adopted by Securities Act Release No. 33-305, Mar. 2, 1935 (available from SEC), rescinded, readopted, and consolidated in the General Rules and Regulations under the Securities Act by Securities Act Release No. 33-627, Mar. 15, 1936 (current version at 17 C.F.R. § 230.152 (1982)).

158. Securities Act Release No. 33-305, Mar. 2, 1935 (available from SEC).

159. H. BLOOMENTHAL, *supra* note 2, at § 4:14[5].

160. See *supra* note 72.

161. See *supra* note 122.

162. The language of the provision is identical in both rules, except that "offering" is used in Rule 146 and "issue" in Rule 147, tracking respectively the exact language of Section 4(2) and Section 3(a)(11) of the Securities Act.

class as those offered, offered for sale or sold pursuant to the rule.¹⁶³

The Commission thus guaranteed issuers that nonpublic or intrastate offerings made at least six months apart and in compliance with Rules 146 or 147 would be free from the risks of possible integration.¹⁶⁴ In so ruling, the SEC singled out one of the five factors in its previously stated tests for integration,¹⁶⁵ that of closeness in time,¹⁶⁶ and made it alone conclusive when the temporal proximity of offerings exceeded six months. For offerings outside that safe harbor, the Commission stated that the question of integration would depend on their facts as analyzed in light of its Releases 4434 and 4452.¹⁶⁷

One commentator complained that the six month period was unnecessarily long¹⁶⁸ and also predicted that such a mechanical approach would provide a disincentive to further explanation of the alternative theories governing integration.¹⁶⁹ The Commission, however, has continued to employ the six month safe harbor in its recently promulgated Regulation D;¹⁷⁰ Rule 502 adopts the assurance for all offerings made pursuant to Rules 504, 505, or 506.¹⁷¹ Rule 502 also states that integration of offerings not qualifying under that timetable depends on their facts and circumstances considered in light of the five factors enumerated in the Commission's 1962 release.¹⁷²

Although this rule continues to comfort issuers who space their unregistered financing efforts more than six months apart, it is of little solace to those in need of privately raised capital more than twice a year. As has been noted,¹⁷³ those businesses particularly include companies in the mineral exploration or real estate fields.

C. No-Action Letters

Another component of the developing law (or lore)¹⁷⁴ of integration was a series of interpretive responses by the Commission's staff to inquiries seeking advice about the propriety of certain transactions.¹⁷⁵ These so-

163. 17 C.F.R. § 230.146(b)(1) (1982) (emphasis in original). The proviso language of Rule 147 is slightly different from that quoted in the text from Rule 146. Rule 147 reads: "Provided That there are during either of said six month periods no offers for sale or sales of securities by or for the issuer of the same or similar classes as those offered, offered for sale, or sold pursuant to the rule." 17 C.F.R. § 230.147 (1982) (emphasis in original). As one commentator has observed, the difference in language is inconsequential. Deaktor, *supra* note 126, at 515 n.300.

164. See *Hicks*, *supra* note 122, at 469-77 for an elaborate description of this safe harbor provision as it relates to the intrastate exemption.

165. Securities Act Releases Nos. 33-4434 and 33-4552, *supra* notes 152-53.

166. "Are the offerings made at or about the same time," appears as the third factor in the five-factor test articulated in both Securities Act Releases Nos. 33-4434 and 33-4552.

167. Note to Rule 146(b)(1), 17 C.F.R. § 230.146(b)(1) (1982) (citing Preliminary Note 3 of that Rule); and Preliminary Note 3 of Rule 147, 17 C.F.R. § 230.147 (1982).

168. Deaktor, *supra* note 126, at 516.

169. *Id.*

170. See *supra* notes 97-117 and accompanying text.

171. Securities Act Rule 502(a), 17 C.F.R. § 230.502(a) (1982).

172. See the note following Securities Act Rule 502(a), *supra* note 171.

173. See, e.g., Note, *Securities Regulation: Integration of Securities Offerings*, 34 OKLA. L. REV. 864 869 (1981).

174. The descriptive pun is borrowed from the *ABA Proposal*, *supra* note 30, at 1605.

175. 17 C.F.R. §§ 200.81, 202.2 (1982). In Securities Act Release No. 33-5098, Oct. 29, 1970,

called no-action letters were expressly circumscribed in scope, addressing only the issue of whether the staff would recommend enforcement action in the particular situations presented.¹⁷⁶ Counsel and commentators have nevertheless taken them as providing some type of bureaucratic gloss on various aspects of securities law, particularly on the five factor tests for integration enunciated by the Commission in its 1961 and 1962 releases.¹⁷⁷

In looking to the no-action letters for guidance, it is important to be mindful of their limitations; they constitute no formal action by the Commission, but only *ad hoc* advice by its staff.¹⁷⁸ In some instances, as Commission attorneys themselves have stated, the letters have reflected not so much legal opinions but rather pragmatic judgments that the SEC's enforcement resources would not be expended on the instant matters.¹⁷⁹

If considered as a coherent body of law, the letters pose additional problems. As the ABA subcommittee itself has noted, the letters are often difficult to harmonize even when they deal with analogous situations.¹⁸⁰ They typically contain little reasoning or elaboration on the basis for the staff's opinion.¹⁸¹ In addition, the Supreme Court has commented that many of the Commission's recent legal interpretations have not been sustained in the high Court's rulings and has expressly stated that judicial deference to the SEC's administrative expertise is not always warranted.¹⁸²

In an apparent recognition of these pitfalls, in 1979 the SEC staff

[1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77.921, the SEC adopted 17 C.F.R. § 200.81 and announced its new policy of making such correspondences available to the public.

176. The Commission also responds to inquiries concerning interpretations of securities statutes or its rules and regulations. These "interpretative" and "no-action" letters are commonly referred to together as "no-action letters." See Deakor, *supra* note 126, at 525 n.353. For a critical review of the no-action letter process, see Lockhart, *SEC No-Action Letters: Informal Advice As A Discretionary Administrative Clearance*, 37 L. & CONTEMP. PROBS. 989 (1972); Lowenfels, *SEC No-Action Letters: Conflicts with Existing Statutes, Cases, and Commission Releases*, 59 VA. L. REV. 303 (1973); Lowenfels, *SEC "No-Action" Letters: Some Problems and Suggested Approaches*, 71 COLUM. L. REV. 1256 (1971).

177. See generally Deakor, *supra* note 126, at 526 n.354; Note, *supra* note 173, at 870 n.47 and accompanying text.

178. Securities Act Release No. 33-6253, 1980, 1 Fed. Sec. L. Rep. ¶ 134A n.4.

179. See, e.g., *Delorean Motor Co.*, available Sept. 15, 1977, SEC NO-ACTION LETTERS (CCH) fiche 59, frame A4, where the staff closed its response with this remark: "Further, this letter only expresses the Division's position on enforcement action and does not purport to express any legal conclusion on the questions presented." *Id.*

180. *ABA Proposal*, *supra* note 30, at 1605 n.44, citing its earlier discussion *id.* at 1592 and notes 2 & 3 of JIC Drilling Companies [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,765 (Aug. 23, 1975) and Martin Exploration Co. [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,794 (Sept. 7, 1976). Both situations involved two closely timed offerings of limited partnership interests to explore for oil and gas. The offerings in *JIC* and *Martin* had common general partners. The partnerships in *JIC*, however, would drill on prospects obtained from the same unaffiliated third party, whereas the source of *Martin*'s prospects was not mentioned. The staff denied a no-action letter in *JIC*, stating that the offerings involved a single plan of financing, i.e., to develop the prospects held by the unaffiliated third party. In *Martin*, however, a no-action letter was granted.

181. In *Martin Exploration Co.*, *supra* note 180, the staff made no attempt to articulate a distinction between that situation and JIC Drilling Company, which was denied a no-action letter only two weeks earlier. In the *Martin* letter, the staff merely recited the facts as presented by *Martin*'s counsel and stated: "Based upon the facts presented, this Division will not raise any questions with respect to the integration of the two offerings." *Martin Exploration Co.* [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,794 at 87,076.

182. *International Brhd. of Teamsters v. Daniel*, 439 U.S. 566 n.20 (1979).

called a halt to the procedure of issuing no-action letters, announcing that it would cease interpretive advice on integration issues.¹⁸³ The staff reasoned that the complex nature of many of the submitted arrangements increased the danger that its letters would be given improper precedential value.

Viewing these no-action letters nonetheless as an historical body of quasi-administrative case law, it appears that the staff often did not integrate commonly sponsored offerings having similar purposes.¹⁸⁴ This rather permissive attitude may have resulted from the fact that such common promotions were often presented to the staff as financially independent ventures which would succeed or fail on their own merits.¹⁸⁵ The staff did integrate offerings for oil and gas exploration which involved drilling either on the same property,¹⁸⁶ in commonly held leaseholds,¹⁸⁷ or in leases obtained from a common source.¹⁸⁸ In those situations, the staff presumably saw an interdependence in the offerings which was not present

183. Clover Fin. Corp., SEC No-Action Letter (issued Mar. 5, 1979) [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,091.

184. *See, e.g.* National Ass'n of Home Builders, available Mar. 23, 1972, SEC No-ACTION LETTERS (CCH), Roll 4, frame 06631 (Separate limited partnerships for multi-family housing sites were not integrated despite common general partners); Tele-Tower, Inc., [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH), ¶ 81,540 (Jan. 25, 1978) (separate limited partnerships with a common general partner formed to develop electronic billboards at various locations were not integrated); Dogwood Farms, Inc. (no-action letter) (available Sept. 1, 1975) (a series of limited partnerships with a common general partner formed to raise one race horse each were not integrated); Canon Club Co., available June 26, 1978 [1978] SEC No-ACTION LETTERS (CCH) fiche 31, frame 11 (four partnerships formed by the same entity to rehabilitate noncontiguous government housing were not integrated); Churchill & Hoskins, available Oct. 24, 1978 [1978] SEC No-ACTION LETTERS (CCH), fiche 49, frame H1 (several limited partnerships formed by a common organizer whose affiliate would supply leases for drilling were not integrated when the leases were to be drilled by an independent party); Vince Allen & Assoc., available Dec. 13, 1976 [1976] SEC No-ACTION LETTERS (CCH), roll 12, frame 16,258 (a general partner of two limited partnerships formed to explore for oil and gas was granted a no-action letter when he represented that neither he nor his affiliate had transferred property interests to either partnership); DeLorean Motor Co., available Sept. 15, 1977 [1977] SEC No-ACTION LETTER (CCH) fiche 59, frame A4 (a private placement to one prominent entertainer was not integrated with the issuer's registered offering to dealers who would sell its cars); Oklahoma Oil & Gas Co., available Nov. 16, 1978 [1978] SEC No-ACTION LETTERS (CCH), fiche 52, frame L5 (two closely timed partnership offerings of the same general partner were not integrated where the partnerships would not own interests in any prospects within 300 miles of each other). *See also* discussion of Martin Exploration Co., *supra* notes 180-81.

185. In the case of oil and gas offerings which were not integrated, the prospects owned by the separate entities were geographically distant. *See, e.g.*, Churchill & Hoskins, *supra* note 184, (at least ten miles apart); Martin Exploration Co., *supra* notes 180-81, (in separate states); Oklahoma Oil & Gas Co., *supra* note 184, (at least 300 miles apart).

In the case of offerings of interest in real estate, separate geographic location was likewise important for offerings that were not integrated, *e.g.*, National Ass'n of Home Builders, *supra* note 184; Cannon Club Co., *supra* note 184. *See also* Tele-Tower, Inc., *supra* note 184, where electronic billboards owned singularly by each partnership would be located in separate shopping centers.

186. Thomas H. Chambers, available June 28, 1976 [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,618.

187. May Petroleum Co., available Aug. 28, 1974 [1974] SEC No-ACTION LETTERS (CCH), roll 8, frame 11,187.

188. JIC Drilling Co., *supra* note 180, Charles E. Watters, available May 24, 1978 [1978] SEC No-ACTION LETTERS (CCH), fiche 26, frame 121; Marshall C. Taylor, available April 6, 1979 [1979] SEC No-ACTION LETTERS (CCH), fiche 20, frame C17. *But see* Churchill & Hoskins, *supra* note 184, where leases were supplied by an affiliate of the common issuer. Those offerings were not integrated, perhaps because the drilling was conducted by an independent party.

when the projects were obtained from separate, unrelated individuals.¹⁸⁹

Although the staff expressed little or no reasoning for its positions, it appears that Commission attorneys were inclined not to integrate offerings where the economic risks were thought segregable, even though the funds were often raised for similar purposes and to finance the promoters' ongoing businesses.¹⁹⁰ Such offerings were usually made in close temporal promixity,¹⁹¹ and cash was almost always the common consideration.¹⁹² The obligations issued were many times owing from different legal entities,¹⁹³ thus arguably constituting different classes of securities. Those entities, however, usually had one or more common controlling persons.¹⁹⁴

One can speculate that the staff's reluctance to integrate such commonly sponsored offerings arose in part as a concession to issuers who operated in the days before Regulation D¹⁹⁵ and under the more restrictive private placement guidelines of Rule 146.¹⁹⁶ With issuers of private placements then limited in most instances to thirty-five investors and required to furnish their offerees with disclosure documents similar to those in a registration statement, Commission staffers may have felt that a more vigorous integration policy would have made the process of capital formation unduly burdensome. Given today's more liberal private placement rules in Regulation D, such an attitude is less justifiable.

D. *Pre-Murphy Judicial Decisions*

The case law on integration in the years following the Commission's two landmark releases was scanty. Professor Deaktor listed fourteen post-1961 reported decisions¹⁹⁷ in his 1979 article and remarked that "a relatively large portion of the integration cases make no mention of the work of the SEC in the area, nor of cases or authorities which have drawn on

189. In JIC Drilling Co., the staff reasoned in favor of integration, noting that "the offer and sale of the Units will involve a single plan of financing, the general purpose of which is the development of the oil and leasehold interests in wells owned by the Enterprises." [1976-1977 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 80,765 at 86,980.

190. *See* the no-action letters granted as discussed *supra* note 184.

191. In a number of the no-action letters discussed *supra* note 184, offerings were made within six months of one another, *e.g.*, Oklahoma Oil & Gas Co.; Martin Exploration Co.; Churchill & Hoskins; and Cannon Club Co.

192. None of the no-action letters discussed herein gave any indication that consideration other than cash would be paid for the securities.

193. All the no-action letters discussed *supra* note 184, except DeLorean Co., available Sept. 15, 1977, SEC NO-ACTION LETTERS (CCH), fiche 59, frame A4, involved offerings of interests in at least two separate limited partnerships. The *DeLorean* case involved common stock offered pursuant to a registration statement and a private placement.

194. Most commonly, the no-action letters discussed *supra* note 184 involved offerings of interests in different limited partnerships which had at least one common general partner.

195. *See supra* notes 97-117 and accompanying text.

196. *See supra* notes 72-78 and accompanying text.

Rule 506 now makes it possible for an issuer to raise money from an unlimited number of accredited investors without registration while Rule 146 limited its private placements to no more than 35 purchasers, exclusive of those who invested \$150,000 or more. Securities Act Rule 146(g), 17 C.F.R. § 230.146(g) (1982). The term "accredited investor" has been defined liberally to include, among others, any natural person who has a net worth of \$1 million or an annual income in excess of \$200,000 in each of the two most recent years and who reasonably expects such income in the current year. Securities Act Rule 501(a)(6)-(7), 17 C.F.R. §§ 230.501(a)(6)-(7) (1982).

197. Deaktor, *supra* note 126, at 506 n.242.

that work. Rather the courts and parties appear to have dealt with the integration issue purely on instinct."¹⁹⁸

A number of these judicial decisions before 1976 declined to integrate offerings. *Value Line Fund, Inc. v. Marcus*¹⁹⁹ involved an attempt to integrate the private sale of stock by a corporation's officer-director with a number of offerings by the corporation itself issued in the acquisition of other businesses. The court found that the sales failed to satisfy the criteria discussed in the SEC integration releases: they were not part of a single plan of financing; they involved different classes of securities; and they were not made at the same general time, for the same general purpose, or for the same consideration. The court also mentioned a sixth factor justifying nonintegration—that the offerings were made by two different persons.²⁰⁰

Although the offerings in *Marcus* were made by affiliates, it is not surprising that the court declined to integrate them since their purposes were quite different. The corporate sales were accomplished in the acquisition of other companies while the individual sales were made for cash to provide income for the selling officer-director.

In *SEC v. Dunfee*,²⁰¹ a number of common factors were present in the sale of promissory notes in two closely timed offerings by a single issuer. In an anomalous decision, however, the court declined to integrate them, citing their different interest rates and maturity dates, and an eight month hiatus between them. Considering the single plan of financing which apparently motivated both sales, the decision is hard to justify by distinguishing the terms of the obligations. The issuer's unsuccessful attempt to qualify the second offering for an exemption under Regulation A may have impressed the court, or perhaps the court considered the time gap between the two offerings to be a significant factor justifying the nonintegration.

Three decisions in the early 1970's also declined to integrate the considered offerings. In *Bowers v. Columbia General Corp.*,²⁰² the defendant issued its securities at various intervals in consideration for corporate purchases. The court found no single plan of distribution but only "perhaps a general willingness on the part of its management to issue its securities as and when an attractive acquisition opportunity presented itself."²⁰³ In *Livens v. William D. Witter, Inc.*²⁰⁴ and *Barrett v. Triangle Mining Corp.*,²⁰⁵ the courts found that the issuers expected their initial financing arrangements to be the sole ones necessary. Additional offerings were made only when the issuers met unpredictable problems. The courts

198. *Id.* at 509. The ABA subcommittee's proposal likewise finds "very few cases [on integration] have provided an analysis that is instructive to counsel involved in securities offerings that present such issues." *ABA Proposal*, *supra* note 30, at 1597 (footnote omitted).

199. [1964-1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,523 (S.D. N.Y. 1965).

200. *Id.* at 94,971. *See also ABA Proposal*, *supra* note 30, at 1598.

201. [1966-1967 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,970 (W.D. Mo. 1966).

202. 336 F. Supp. 609 (D. Del. 1971).

203. *Id.* at 625.

204. 374 F. Supp. 1104 (D. Mass. 1974).

205. [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,438 (S.D.N.Y. 1976).

therefore ruled that the additional sales should not be considered as part of the original financing plan.²⁰⁶

After these early decisions, a discernible trend in favor of integrating offerings began. Since 1976 every reported decision addressing the issue has held offerings integrable.²⁰⁷ Three cases in the mid 1970's involving oil and gas ventures²⁰⁸ have also strengthened the integration doctrine; all three treated the entities that organized and ran limited partnerships as issuers of the securities.²⁰⁹

First, in *Mason v. Marshall*,²¹⁰ the defendant limited partnership attempted to integrate two offerings of fractional undivided interests in oil and gas drilling ventures so as to raise the statute of limitations as a bar to the plaintiff's claims. The court held that the two programs were separate securities and not integrable, but presumed that the *Mason* limited partnership was the issuer of both offerings as it ran and was ultimately responsible for the success or failure of each of the drilling ventures for which it solicited investments. This was so because the statutory "issuer" in oil and gas offerings is the owner of those rights which divides them into fractional interests for the purpose of making a public offering.²¹¹

Second, in *Bayoud v. Ballard*²¹² two wealthy brothers purchased limited partnership and other interests in privately negotiated transactions to invest in oil and gas explorations. The general partner, a corporation, was contemporaneously acting as the general partner for other limited partnerships in the same business which were offering SEC registered interests to the public. The plaintiffs sought to integrate their privately purchased interests with the publicly offered ones to destroy any private placement exemption that the issuing limited partnership might claim for the brothers' purchases. The *Bayoud* court considered the corporate general partner as the issuer of both the plaintiffs' securities and the publicly offered ones, a treatment consonant with the liability provision of partnership law.²¹³ The *Bayoud* court nevertheless refused to integrate the brothers' offerings with the public one and gave only this summary explanation for its ruling: "the two issuances differed in significant and conclusive ways, . . ."²¹⁴

206. *Livens*, 374 F. Supp. at 1106-07; *Barrett*, [1975-1976 Transfer Binder] Fed. Sec. L. Rep. ¶ 95,438 at 99,212.

207. SEC v. Murphy, 626 F.2d 633 (9th Cir. 1980); Doran v. Petroleum Management Corp., 545 F.2d 893 (5th Cir. 1977); General Life of Mo. Inv. Co. v. Shamburger, 546 F.2d 774 (8th Cir. 1976); McDaniel v. Compania Minera Mar de Cortes, Etc. 528 F. Supp. 152, 164 (D. Ariz. 1981); SEC v. Asset Management Corp., [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,278 (S.D. Ind. 1979); SEC v. Cal-Am Corp., 445 F. Supp. 1329 (C.D. Cal. 1978); SEC v. Galaxy Foods, Inc., 417 F. Supp. 1225 (E.D.N.Y. 1976); Kennedy v. Tallant, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,779 (S.D. Ga. 1976).

208. Doran v. Petroleum Management Corp., 545 F.2d 893 (5th Cir. 1977); Bayoud v. Ballard, 404 F. Supp. 417 (N.D. Tex. 1975); Mason v. Marshall, 412 F. Supp. 294 (N.D. Tex. 1974).

209. See *Murphy*, 626 F.2d at 643, 644, & nn.8-9.

210. 412 F. Supp. 294 (N.D. Tex. 1974).

211. Section 2(4) of the Securities Act, 15 U.S.C. 77b(4). *Murphy*, 626 F.2d at 642 n.6.

212. 404 F. Supp. 417 (N.D. Tex. 1975).

213. Section 15 of the UNIF. PARTNERSHIP ACT, 6 U.L.A. 174 (1969).

214. 404 F. Supp. 424. The court also justified its conclusory finding with the bizarre theory that even if the offerings were integrable, the private placement would be absorbed into the registration statement and covered by it. *Id.*

Finally in *Doran v. Petroleum Management*,²¹⁵ the plaintiff claimed that he was entitled to a rescission of his purchase of a limited partnership interest because the investment as sold to him did not qualify for a valid private placement exemption. Doran was a sophisticated investor who became a "special participant" in a limited partnership organized by the defendant corporation to drill and operate oil wells. Four other individuals invested in the program as "participants," and three others who were offered the opportunity to become either "participants" or "special participants" declined. The only distinction between the two types of investments was that the "participants" were able to take a greater portion of intangible drilling deductions in their tax returns than Doran, the sole "special participant."

The defendant argued that since Doran was the only offeree of its "special participation" offering, it need only show that he was a qualified offeree to be in compliance with the offeree suitability requirement of a statutory private placement. The court rejected that contention because the defendant failed to show what interests were offered to the three investors who declined to make purchases. The court, however, went further and ruled that the appropriate class of offerees whose suitability must be proven by the defendant included all eight individuals who were offered either a "participation" or a "special participation." In doing so, the court integrated the two purportedly separate offerings, finding them to have been made for the same general purpose and as part of a single plan of financing contemplated by the limited partnership agreement.

The *Doran* court appeared to be regarding the defendant corporation as the general partner of the limited partnership which issued the securities. Since the defendant corporation promoted and ran the drilling programs, providing the plaintiff with information about its operation, the court could deem it an "issuer."

E. Recent Cases

In 1980, the Ninth Circuit Court of Appeals significantly refocused the conceptual analysis of integration in *SEC v. Murphy*.²¹⁶ Murphy had been a principal officer in Intertie, a California corporation which ran cable television systems. The company secured financing for its business through promotion of approximately thirty limited partnerships. As the court explained, "[m]ost commonly, Intertie would buy a cable television system, making a cash down payment and financing the remainder, and then sell it to a partnership for a cash down payment and non-recourse promissory notes in favor of Intertie and lease it back from the partnership."²¹⁷

Through this sale-lease back arrangement, Intertie offered its investors tax shelter advantages and the promise of a high return. Murphy, who designed this money-raising effort, engaged International Securities Cor-

215. 545 F.2d 893 (5th Cir. 1977).

216. 626 F.2d 633 (9th Cir. 1980).

217. *Id.* at 637.

poration (ISC), a securities brokerage firm, to sell most of the partnership interests. ISC salesmen usually acted as nominal general partners for each partnership, but they performed few or none of the management duties. Murphy himself admitted that the purpose of the partnerships was "to give dollars to the cable operating company that could be used at a cost they could live with."²¹⁸

None of the limited partnership interests was registered under the Securities Act; ISC and Intertie relied on the private offering exemptions of Section 4(2) and Rule 146. They adduced no evidence, however, to show that they had taken adequate steps to qualify their offerees as suitable investors for valid private placements. In addition, the offering memoranda used by ISC salesmen made numerous material misrepresentations and also failed to state many significant facts, omitting, among other things, any disclosure of Intertie's financial statements.

Murphy appealed an injunction entered against him predicated on findings that he had violated the registration²¹⁹ and antifraud²²⁰ provisions of the federal securities laws. The court of appeals quickly confirmed that the limited partnership interests were securities; it then examined Murphy's claim that the interests were private placements exempt from registration.

That issue required a resolution of the ultimate question first framed in *Ralston Purina*,²²¹—whether this was a situation where the offerees needed the protection against fraud which registration would have provided. Not surprisingly, the court found the answer in the relationship between the issuer and its offerees.²²² In doing so, it gave this expansive, but logical definition to the term "issue": "We hold . . . when a person organizes or sponsors the organization of limited partnerships and is primarily responsible for the success or failure of the venture for which the partnership [sic] is formed, he will be considered an issuer for purposes of determining the availability of the private offering exemption."²²³

The court rooted its rationale in the disclosure philosophy underpinning the Securities Act, noting that a reasonable investor would want information about the person or entity upon whom the success of his investment hinged. The Court found judicial precedent for its reasoning in both the *Doran*²²⁴ and the *Bayoud*²²⁵ cases, where courts had summarily treated as issuers entities that organized partnerships.²²⁶

Although in the *Murphy* case legal formality might indicate that the issuers of the relevant securities were the limited partnerships or their general partners, information about those parties would be of little value to

218. *Id.* at 646.

219. Sections 5(a) and (c) of the Securities Act, 15 U.S.C. §§ 77e(a)-(c).

220. Section 17(a), of the Securities Act, 15 U.S.C. § 77q(a) and Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

221. See the discussion of SEC v. Ralston Purina, *supra* notes 65-68 and accompanying text.

222. *Murphy*, 626 F.2d at 641-42.

223. *Id.* at 644 (footnote omitted).

224. 545 F.2d 893 (5th Cir. 1977). *See supra* note 215 and accompanying text.

225. 404 F. Supp. 417 (N.D. Tex. 1975). *See supra* notes 212-14 and accompanying text.

226. *Murphy*, 626 F.2d at 643 n.8.

investors. The linchpin of the total arrangement was Intertie, and its future prosperity was obviously a prime motive for purchasing the limited partnership interests.

Once the court made the determination that Intertie was the *de facto* issuer of the limited partnership interests,²²⁷ it was well on its way to integrating all the partnership offerings and invalidating their private placement exemptions. To reach this ultimate conclusion, the court of appeals used a flexible four part test, focusing on: (1) the number of offerees, (2) the sophistication of the offerees, (3) the size and manner of the offering, and (4) the relationship of the offerees to the issuer.²²⁸

The *Murphy* court noted that although the number of offerees itself had not been decisive in *Ralston Purina*, "the more offerees, the more likelihood that the offering is public."²²⁹ The court then found that under all but one of the considerations listed in the Commission's 1962 release on integration,²³⁰ all the limited partnerships should be viewed as part of the same offering. The court conceded that the offerings for each of the cable systems were separated in time but ruled that this lone factor was heavily outweighed by their common purpose, i.e., the financing of Intertie. The court also noted that all the securities were of the same class—limited partnership interests. It additionally found that the consideration furnished by investors for securities was the same—cash and notes secured by the particular cable systems purchased.²³¹

After integrating the partnership offerings, the court properly aggregated their offerees. With 400 total purchasers and an unknown additional number of offerees who declined to so invest, a clear suggestion of a public offering rather than a private placement appeared.²³²

Integration of the partnerships was also instrumental in the court's finding that the size of the combined offering, \$7.5 million, should cause it to be viewed as a public offering absent any countervailing demonstration that the investors did not need the protection of registration. The defendant had done nothing to dispel this inference; rather, evidence that almost all of Murphy's investors were unsophisticated or without adequate business advice and had no opportunity to obtain the type of information that a registration statement would have provided further supported the court's view that this was a public offering.

The court ruled *a fortiori* that Murphy could claim no safe harbor from the registration requirements under Rule 146 since the findings about investor sophistication and nondisclosure of information clearly precluded that rule's application.²³³ The court of appeals did not even discuss the thirty-five purchaser limitation of Rule 146²³⁴ which Intertie obviously

227. *Id.* at 643-44.

228. *Id.* at 644-45.

229. *Id.* at 645 (citing *Hill York Corp.*, 448 F.2d at 688).

230. Securities Act Release No. 33-4552, Nov. 6, 1962, 1 Fed. Sec. L. Rep. (CCH) ¶ 2770. See *supra* note 149 and accompanying text.

231. *Murphy*, 626 F.2d at 646.

232. *Id.*

233. *Id.* at 647-48.

234. Securities Act Rule 146(g)(1), 17 C.F.R. § 230.146(g)(1) (1982).

surpassed in its integrated offering.

The court then went on to find that Murphy had personally violated the registration requirement because he was a substantial factor²³⁵ and a necessary participant²³⁶ in the unlawful sales. The court also sustained the lower court's finding that Murphy had violated the antifraud provisions of the federal securities laws and affirmed the injunction entered against him.

The *Murphy* court's expansive definition of the term "issuer" was buttressed by a more recent decision from the Seventh Circuit Court of Appeals, *SEC v. Holschuh*.²³⁷ That case involved the efforts of a corporation to raise funding for coal mining through the sale of interests in limited partnerships handled by a third-party broker. The partnerships were to enter into reciprocal lease arrangements with the corporation which would purportedly result in large royalties to their limited partners. Five such entities were formed by the broker, each of which was to invest \$100,000 to develop one of five mining properties. Defendant Holschuh, the president of the corporation, provided most of the information for the offering circulars distributed by the broker to potential investors.

Limited partnership interests were eventually sold to fifty-nine individuals, only one of whom had any experience in coal mining ventures. Significant misrepresentations were made not only during the solicitation process, but also after the limited partners had made their investments. A substantial amount of the investors' funds was also immediately diverted to an undisclosed major shareholder of the corporation who had recently been indicted in connection with a bank failure. None of the securities had been registered with the SEC.

Holschuh conceded on appeal that the offerings were not exempt from registration as private placements or in any other way. Since the corporation did not appeal, the admission that the registration requirement was violated removed the need for review of this summary finding of the trial court: "The facts clearly demonstrate that the five limited partnership offerings were actually part of one single plan of financing and should therefore be integrated for the purposes of Section 5 of the Securities Act."²³⁸

Holschuh did contend on appeal, however, that he was not an issuer of the securities, and therefore that Section 4(1) of the Securities Act which exempts from registration "transactions by any person other than an is-

235. Although Murphy himself did not sell the unregistered securities, the court found him liable for violating section five as a participant in that illegal activity. The court found that he was a substantial factor in that violation because the illegal offers and sales flowed directly and proximately from what he had done. 626 F.2d at 649-50. This "substantial factor" theory was developed in a line of cases finding such civil liability in private actions under Section 12(1) of the Securities Act, 15 U.S.C. § 77l(1). See, e.g., *Lewis v. Walston & Co.*, 487 F.2d 617, 621-22 (5th Cir. 1973) and *Lennenth v. Mendenhall*, 234 F. Supp. 59, 65 (N.D. Ohio 1964).

236. The court also ruled that Murphy could alternately be held liable as a "necessary participant" in the issuer's violations of section five under such cases as *SEC v. North American Research & Dev. Corp.*, 424 F.2d 63, 81 (2d Cir. 1970) and *SEC v. Culpepper*, 270 F.2d 241, 247 (2d Cir. 1959). *Murphy*, 626 F.2d at 650-52.

237. 694 F.2d 130 (7th Cir. 1982).

238. *SEC v. Asset Management Corp.*, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) 97,278 at 96,970.

suer, underwriter, or dealer”²³⁹ pertained. The court of appeals quickly disposed of such a statutory gloss by adopting the orthodox interpretation of Section 4(1)—that it provides an exemption for transactions, not individuals.²⁴⁰ Thus even though a particular defendant is not an issuer, that exemption is inapplicable to a transaction where some person or entity who does meet the criterion is involved in the offer or sale of unregistered securities.

The court then addressed the question of whether Holschuh’s corporation might be such an issuer in the context of the sale of the limited partnership interests. Deeming the partnerships themselves as issuers would be unrealistic, the court said, because investors really were putting their money into the corporation, and their hopes of return depended exclusively on the corporation’s success. The partnerships were not true businesses but existed only as “device[s] for dividing a right to expected profits of PCR [the corporation] into units of marketable size, accompanied by a tax advantage.”²⁴¹ The *Holschuh* court analogized the reciprocal lease arrangements between PCR and the limited partnerships to the sale-lease back arrangements in *Murphy*.²⁴² It found that a similar relationship of interdependence was created in both situations. In *Holschuh*, as in *Murphy*, the financial success of the limited partnerships hinged on the performance and continued viability of their corporate sponsor.²⁴³

Both corporations were therefore the entities about which prospective investors needed information. Like Intertie, PCR could then be considered an “issuer,” and no Section 4(1) exemption would be available for any transactions involving it, including the limited partnership offerings. The *Holschuh* court therefore affirmed the defendant’s injunction, concluding that he had been a necessary participant and a substantial factor in the sale of unregistered securities.²⁴⁴

Holschuh’s reinforcement of *Murphy*’s broad definition of “issuer” is important because of the significance that the relationship between an issuer and its offerees holds in determining the validity of a claimed private placement. The rulings focus on economic reality²⁴⁵ and pierce through attempts by promoters to conceal their common plans of financing in the guise of separate offerings. By linking the identity of the issuers with the question of relevant disclosure, the decisions in both cases are also in accord with the prime purpose for the registration of securities, i.e., to guarantee that investors will be provided with the necessary data to make informed decisions. In both cases, disclosure about the newly formed lim-

239. 15 U.S.C. § 77d(1).

240. *Holschuh*, 694 F.2d at 137 (citing *Murphy*, 626 F.2d at 648 and *United States v. Wolfson*, 405 F.2d at 782).

241. *Holschuh*, 694 F.2d at 138.

242. *Murphy*, 626 F.2d at 637.

243. *Murphy*, 626 F.2d at 643; *Holschuh*, 694 F.2d at 138-39.

244. 694 F.2d at 139-42. See *supra* notes 235-236.

245. The Supreme Court has often stated the importance of economic reality over form: “Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto.” *United Housing Found., Inc. v. Forman*, 421 U.S. at 849. *Accord Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

ited partnerships provided investors no substitute for such information about the sponsoring corporations. The ABA's proposal, which this Article now discusses in detail, would undermine this tie between appropriate disclosure and the identity of an issuer and would deprive investors of protection against just such fraudulent schemes as those in *Murphy* and *Holschuh*.

V. THE ABA PROPOSAL

The ABA subcommittee's position paper is entitled "Integration of Partnership Offerings: A Proposal for Identifying a Discrete Offering."²⁴⁶ Its stated purpose is twofold: first, "to review the current law on integration with particular attention to its application to partnership offerings," and second, "to propose a new test for identifying discrete offerings which need not be integrated with other offerings sponsored by affiliated persons."²⁴⁷ The subcommittee asserts that this area of securities law has proven troublesome to members of the bar for many years and is in urgent need of clarification in light of the increased use of partnerships as financing vehicles. The authors add their hope that the SEC will give favorable consideration to their comments and adopt them in an interpretative release.²⁴⁸ To date the Commission has taken no such action.²⁴⁹

A. The ABA's Review of Existing Law

The subcommittee states as its objective: "proposing practical guidelines with respect to partnership offerings that will permit a more fair and more certain application of the [integration] doctrine and that are wholly consistent with the exemptive scheme of the 1933 Act and the purposes and policies expressed therein."²⁵⁰ The position paper opens with the accepted assumption that, under the Securities Act, "the financial dealings of an issuer are separable."

Not surprisingly, the subcommittee does not discuss the prominence of registration in the statutory scheme. It begins by describing how the integration doctrine developed from the Commission's earliest rulings in the 1930's to its two key releases in the 1960's.²⁵¹ The proposal next comments on various judicial opinions particularly seizing on certain of the pre-1976 cases where courts declined to integrate offerings.²⁵² For reasons which have already been discussed in this Article,²⁵³ none of those early

246. See *supra* note 30.

247. *ABA Proposal*, *supra* note 30, at 1591 (emphasis in original).

248. *Id.* at introductory footnote.

249. Telephone conversation with George W. Coleman, Chairman of the American Bar Association Task Force on Integration (July 21, 1983). In addition, a search of Lexis on February 1, 1984 reveals no such release by the Commission.

250. *ABA Proposal*, *supra* note 30, at 1592-93.

251. *Id.* at 1593-97. See *supra* notes 152-53 and accompanying text.

252. See *Doran*, 545 F.2d 893; *Bayoud*, 404 F. Supp. 417; *Livens*, 374 F. Supp. 1104; *Barrett*, [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,438; *Bowers* 336 F. Supp. 609 (D. Del. 1971); *Dunfee* [1966-67 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,970 (W.D. Mo. 1966); *Marcus* [1964-66 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,523 (S.D.N.Y. 1965). *ABA Proposal*, *supra* note 30, at 1597-1602.

253. See *supra* notes 199-207 and accompanying text.

opinions can be seen today as persuasive authority for a liberal interpretation of the SEC's criteria for integration, particularly when those decisions are viewed in the light of more recent judicial opinions.

The ABA proposal spends considerable time discussing *SEC v. Murphy*, a case it claims many practitioners find "startling . . . because of the breadth of its language."²⁵⁴ The subcommittee remarks that the court's decision to consider Intertie the issuer of the limited partnership interests was the product of "an analysis that seems very result oriented." Some would disregard *Murphy's* reasoning, the subcommittee says, because the case involved flagrant fraud, "such as the commingling of the funds from the various partnerships and the filing of partnership tax returns claiming depreciation and tax credits on equipment that was never purchased."²⁵⁵

The subcommittee especially views with alarm the *Murphy* court's corollary decision to aggregate the total number of purchasers of the limited partnership interests so that the resulting number, 400, clearly suggested a public offering rather than a private placement. The proposal concludes its discussion of *Murphy* with this summary: "The *Murphy* court's reaction to the number of purchasers as well as its views on the adequacy of disclosure, e.g., the financial importance of the offerings to Intertie, seem to have dictated its conclusion on the conceptually unrelated issue of integration."²⁵⁶ The subcommittee thus fails to acknowledge that *Murphy* appropriately linked its integration analysis to the need of investors for information about the key figure of an offering—the true "issuer."

The subcommittee also describes the administratively created safe harbors from integration and briefly discusses staff no-action letters dealing with that subject. The proposal finds these interpretative responses "difficult to reconcile," but observes:

It appears to have been easier for the staff to find separate projects, and therefore discrete transactions, if real estate, horses, or shopping center booths, rather than oil and gas properties, were involved. This may be evidence of a confusing and ill-advised use of integration as a means to deal with perceived problems in specific areas of business, even when registration issues were not truly present.²⁵⁷

Just how the staff confused the concept of integration or precisely when registration issues were not truly present, the subcommittee does not say.

The proposal then proceeds to enumerate what it believes are the shortcomings of the current guidelines for integration as they have been interpreted. The subcommittee particularly fixes on the five-factor test promulgated by the Commission in its 1961 and 1962 releases, noting that these evolved in a more traditional corporate context and have been inconsistently applied by the courts and the Commission in analyzing multiple offerings by other entities. The subcommittee finds the greatest inadequacy of the releases to be that "they do not give any weight to the economic independence of the partnership entity created through the

254. *ABA Proposal*, *supra* note 30, at 1603.

255. *Id.* at 1604.

256. *Id.* at 1605.

257. *Id.* at 1605-06.

offering.”²⁵⁸

The subcommittee then proceeds to judge each of the traditional five factors vis-a-vis its proposed new standard of economic independence. It states that if the proceeds of commonly sponsored offerings are used to finance projects that “are in fact separate and distinct, and not financially dependent upon one another,” they should not be considered as “for the same general purpose” and “a single plan of financing.”²⁵⁹ This should be so, says the ABA, because offerees in different offerings would see their proceeds applied to different projects that are substantially independent of each other.

This split vision, which the subcommittee hypothetically attributes to offerees, is also used to explain away the relevance of the three additional traditional criteria. As to the similarity of consideration, the proposal states that the focus should not be on what type of property an investor exchanges for his security, but on the nature of his contact with the offeror. The proposal would likewise not consider limited partners in different partnerships to have all purchased the same class of security unless the holders of these interests all had rights to the same assets. Proximity in time would also not be dispositive unless all investments were made “in the same project.” Under the ABA’s analysis, common sponsorship would thus not be of prime importance in determining whether or not to integrate offerings.

B. The Proposal for Reform

The subcommittee then details the particulars of its revised criteria for integration, the “discrete offerings safe harbor.” The proposal states: “In general, a discrete offering in the partnership context exists when the offering is designed to fund a separate and independent entity that is not financially dependent upon any entity created through any other offering involving a common sponsor.”²⁶⁰

The ABA lists three conditions for a “discrete offering” which, when satisfied, would make the safe harbor applicable: (1) separate entity, (2) economic independence, and (3) application of proceeds.²⁶¹ To qualify as separate entities, each partnership would have to have a distinct legal existence with its own books and records. Funds of each entity could not be commingled with those of any affiliate. To be deemed economically independent, each partnership’s fortunes could not be substantially contingent on those of other commonly sponsored entities.

To meet the third criterion, no material portion of the gross offering proceeds of any partnership could be invested in properties where an affiliate had also placed a significant percentage of its funds. For “blind pools,” where at least half of such properties are not identified to the offerees, similar offerings by affiliates must have committed the major portion

258. *Id.* at 1608.

259. *Id.* at 1608-10.

260. *Id.* at 1610.

261. *Id.* at 1611.

of their proceeds to specific properties before the blind pool offering is made. Furthermore, no additional blind pool offerings by related entities could have begun before the first partnership had earmarked the major portion of its proceeds for specific properties.

C. The ABA's Examples of its Proposal

The subcommittee illustrates the application of these criteria in seventeen hypothetical situations from four different industry groups where partnerships are often used as financing devices: (1) oil and gas drilling, (2) research and development, (3) equipment leasing, and (4) real estate. All of the examples presuppose fulfillment of the proposal's first condition, i.e., the existence of different legal entities which maintain separate books and records and which do not commingle their funds. They thus focus on problems in meeting the proposal's latter two conditions concerning economic independence and application of proceeds.

A commentator need look no further, however, than Example One to find a situation which demonstrates the inadequacy of the ABA's proposed new standards.²⁶² The subcommittee posits that this example presents "a clear case for non-integration under both the proposed discrete offering test and existing no-action letters involving partnerships with common sponsors."²⁶³ The partnerships in Example One are nonetheless integrable under current judicial precedent which expresses reasoned statutory interpretation.

Example One is as follows:

Within a period of six months XYZ Oil Company, as general partner, organizes two limited partnerships (partnership A and partnership B) to conduct oil and gas drilling programs. The offering and sale of interest in partnership A concludes and partnership A is organized before the offer and sale of interests in partnership B commences. The prospects to be acquired by partnership A and partnership B are fully disclosed. . . .²⁶⁴

The subcommittee's comment finds concern here with only the third condition of its proposal, the application of proceeds question. It states that this would clearly be satisfied since neither partnership would have a material portion of its gross offering proceeds invested in common properties. In the offerees' perspective, as construed by the proposal, potential investors would see that their contribution to the "A" partnership would place their funds in different drilling projects and would give them a claim to different assets than if they invested in the "B" partnership.

Such an approach misses the key insight of *Murphy*.²⁶⁵ Investors in both partnerships are placing their money in an oil and gas drilling business run by the XYZ Company. The separation of investments by earmarking them for different projects is, to use Justice Cardozo's memo-

262. *Id.* at 1612-13.

263. *Id.* at 1612. In making this assertion, the ABA points to certain SEC no-action letters discussed *supra* note 184.

264. *ABA Proposal*, *supra* note 30, at 1612.

265. See *supra* notes 216-36 and accompanying text.

ral phrase, "a distinction without a difference."²⁶⁶ The investors' basic concern is fixed on XYZ as the entity upon whose skills and business acumen they are relying for profit. The "investments contract" is made, in reality, between the limited partners and XYZ for the purpose of financing XYZ's exploration for oil.

The subcommittee's artificial distinction here is reminiscent of the defendant's argument in *SEC v. W.J. Howey Co.*²⁶⁷ that the sale of individual rows of orange trees coupled with arrangements to service them was little more than a series of real estate transactions. The Supreme Court stripped away that ruse, ruling that the defendant was really selling investments in the common enterprise of orange growing, i.e., securities.²⁶⁸

Although the ABA would concede that the limited partnership interests in Example One are securities, it would disingenuously divide the two closely timed efforts to finance XYZ's oil and gas drilling operations. Congress, the courts, and the Commission have placed well reasoned limits on the extent of such money raising that can be attempted without the protection to investors that registration provides.²⁶⁹ To sanction such unregistered transactions as proposed in Example One would eviscerate that safeguard.

The other examples provided by the proposal contain even more egregious situations of nonregistration which the subcommittee would condone. Example Two slightly varies the facts of Example One by providing some minimal overlapping of properties between partnership A and partnership B so that a minor percentage of the proceeds of each partnership offering would be invested in properties which the other owned. The comment permitting the nonintegration of these offerings states in part:

Similarly, the question whether the partnerships obtained their property from a common source . . . is not relevant under the proposed discrete offering test since *that question is not significant to an offeree*, and since, in most cases, the sponsor itself, or an affiliate will acquire the properties for administrative convenience prior to transferring them to a partnership.²⁷⁰

The subcommittee again claims to speak for investors, presuming that they would disregard a factor which clearly indicates the integral nature of a promoter's workings. Far from being irrelevant, a common source of drilling properties and the cross-application of some of the offering proceeds demonstrate the unified nature of these purportedly separate investment opportunities.

In Examples Three and Four, the subcommittee concedes that closely timed blind pool offerings should be integrated.²⁷¹ This should be done, says the subcommittee, because at the time they are made, the two offer-

266. *Nixon v. Condon*, 286 U.S. 73 (1932).

267. 328 U.S. 293 (1946).

268. See the discussion of economic reality versus form, *supra* note 245 and accompanying text.

269. See the discussion of § 4(2) of the Securities Act and Rule 146, thereunder, *supra* notes 62-81, and Regulation D, *supra* notes 97-117 and accompanying text.

270. *ABA Proposal*, *supra* note 30, at 1614-15 (emphasis added).

271. *Id.* at 1615-16.

ings will be indistinguishable from a prospective investor's point of view, even when different properties will ultimately be selected for each partnership. On the other hand, the subcommittee does say in Example One that earmarking the partnership proceeds initially for different properties makes a material difference to investors. A realistic approach, however, would view investors in the oil drilling business as having the same prime motive regardless of when the partnerships' properties are selected, i.e., to trust the business judgment and skills of the sponsoring entity rather than focusing on the prospects of any particular project.

Example Five²⁷² presents the situation of *Doran v. Petroleum Management Corp.*,²⁷³ where a common promoter sponsored two partnerships which would pay different drilling costs on certain identified properties. The proposal interprets this scenario as failing both the economic independence test and the application of proceeds condition of its safe harbor because the offerings' proceeds are intended to be spent on common properties. The subcommittee's comment does, however, argue for nonintegration on the alternative grounds that the different offerings present distinct risks. It also maintains that its proposal might be applicable if one of the partnerships were to spend its funds in participation with several other partnerships, so that the amount expended on common projects with any one particular partnership would be insignificant. Both of these approaches again ignore the overriding reason for all the money-raising efforts—the financing of the oil drilling business of the common sponsor. That fact gives unity to the purportedly separate ventures which no amount of contrived segregation can overcome.

The proposal's three final situations involving oil and gas drilling, Examples Six,²⁷⁴ Seven,²⁷⁵ and Eight,²⁷⁶ concern common sponsorship of closely timed offerings funding limited partnerships which either succeed to one another's interests in various properties or form a joint venture in the same exploratory prospect. Although the subcommittee admits that the safe harbor would not apply if material portions of the proceeds of those offerings were used in common properties, the unity of the promoter's enterprise still should be the paramount consideration requiring their combination. This factor ought to be even more pertinent in light of the proposal's alternative argument that the partnerships combined in a joint venture need not be integrated if their sponsor can somehow structure the terms of such offering so that they might issue "different classes of securities,"²⁷⁷ e.g., by making one a general partnership²⁷⁸ and selling its

272. *Id.* at 1616.

273. 545 F. Supp. 893 (5th Cir. 1977). *See supra* note 215 and accompanying text.

274. *ABA Proposal*, *supra* note 30, at 1616-17.

275. *Id.* at 1617.

276. *Id.* at 1617-18.

277. *Id.* *See also* Securities Act Release No. 33-4552, *supra* note 149.

278. Although interests in general partnerships are typically not securities because the partners are not passive investors, they may be deemed to be securities when the partners have no real opportunity to exert control over the business. *Williamson v. Tucker*, 645 F.2d 404, 422-24 (5th Cir.) *cert. denied*, 454 U.S. 897 (1981). *See L. Loss, supra* note 2, at 199.

interests only to institutional investors who purportedly do not need the protection of registration.

Examples Nine and Ten pertain to partnerships formed in close temporal proximity by a single firm to finance its research and development efforts. Example Nine²⁷⁹ describes a company creating two partnerships to fund two different medical investigations; Example Ten²⁸⁰ presents a manufacturer sponsoring three partnerships to finance the development of different airplane parts to either be marketed separately or used synergistically to refine a common product. Because the subcommittee finds the limited partnerships in both examples economically independent "from the offeree's point of view,"²⁸¹ it would not integrate the offerings in either situation.

As in the oil drilling examples,²⁸² however, the proposal attributes a false perspective to investors. The research-oriented firms are the common issuers of interests in their several partnerships; they are the entities which offerees will regard as crucial to the success or failure of the projects. In effect each of these partnerships is a financing device for the firm that sponsors it. As such, their closely-timed offerings must not be permitted to avoid registration by artificial division, even if they purport to be issued for development of technologies which can be marketed as separate products.

Example Eleven²⁸³ addresses the integration of limited partnerships formed to lease equipment and created closely in time by the same general partner. The entities are formed in such a way that when the funds of one are exhausted in the purchase of equipment, another partnership is created for the same purpose. Even if such programs are blind pools (the equipment to be leased is not identified at the time of the investments) and a large number of the lessees are the same, the subcommittee would still not combine these offerings if the funds were not commingled to purchase the same equipment. Here again, however, these closely timed offerings are but a single ongoing device to finance a business. All investors are purchasing their interests in primary reliance on the money-making skills of the same general partner or promoter who stands behind all the limited partnerships.

Examples Twelve through Seventeen present real estate partnerships in the same vein.²⁸⁴ The first two²⁸⁵ scenarios discuss situations where a common corporate sponsor forms two partnerships to acquire different motels that will both be operated by an affiliate of the corporation. Despite the apparent integral nature of the operations, the proposal would have its safe harbor apply to them because of their "financial independence."

279. *ABA Proposal*, *supra* note 30, at 1618.

280. *Id.* at 1618-19.

281. *Id.* at 1618.

282. *Id.* at 1612-18.

283. *Id.* at 1619-20.

284. *Id.* at 1620-23.

285. *Id.* at 1620-21.

In examples Fourteen²⁸⁶ and Sixteen,²⁸⁷ a corporate developer who owns an unimproved parcel of real estate forms a partnership to construct rental units on a portion of the land. Shortly thereafter, it finances the building of more housing on that land through either another partnership or the sale of its common stock to institutional investors. Despite such common sponsorship, the subcommittee's proposal would not integrate the two partnership offerings unless both sets of apartments were to be operated out of a single rental office. It also asserts that the partnership and stock offerings should not be combined "because the securities are of two different classes." Such an assertion is highly questionable given the common promotion and purpose of the issuances.

Likewise, the proposal would not integrate the commonly promoted projects discussed in Examples Fifteen²⁸⁸ and Seventeen.²⁸⁹ In Example Fifteen, the corporate organizer of a partnership which was committed to advancing funds to that entity found it necessary to apply certain organizational fees and other compensation it later earned from another partnership to discharge that earlier obligation. The subcommittee found that the two promotions, which both involved real estate development, were economically independent; the subcommittee did, however, urge disclosure of the corporation's plans to fund its initial obligation from the revenue it earned through organization of the later-formed entity.

In example Seventeen, a corporation organized a number of limited partnerships to erect electric billboards in different shopping centers. In keeping with its "discrete offering" philosophy, the subcommittee would not combine the offerings if the separate billboards which the partnerships owned and operated were at distinct geographic sites. Both Examples Fifteen and Seventeen, however, present essentially the same problem as do other closely timed programs for the financing of similar operations of a common sponsoring entity. Seen in that light, the logic of controlling judicial precedent would combine those offerings in testing their ability to satisfy any claimed exemptions from registration.

VI. CONCLUSION

The American Bar Association's "discrete offering" proposal is merely an elegant attempt to circumvent the registration process by artificially expanding its carefully restricted exemptions. The various financial dealings of issuers are separable, but not on the basis of contrived divisions. Even though closely timed offerings may be "financially independent" in that they have claims to different assets, they are, in reality, part of a continual attempt to fund one business operation. In such situations, the crucial insight of *Murphy*²⁹⁰ is extremely pertinent; i.e. investors need information about the central enterprise. If a combination of offerings would place the

286. *Id.* at 1621-22.

287. *Id.* at 1623.

288. *Id.* at 1622.

289. *Id.* at 1623.

290. *Supra* notes 216-36 and accompanying text.

total issuance outside the well considered exemptions to registration, an SEC filing is in order.

However much issuers resent it, registration is not unduly onerous or a serious impediment to capital formation when viewed in light of the recently liberalized exemptions and the SEC's steady attempt to expedite the process. Perhaps the true aversion many issuers have to registration is based on fear that the SEC or state authorities might deem their offering materials to contain inadequate disclosure or to present unfair investment opportunities. For many years, however, *caveat emptor*²⁹¹ has been inapplicable to the sale of securities in this country, and it is against just such frauds as carried out in *Murphy* and *Holschuh* that registration guards. The American investor and the capital markets have been well served by the great reforms of the 1930's, and it would be unfortunate to have them eroded by the ABA's ill-advised proposal.

291. As the United States Supreme Court has said, the federal securities laws have as their "fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." SEC v. Capital Gains Research Bureau, Inc. 375 U.S. 180, 186 (1963). *Accord* Affiliated Ute Citizens of Utah v. United States 406 U.S. 128, 151 (1972).

