

1994

## The Integration of Securities Offerings: A Proposed Formula That Fosters the Policies of Securities Regulation

Cheryl L. Wade

*Assist. Prof. of Law, Hofstra University School of Law*

Follow this and additional works at: <http://lawcommons.luc.edu/lucj>

 Part of the [Securities Law Commons](#)

---

### Recommended Citation

Cheryl L. Wade, *The Integration of Securities Offerings: A Proposed Formula That Fosters the Policies of Securities Regulation*, 25 Loy. U. Chi. L. J. 199 (1994).

Available at: <http://lawcommons.luc.edu/lucj/vol25/iss2/3>

This Article is brought to you for free and open access by LAW eCommons. It has been accepted for inclusion in Loyola University Chicago Law Journal by an authorized administrator of LAW eCommons. For more information, please contact [law-library@luc.edu](mailto:law-library@luc.edu).

# The Integration of Securities Offerings: A Proposed Formula That Fosters the Policies of Securities Regulation

Cheryl L. Wade\*

## I. INTRODUCTION

The Securities Act of 1933 ("1933 Act" or "the Act")<sup>1</sup> generally requires the filing of a registration statement with the Securities and Exchange Commission (the "SEC") prior to the offer or sale<sup>2</sup> of any security<sup>3</sup> and prohibits the sale of any security prior to the effective date of the registration statement.<sup>4</sup> For the prospective issuer of securities, the preparation and filing of this registration statement can be

---

\* Assistant Professor of Law, Hofstra University School of Law; B.A., State University of New York at Stony Brook, 1976; M.A., St. John's University, 1980; J.D., Hofstra University School of Law, 1988.

Eternal gratitude to the late Dwight L. Greene, my colleague, friend, and mentor, for his help and guidance with this article. I thank the Hofstra School of Law for supporting my research with a generous grant. I am very grateful to Patricia M. Adamski for her invaluable assistance. Special thanks to Athornia Steele, Wendy M. Rogovin, John D. Gregory, and Lawrence W. Kessler for reading and commenting on earlier drafts. Excellent research assistance was provided by Zaralise P. Bailey and Steven H. Weisman.

1. 15 U.S.C. §§ 77a - 77aa (1988).

2. Section 2(3) of the 1933 Act defines "sale" and "offer" broadly. A "sale" includes "every contract of sale or disposition of a security or interest in a security for value." 15 U.S.C. § 77b(3) (1988). An "offer" includes "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." *Id.* See generally LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 247-52 (2d ed. 1988).

3. Section 2(1) of the 1933 Act defines "security" to include common financial instruments such as notes, stock, bonds, debentures, and other less obvious instruments such as investment contracts and voting-trust certificates. 15 U.S.C. § 77b(1) (1988). The statute's broad definition of "security" has led courts to find the sale of securities in transactions involving the sale of portions of an orange grove, SEC v. W.J. Howey Co., 328 U.S. 293, 299-300 (1946); multi-level distributorships, SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 485 (5th Cir. 1974); and beavers, Continental Marketing Corp. v. SEC, 387 F.2d 466, 471 (10th Cir. 1967). See generally 3 HAROLD S. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW §§ 2.02-.24 (Release No. 44, 1993).

4. 1933 Act § 5, 15 U.S.C. § 77e (1988). A registration statement must include information necessary to enable a reasonable investor to make an informed investment decision. See *infra* notes 17-19 and accompanying text.

costly and time-consuming.<sup>5</sup> To prevent the hampering of commerce that results from unnecessary registration, the 1933 Act provides a variety of exemptions from registration that relieve issuers of the cost and delay of registration. These exemptions generally reflect a balancing of the 1933 Act's goal of protecting investors through mandatory registration with its goal of facilitating capital formation, particularly for small issuers. Under certain circumstances, separate offerings, each of which would satisfy the requirements of an exemption if considered separately, may be combined under the SEC's "integration" theory. The combination of two or more offerings often results in a single, integrated offering that does not qualify for an exemption when considered as a whole. When the integrated offering fails to satisfy the requirements of any of the 1933 Act's exemptions from registration, the issuer faces serious consequences for offering unregistered securities in violation of section 5 of the Act. An unregistered offering can result in an injunctive action by the SEC and in civil actions by purchasers of the unregistered securities.<sup>6</sup>

To determine whether separate offerings are to be integrated, the SEC has developed a test for integration that consists of five factors. Offerings will be integrated when: (1) the offerings are part of the same plan of financing; (2) the offerings are made for the same general purpose; (3) the same class of security is issued in each of the offerings; (4) the offerings are made at or about the same time; and (5) the same kind of consideration is to be received in each of the offerings.<sup>7</sup> This test for integration poses two problems. First, because the test lacks clarity,<sup>8</sup> it is frequently impossible to predict whether an issuer's offerings will be integrated. When structuring transactions, a prospective issuer may bear considerable expense and delay in obtain-

---

5. See Darryl B. Deaktor, *Integration of Securities Offerings*, 31 U. FLA. L. REV. 465, 469 (1979). An issuer attempting to raise money by offering securities to the public must spend considerable amounts of time and money to register the securities with the Securities and Exchange Commission (the "SEC"). See *id.* at 469 n.17; Daniel J. Morrissey, *Integration of Securities Offerings—The ABA's "Indiscreet" Proposal* 26 ARIZ. L. REV. 41, 42 n.9 (1984). Merely compiling the necessary data to draft the registration statement takes a great deal of time, and after submitting preliminary drafts of the registration statement to the SEC, the issuer must wait for comments from the SEC staff and modify the registration statement to address the SEC's concerns. Morrissey, *supra*, at 42 n.9. A substantial sum of money is also spent on fees for professionals such as attorneys, accountants, and investment bankers, and potentially enormous printing costs can increase the cost of registering securities considerably. See *id.*

6. Section 12(1) of the 1933 Act grants investors the right of rescission for section 5 violations by issuers. 15 U.S.C. § 77i.

7. Securities Act Release No. 4552, 27 Fed. Reg. 11,316, 11,317, 1 Fed. Sec. L. Rep. (CCH) ¶¶ 2770, 2781 (1962).

8. See *infra* part IV.A.1.

ing legal advice to determine whether the enumerated factors apply to its offerings, thereby causing integration and, perhaps, requiring registration. Issuers' counsel, however, are typically unable to provide any assurance that the offerings will be protected from a later finding of integration. Because of the formula's uncertainty, offerings may be precluded or delayed, and some possibly exempt offerings may be unnecessarily registered. Second, the test's five factors reflect neither the fundamental theory of the integration doctrine nor the goals and policies of the 1933 Act.

In this Article I will propose a test that enhances certainty while achieving the legitimate goals served by integration. In part II, I examine the goal of investor protection that registration was designed to provide as well as the competing goal of facilitating capital formation by relieving issuers of the burden of registration in certain instances. In part III, I describe and critique each of the five factors of the SEC's current test for integration. In part IV, I analyze the problems created by the SEC's integration analysis, and I also consider another approach to integration proposed by the Task Force on Integration (the "Task Force"), a review group established by the American Bar Association's Committee on Federal Regulation of Securities. I conclude that although the Task Force's proposal, standing alone, is inadequate, the safe harbors enumerated in the proposal should be adopted to provide more objective certainty to the threshold examination of the integration question. In part V, I discuss the many contexts in which the Task Force's safe harbors will be unavailable for multiple securities offerings. In those instances, I propose that integration should not be automatic. Rather, integration should occur only when the issuer is unable to demonstrate a rational business purpose for making separate offerings. Such a test would focus more appropriately on the issuer's reasons for the particular structure of the offering.

## II. BACKGROUND

### A. *Policy Considerations Under the Securities Act of 1933*

Congress enacted the 1933 Act in response to the practices of some companies that raised funds by offering and selling their securities to the public without revealing sufficient information concerning the enterprise and the securities offered.<sup>9</sup> Initially, the Act's primary pur-

---

9. See Elisabeth Keller & Gregory A. Gehlmann, *Symposium: Current Issues in Securities Regulation, Introductory Comment: A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 329,

pose and prevailing goal was to insure that investors were protected by enabling them to make informed investment decisions.<sup>10</sup> The Act sought to accomplish this by requiring issuers to make "full and fair disclosure of the character of [the] securities" that they offered and sold to the public.<sup>11</sup> Indeed, the concept of disclosure is the pervading philosophy of the entire body of securities laws.<sup>12</sup>

The extent to which information available to offerees of registered securities actually assists them in making informed investment decisions is unclear.<sup>13</sup> First, because the SEC precludes the inclusion in disclosure documents of favorable information that cannot be verified, the 1933 Act's disclosure policies have caused an "unduly pessimistic" tone in registration materials.<sup>14</sup> This pessimistic tone can distort the disclosed information<sup>15</sup> and dissuade investors from evaluating and taking advantage of potentially valuable opportunities.<sup>16</sup> Further complicating the analysis of information contained in registration statements is the inability of investors to verify the truthfulness of all statements presented in the registration statement.<sup>17</sup>

---

334-35 (1988). At the beginning of this century, the new enterprises—transportation companies, radio companies and manufacturers of new products and equipment—raised money by offering and selling their securities to eager groups of investors. *Id.* These optimistic investors, anxious to make a great deal of money as quickly as possible, purchased the securities issued by these new companies after having received only superficial and incomplete descriptions of the securities, the issuers' businesses, and the manner in which the capital raised by the offerings would be used. *Id.* Many investors were defrauded by sellers of completely worthless securities. One unscrupulous businessman boasted of his ability to raise funds by defrauding investors in his book, entitled *My Adventures with Your Money*, which he dedicated "[t]o the American Damphool Speculator, surnamed the American Sucker, otherwise described herein as The Thinker, Who Thinks He Knows But He Doesn't—Greetings!" *Id.* (quoting Laylin K. James, *The Securities Act of 1933*, 32 MICH. L. REV. 624, 627 (1934)).

10. See Securities Act of 1933, Pub. L. No. 22, pmbl., 48 Stat. 74 (1933).

11. *Id.* Because the 1933 Act primarily protects investors against insufficient disclosure, it has been referred to as the "rotten egg statute"; that is, one can sell all the rotten eggs one wants if one discloses that the eggs are rotten. A Panel Discussion, *New Approaches to Disclosure in Registered Security Offerings*, 28 BUS. LAW. 505 (1973) [hereinafter "Panel Discussion"]. If the investor purchases the "rotten eggs" on an informed basis, the Act provides no relief.

Although the Act's principal focus pertains to disclosure, the Act also contains an anti-fraud provision that prohibits the offer or sale of any security through fraud or misrepresentation while using the facilities of interstate commerce or the mails. See 1933 Act § 17, 15 U.S.C. § 77q (1988).

12. See, e.g., Panel Discussion, *supra* note 11, at 505.

13. See, e.g., Alison Grey Anderson, *The Disclosure Process in Federal Securities Regulation: A Brief Review*, 25 HASTINGS L.J. 311, 338-39 (1974).

14. *Id.*

15. See Panel Discussion, *supra* note 11, at 526-27.

16. See Anderson, *supra* note 13, at 338-39.

17. See Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the*

Moreover, much of the language used in the disclosure materials of different issuers regarding different offerings is uniform. This uniformity diminishes the value of information provided through registration to the offeree for the purpose of analyzing and comparing investment opportunities.<sup>18</sup> Finally, the financial information disclosed through registration may be so complex that it is beyond the understanding of unsophisticated investors and is therefore of no practical use to them.<sup>19</sup> Some commentators assert that most average investors ignore the vast amounts of data disclosed in registration materials.<sup>20</sup> Even if offerees do not use the disclosed data, however, the disclosure requirement and an issuer's potential liability for false and misleading statements made in disclosure documents protect investors by deterring issuers from engaging in practices that may potentially harm offerees.<sup>21</sup>

The 1933 Act's disclosure requirement also serves a secondary interest of promoting greater efficiency in securities markets by guaranteeing the availability of investment information needed by securities analysts.<sup>22</sup> Mandatory disclosure essentially subsidizes the cost of gathering the most accurate information, enabling securities analysts to evaluate investment opportunities in a more efficient manner and ultimately making the securities market more efficient.<sup>23</sup> Because investment information is collected in one source, analysts do not waste economic resources pursuing investment information as they attempt to gain a trading advantage.<sup>24</sup>

Moreover, mandatory disclosure reduces the amount of information gathering that must be done by individual investors. Even if one assumes that many investors who attempt to rely upon information

---

*Protection of Investors*, 70 VA. L. REV. 669, 674 (1984). Judge Easterbrook and Professor Fischel noted that "low quality sellers can mimic the disclosure of ascertainable facts while making bogus statements about things buyers cannot verify." *Id.* As a result, the low quality sellers erode the value of the information in registration statements, preventing purchasers from distinguishing between high and low quality securities. *Id.*

18. See Anderson, *supra* note 13, at 312; Panel Discussion, *supra* note 11, at 526.

19. See Anderson, *supra* note 13, at 312.

20. See Thomas A. Halleran & John N. Calderwood, *Effect of Federal Regulation on Distribution of and Trading in Securities*, 28 GEO. WASH. L. REV. 86, 96 (1959).

21. See Gregg A. Jarrell, *The Economic Effects of Federal Regulation of The Market for New Security Issues*, 24 J.L. & ECON. 613, 668 (1981).

22. Anderson, *supra* note 13, at 314; see also John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 722 (1984).

23. See Coffee, *supra* note 22, at 722.

24. See *id.*

obtained through disclosure remain "uninformed,"<sup>25</sup> mandatory disclosure creates efficiencies that theoretically benefit these uninformed investors. Uninformed investors may purchase securities confident that their price reflects the true value of the securities based upon the market's response to the actions of informed investors.<sup>26</sup> Some commentators believe that mandatory disclosure benefits the economy as a whole, since many active investors are confident that the disclosure system provides equal access to investment information.<sup>27</sup> Although mandatory disclosure offers some benefits, it may also carry significant costs, such as large expenditures of time and money to comply with registration. Consequently, issuers, particularly small businesses, may be forced to forego potentially beneficial opportunities because the expense and delay of the disclosure system render capital markets inaccessible.<sup>28</sup>

In order to accomplish the goal of "full and fair disclosure,"<sup>29</sup> section 5 of the 1933 Act requires issuers to register their securities offerings with the SEC before their securities are offered and sold to the public.<sup>30</sup> Prospective issuers must disclose relevant information concerning the securities offering in a registration statement and prospectus and must file these documents with the SEC before delivering the prospectus to potential investors.<sup>31</sup> It might take three to six

---

25. See *supra* text accompanying note 20.

26. See Easterbrook & Fischel, *supra* note 17, at 694 ("The uninformed trader can take a free ride on the information impounded by the market: they get the same price received by the professional traders without having to do any of the work of learning information.").

Judge Easterbrook and Professor Fischel question, however, whether the regulation of securities offerings has in fact increased market efficiency or protected investors by decreasing fraudulent activity by issuers. See *id.* at 693, 696; but see Jarrell, *supra* note 21, at 641, 666 (concluding that securities offered prior to passage of the 1933 Act were not overpriced, though not rejecting the idea that the mandatory disclosure system enhances market efficiency).

27. See Easterbrook & Fischel, *supra* note 17, at 685; see also Jarrell, *supra* note 21, at 668 (suggesting that the high cost of registration reduces the risk to investors inherent in new issues by decreasing the volume of new issues).

28. See Easterbrook & Fischel, *supra* note 17, at 708.

29. The preamble to the 1933 Act specifically compels "full and fair disclosure." See *supra* text accompanying note 11.

30. See 1933 Act § 5, 15 U.S.C. § 77e (1988).

31. Section 7 of the Act requires issuers to disclose all information and file all documents specified in Schedule A of the Act. 1933 Act § 7, 15 U.S.C. § 77g (1988). Much of the data relates to the offering and to the issuer's business, management, and assets. For instance, issuers must describe or list the general character of the business, the identification of directors and officers and their remuneration, the purpose or purposes of the issue, the manner in which the price to be paid for the securities was determined, the way in which the proceeds from the offering will be used, the arrangements and costs of the underwriting, the plan of distribution, and a description of the

months for a company to prepare and file registration materials with the SEC before the company may raise capital by offering its securities to the public.<sup>32</sup> Additionally, issuers sometimes spend hundreds of thousands of dollars in legal, filing, and accounting fees and printing expenses for registration statements.<sup>33</sup>

In addition to requiring large expenditures of time and funds, mandatory disclosure can also be costly in terms of lost opportunities. It is possible that companies, especially small businesses, may be forced to forego potentially beneficial ventures because the expense and delay of the disclosure system renders capital markets inaccessible.<sup>34</sup> Recognizing that the benefits of disclosure may, in certain instances, be outweighed by the burden that registration places on an issuer's ability to raise capital, the 1933 Act provides several exemptions from registration.<sup>35</sup> Issuers do not have to register their

---

securities being registered. *See generally* 1933 Act Schedule A, 15 U.S.C. § 77aa (1988); 2 LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 599-601 (3d ed. 1989). Financial conditions such as material contracts, capital structure, and recent history must also be fully described, and information relating to the issuer's parents, affiliates, and subsidiaries must be disclosed. 2 LOSS & SELIGMAN, *supra*, at 600.

32. Carl W. Schneider et al., *Going Public: Practice, Procedure, and Consequences*, 27 VILL. L. REV. 1, 26-28 (1981). After the materials are initially prepared and filed with the SEC, they are often revised several times to conform with comments made by SEC staff, incurring additional attorney's fees and further delaying the commencement of the offering. 1 LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 517-32 (3d ed. 1989).

33. Schneider et al., *supra* note 32, at 29-33. Judge Easterbrook and Professor Fischel suggest that one of the reasons the disclosure system remains in place is that professionals in the area of securities regulation make a great deal of money and therefore "have every incentive to support the status quo on an interest-group basis." Easterbrook & Fischel, *supra* note 17, at 671-72.

34. *See* Easterbrook & Fischel, *supra* note 17, at 708.

35. The 1933 Act provides exemptions from registration for certain securities pursuant to § 3, 15 U.S.C. § 77c (1988), and for certain transactions pursuant to § 4, 15 U.S.C. § 77d (1988). Under the Act, the nature of either the specific securities or the particular transaction justifies excusing the prospective issuer from registering its securities offering. *See* 15 U.S.C. §§ 77c-77d. The differences between "exempt securities" and "exempt transactions," however, are often obscure and indistinct, and the reasons for listing an exemption as an exempt security rather than an exempt transaction frequently seem illogical and untenable. *See* 3 LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 1142-44 (3d ed. 1989) (arguing that securities exempt pursuant to §§ 3(a)(9)-(11), 3(b), and 3(c) of the Act are actually exempt transactions).

The Act provides, for example, the following exemptions: § 3(a)(9) (securities exchanged by a single issuer with its security holders); § 3(a)(10) (judicially or administratively approved exchanges); § 3(a)(11) (intrastate offerings); § 3(b) and Regulation A (providing a simplified form of registration for smaller offerings); § 3(c) and Regulation E (offerings by small business investment companies); § 4(2) and Regulation D (private offerings); § 4(6) (offers or sales to accredited investors); Regulation B (various types of offerings of fractional undivided interests in oil or gas rights up to \$250,000 per year); and Regulation F (assessments on assessable stock of any corporation with its principal place of business in any state or territory of the United States). *See* 3 LOSS & SELIGMAN,



securities offerings when they can satisfy all of the requirements under an exemption, thereby avoiding the delay and expense of the registration process that impedes their ability to raise capital.

These exemptions from registration embody the policy of the 1933 Act to facilitate commerce, a goal that competes with the policy of disclosure and investor protection through disclosure.<sup>36</sup> The facilitation of commerce has emerged as a goal equally important to that of investor protection under the Act. More specifically, facilitating the small issuers' ability to raise capital has always been and continues to be an important focus in securities regulation. In July 1992, the SEC adopted a series of significant rule revisions known as the "Small Business Initiatives," designed to facilitate the raising of capital by small businesses and to reduce the burdens placed on these companies by the federal securities laws.<sup>37</sup> The initiatives are intended to "facilitate the access of small business issuers to the public markets"<sup>38</sup> and to "simplify the small business disclosure requirements" under the Act.<sup>39</sup> Recent amendments to Rule 144A similarly reflect the importance that the SEC places on the facilitation of commerce. Rule 144A essentially provides a safe harbor from registration for the resale of certain securities to "qualified institutional buyers."<sup>40</sup> The amendments to Rule

---

*supra*, at 1142-1473 for a thorough analysis of these and other exemptions provided by the 1933 Act.

36. See *Ruefenacht v. O'Halloran*, 737 F.2d 320, 334 (3d Cir. 1984) (commenting that in enacting the 1933 Act, which provides exemptions for certain transactions, "Congress acted with a number of rationales in mind, among them the facilitation of commerce in certain named instruments to reduce transaction costs and enhance the free flow of capital"); Manuel F. Cohen, *Federal Legislation Affecting the Public Offering of Securities*, 28 GEO. WASH. L. REV. 119, 148-49 (1959) ("The [exemptions in the 1933 Act] reflect a Congressional determination to temper the full effect of the statute as against offerings by small business concerns and certain companies organized to provide capital to such concerns."); see generally Raymond M. Jacobson, *Exemptions in Securities Act Registration*, 33 FLA. B.J. 69 (1959).

37. Small Business Initiatives, 57 Fed. Reg. 36,442 (1992) (codified as amended in scattered sections of 17 C.F.R. and containing Securities Act Release No. 6924, Exchange Act Release No. 30,968, and Trust Indenture Act Release No. 2287).

To facilitate the raising of capital and reduce the burden of compliance with the securities laws, the SEC revised Regulation A and Rule 504. Regulation A as revised allows eligible companies to "test the waters" by soliciting indications from the public as to the public's interest in the company and its business *prior* to the costly preparation of a Regulation A offering document. SEC Regulation A, 17 C.F.R. § 230.254 (1993). Similarly, Rule 504 has been revised to permit less restrictive use of the one million dollar exemption. SEC Rule 504, 17 C.F.R. § 230.504 (1993).

38. Additional Small Business Initiatives, 58 Fed. Reg. 26,509, 26,510 (1993) (codified as amended in scattered sections of 17 C.F.R.).

39. Ralph S. Janvey, *The SEC's Small Business Initiatives: Regulatory Reform or Shabby Conduct?*, 21 SEC. REG. L.J. 4 (1993).

40. SEC Rule 144A, 17 C.F.R. § 230.144A (1993).

144A reflect the SEC's goal of facilitating commerce by expanding the category of institutional investors eligible to buy unregistered securities in a private placement.<sup>41</sup> The expansion of the application of this exemption facilitates the raising of capital for small issuers by reducing their costs of financing.<sup>42</sup>

In pursuing the goal of facilitating commerce, the SEC has not, however, abandoned its goal of investor protection. The SEC has promulgated and interpreted rules on exemptions to provide more substantive protection for offerees and purchasers of unregistered securities than was contemplated under the exemptions originally enacted by Congress in the Act.<sup>43</sup> For example, issuers relying upon the private placement exemption of Regulation D<sup>44</sup> can only offer their securities to a limited number of potential investors who are deemed to have investment sophistication and access to information concerning the issuer and its offering.<sup>45</sup> Due to their business acumen and access to information, the offerees of a private placement are deemed not to need the protection that registration affords.<sup>46</sup> Offerees of a securities transaction that is exempt pursuant to Regulation D nevertheless receive a private placement memorandum disclosing information pertaining to the issuer and its offering.<sup>47</sup> Since less information is required in the private placement memorandum than in the documents of a registered offering, preparation of the private placement offering materials saves time and money for issuers relying on this exemption.<sup>48</sup> The private placement offerees are, however, substantively protected by the disclosure contained in the private placement memorandum and by their access to information about the offering and the issuer.<sup>49</sup>

---

41. See Private Resales of Securities to Institutions, 57 Fed. Reg. 48,721 (1992) (containing Securities Act Release No. 6963).

42. *Id.*

43. See A.B.A. Committee on Federal Regulation of Securities, *Integration of Securities Offerings: Report of the Task Force on Integration*, 41 BUS. LAW. 595, 641 (1986) [hereinafter *Task Force on Integration*].

44. SEC Rule 506, 17 C.F.R. § 230.506 (1993).

45. *Id.*

46. See *id.*

47. See SEC Rule 502, 17 C.F.R. § 230.502 (1993); SEC Rule 506, 17 C.F.R. § 230.506 (1993).

48. A private placement memorandum, however, still contains a significant amount of data. See SEC Rule 502, 17 C.F.R. § 230.502 (1993) (setting forth the information that must be provided in a private placement memorandum).

49. Under SEC Rule 502, the issuer must give purchasers of securities offered under Rule 505 or 506 "the opportunity to ask questions and receive answers concerning the terms and conditions of the offering." SEC Rule 502(b)(2)(v), 17 C.F.R. § 230.502 (1993).

The exemptions from registration reflect a willingness, in certain instances, to assist issuers in capital formation at a tolerable cost to investors.<sup>50</sup> When an issuer satisfies the requirements under any one of the 1933 Act's exemptions, the benefits of disclosure through the registration process give way to the Act's countervailing policy of facilitating capital formation. When exemption requirements are met, issuers are assisted in raising funds even though there is a cost to investors—the lack of the information that registration provides. An issuer may only forego the costs of registration if its offering satisfies all the requirements of an exemption. The 1933 Act has carefully drawn the boundaries of the exemptions.<sup>51</sup> If an issuer falls within these boundaries, the goal of facilitating commerce appropriately takes precedence because either the particular exemption provides substantive protection to the investors or the investors simply do not need the protection provided by registration. In contrast, if issuers proceed beyond these boundaries and splinter a single nonexempt offering into two or more exempt offerings, the disclosure system would essentially be eviscerated by an attempt to sell unregistered securities for which no exemption is available. When an issuer goes beyond the boundaries drawn under the exemptions, the goal of information dissemination through disclosure overcomes the goal of facilitating commerce. To prevent sales of securities in the latter circumstance, the SEC developed the doctrine of integration.

### *B. The Role of Integration*

Although the SEC recognizes that less disclosure is sometimes necessary to facilitate commerce and capital formation,<sup>52</sup> it has been unwilling to do away with the disclosure system altogether. One manifestation of the SEC's continued adherence to the principle of investor protection through disclosure is the integration doctrine. In conceiving the integration principle, the SEC recognized that while it is sometimes necessary to assist capital formation by providing registration exemptions, the benefits of disclosure should not be sacrificed unless an issuer satisfies all requirements of a particular exemption. Inherent in the integration principle is the concept that although issuers should be assisted in raising capital, investor protection should be sacrificed only in the limited circumstances specified in each exemption. The SEC devised the integration

---

50. See Deaktor, *supra* note 5, at 474.

51. See Morrissey, *supra* note 5, at 54.

52. See *supra* notes 35-42 and accompanying text.

principle to avoid abuse of the exemptions from registration.

The SEC developed the concept of integration shortly after the passage of the 1933 Act<sup>53</sup> to prevent issuers from circumventing the Act's registration requirements.<sup>54</sup> To evade the Act's registration requirements and the accompanying expense and delay where there is no legitimately available exemption, many issuers divide what is essentially one offering, for which no exemption is available, into two or more separate offerings that each satisfy exemption requirements.<sup>55</sup> Because the boundaries of the Act's exemptions have been carefully drawn, the division of single offerings for the sole purpose of avoiding registration frustrates the Act's registration requirement and the Act's goal of investor protection through "full and fair disclosure." The integration principle attempts to prevent this misuse of the Act's exemptions by combining offerings that have been purposefully separated into a single, integrated offering for which there may be no exemption from registration.<sup>56</sup> Offerings are integrated and registration is required when issuers have abused the Act's exemptions.

To determine whether an issuer has artificially divided an offering to evade the 1933 Act's registration requirements, the SEC examines multiple, apparently exempt offerings to determine whether those offerings actually constitute a single, larger offering.<sup>57</sup> If the SEC

---

53. See Securities Act Release No. 97, 1 Fed. Sec. L. Rep. (CCH) ¶ 1027 (Dec. 28, 1933) (declaring that the intrastate offering exemption pursuant to § 3(a)(11) would not be available to an issuer planning both an intrastate offering and a registered interstate offering because the two offerings would actually constitute a single issue, and the interstate sales would taint the intrastate offering); see also Deaktor, *supra* note 5, at 492.

54. See generally *Task Force on Integration*, *supra* note 43, at 595; Deaktor, *supra* note 5, at 492.

55. See Kathryn Taylor Frame, Note, *Securities Regulation: Integration of Securities Offerings*, 34 OKLA. L. REV. 864, 866 (1981).

56. See *Task Force on Integration*, *supra* note 43, at 595, 641; Morrissey, *supra* note 5, at 43-44. When transactions are integrated into a single offering that does not qualify for an exemption, there are two possible consequences. First, the purchasers of the securities may bring an action to rescind their purchases. Second, the SEC may bring suit to enjoin an issuer's continued offer and sale of securities in reliance upon exemptions that are no longer available as a result of the integration of the offerings. See *supra* note 6 and accompanying text; Morrissey, *supra* note 5, at 43-44; Deaktor, *supra* note 5, at 470-71.

57. See Morrissey, *supra* note 5, at 54. Note, however, that an exempt offering may be integrated with either another exempt offering or a nonexempt offering, *Task Force on Integration*, *supra* note 43, at 595, if those offerings are not separated by at least six months of time. See *infra* note 61 discussing the SEC's temporal safe harbor from integration. Indeed, integration may ensue from innumerable combinations of offerings. For example, depending upon the particular circumstances, an apparently exempt private placement offering pursuant to SEC Rule 506 may be integrated with either a separate,

concludes that the offerings should be integrated, either the combined offering, considered as a whole, must independently satisfy the requirements of an exemption, or the issuer must register the offering. The concept of integration retains the benefits of disclosure<sup>58</sup> by precluding issuers from exceeding the boundaries of the Act's exemptions "by resorting to a combination of transactional exemptions to insulate what would otherwise be a nonexempt public offering from the Act's registration provisions."<sup>59</sup>

Even a faultless issuer, however, must be aware of the "pitfalls" that the SEC's integration doctrine presents.<sup>60</sup> When planning a transaction, a prospective issuer of an apparently exempt offering must carefully examine previous and possible subsequent offerings to determine whether any combination of the offerings might later be integrated. Unless the proposed offerings qualify under one of the limited safe harbors from integration,<sup>61</sup> the issuer must decipher the SEC's five factor test to determine whether offerings should be integrated.<sup>62</sup> Such determinations have proven immensely difficult for both prospective issuers and the SEC itself.<sup>63</sup> A close examination of each of the five factors contained in Release No. 4552 will illustrate the problems of the SEC's integration policy.

---

apparently exempt intrastate offering pursuant to § 3(a)(11) or a separate registered offering. See, e.g., 3 LOSS & SELIGMAN, *supra* note 35, at 1212.

58. See *supra* text accompanying notes 10-12, 22-27 and accompanying text.

59. Deaktor, *supra* note 5, at 492.

60. See *id.* at 472.

61. The SEC provides several safe harbors from integration. These include provisions that prevent the integration of offerings pursuant to Regulation D, SEC Rule 502, 17 C.F.R. § 230.502 (1993); Regulation A, Rule 251, 17 C.F.R. § 230.251 (1993); and, intrastate offerings pursuant to SEC Rule 147, 17 C.F.R. § 230.147 (1993). For example, SEC Rule 502 provides a temporal safe harbor for certain offerings separated by at least six months. See 17 C.F.R. § 230.502 (1993). For a thorough analysis of the SEC's safe harbors from integration, see 3 LOSS & SELIGMAN, *supra* note 35, at 1221-28.

Even though these safe harbor provisions assist some prospective issuers, the provisions do not resolve many of the questions pertaining to the SEC's integration policy and specifically to its five factor test. Moreover, these safe harbor provisions do not cover the transactions of small issuers that legitimately separate offerings because they must raise capital frequently and consequently are unable to separate their offerings by at least six-month periods in compliance with any of the safe harbor provisions.

When structuring transactions, the unavailability of a safe harbor from registration might cause an issuer to conclude that offerings must be registered if no other exemption from registration is clearly available. Consequently, the issuer might incur delay and additional expense at a time when it is least able to afford to do so.

62. See *supra* text accompanying note 7.

63. See *infra* part IV.A.1.

### III. DISCUSSION: A FACTOR-BY-FACTOR ANALYSIS OF THE SEC'S TEST FOR INTEGRATION

#### A. *The Single Plan of Financing Factor*

One of the components of the SEC's formula for integration involves determining whether separate offerings constitute a single plan of financing.<sup>64</sup> The SEC staff and the courts have frequently cited the single plan of financing factor in deciding whether multiple securities offerings should be integrated.<sup>65</sup> In fact, a single plan of financing was found in every case where integration was mandated.<sup>66</sup> The importance of this observation, however, is limited by the fact that a single plan of financing arguably existed in many of the cases where the SEC staff did not recommend that the offerings be integrated.<sup>67</sup> The frequency with which the SEC staff and the courts cite this factor seems to indicate that they attach some significance to it. The nebulous interpretation of this factor, however, causes much confusion and uncertainty for issuers attempting to raise capital and leaves too much room for manipulation by issuers intending to evade the Act's registration requirements.<sup>68</sup>

Although the SEC has not developed a precise method of determining when two or more securities offerings constitute a single plan of financing, some of the cases and SEC no-action letters generally suggest that there are three components to be considered: (1) the method by which an issuer offers securities; (2) the timing of the offerings; and (3) whether the offerings are financially interdependent.<sup>69</sup> Some issuers' counsel have proposed that offerings made under different methods of distribution involve different plans of financing.<sup>70</sup> When offerings are made to different groups, for example, one offering made to the public and another offering to employees, the SEC might determine that the offerings are not part of a single plan because

---

64. See Securities Act Release No. 4552, 27 Fed. Reg. 11,316, 11,317, 1 Fed. Sec. L. Rep. (CCH) ¶ 2770, 2781 (1962).

65. See, e.g., SEC v. Murphy, 626 F.2d 633, 645-46 (9th Cir. 1980); Walker v. Montclair Housing Partners, 736 F. Supp. 1358, 1364-65 (M.D.N.C. 1990); Tele-Tower, Inc., SEC No-Action Letter, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,540, at 80,188 (Jan. 25, 1978).

66. Frame, *supra* note 55, at 870-71.

67. See Canon Club Co., SEC No-Action Letter, 1978 WL 12826 (May 25, 1978); Shockey Cos., SEC No-Action Letter [1976-77 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,924, at 87,437 (Nov. 12, 1976).

68. Deaktor, *supra* note 5, at 541.

69. See 3 LOSS & SELIGMAN, *supra* note 35, at 1214.

70. See Deaktor, *supra* note 5, at 530.

they involve different methods of offering the securities.<sup>71</sup> As to whether offerings are financially interdependent, one letter of inquiry to the SEC asserted that because "the success or failure of the exchange will be independent of the success or failure of the [other] offering" no single plan of financing existed.<sup>72</sup> In its reply, the SEC staff, without discussing the merits of the assertion contained in the letter of inquiry, recommended that no action to integrate be taken.<sup>73</sup>

Some confusion stems from the SEC's and the courts' failure to define precisely and apply consistently the three suggested components of the single plan of financing factor. Neither the cases nor the no-action letters provides a clear definition or description of "financially interdependent" offerings or offerings "coordinated with each other as to timing." In addition to the fact that it is unclear when or how one should use these suggested components to test for a single plan of financing, they are easily manipulated. Issuers can vary the methods of distributing the securities in slight ways in order to avoid a finding that offerings involve a single plan of financing.<sup>74</sup>

Not only have several courts construed these components differently, some completely ignore these three components in determining whether there is a single plan of financing. One court in particular found that several offerings were not part of a single plan of financing because at the time of the first offering the issuer did not intend to make the subsequent offerings.<sup>75</sup> Courts defining the single plan factor in this way allow issuers to make additional offerings to raise funds for unanticipated needs. This approach to the single plan factor requires a subjective examination of the expectations of the issuer's management. Such an analysis of the issuer's intentions could be easily manipulated, since an issuer's management could avoid integra-

---

71. *See, e.g.*, Pacific Physician Servs., Inc., SEC No-Action Letter, 1985 WL 55629 (July 22, 1985).

72. UST Corp., SEC No-Action Letter, 1977 WL 14485, at \*4 (Apr. 8, 1977).

73. *Id.*

74. *See, e.g.*, Pittsburgh Nat'l Corp., SEC No-Action Letter, 1977 WL 10903, at \*4 (July 13, 1977) (concluding that "the methods of offering the two types of securities are sufficiently different to constitute separate plans of financing").

75. *See* Livens v. William D. Witter, Inc., 374 F. Supp. 1104, 1107 (D. Mass. 1974) (holding that although six offerings were made for the same general purpose, because the issuer had hoped that the first financing would be sufficient and expected each successive financing to be the last, the offerings did not involve a single plan of financing and "the integrated offering doctrine is clearly inapplicable"); *see also* Barrett v. Triangle Mining Corp., No. 72 Civ. 5111, 1976 WL 760, at \*6 (S.D.N.Y. Feb. 2, 1976) (holding that integration was not mandated where "unforeseen operating difficulties" required the issuer to raise additional funds); Bowers v. Columbia Gen. Corp., 336 F. Supp. 609, 624-25 (D. Del. 1971) (concluding that numerous offerings issued over a three year period to acquire ten "unique" businesses did not require integration).

tion by stating that it did not intend to make subsequent offerings.<sup>76</sup> This approach may also, in effect, punish well-managed issuers that can foresee their capital requirements and that plan at one time to make several legitimately separated offerings—that is, offerings that are not separated in order to evade the Act's registration requirements.<sup>77</sup>

Another confusing approach that the SEC staff and the courts have taken uses other factors of the five factor test to define the single plan of financing factor. Specifically, the cases and no-action letters commonly fail to distinguish between the single plan of financing and the same general purpose factors. Very often the discussion of these two factors is not analytically distinct.<sup>78</sup> Several cases and no-action letters have suggested that offerings are not part of a single plan of financing when offerings are made for different purposes.<sup>79</sup> In another instance, the SEC staff indicated that integration might be warranted because the offerings were made at or about the same time and for the same purpose, and therefore involved a single plan of financing.<sup>80</sup> This failure to distinguish the single plan of financing factor analysis from that required by the remaining factors essentially renders it useless in the integration analysis.

Despite the frequency of its citation, the single plan of financing

---

76. See Deaktor, *supra* note 5, at 531.

77. Russell B. Stevenson, Jr., *Integration and Private Placements*, 19 REV. SEC. & COM. REG. 49, 51 (1986).

78. See 3 LOSS & SELIGMAN, *supra* note 35, at 1215; see also Deaktor, *supra* note 5, at 530-31 (noting that factors are often defined by other factors).

79. See, e.g., Pacific Physician Servs., Inc., SEC No-Action Letter, 1985 WL 55629 (July 22, 1985). In *Pacific Physician Services*, the SEC determined that offerings to two distinct groups, the public and numerous employees, were "not intended for the same purpose and [were] not part of a single plan of financing." *Id.* at \*3.

Similarly, where offerings possess the same general purpose, the offerings most likely possess a single plan of financing. See, e.g., Charles E. Watters, SEC No-Action Letter, 1978 WL 13303 (Apr. 24, 1978). In *Watters*, Charles Watters sought to acquire oil and gas leases from landowners by giving them royalty interests. *Id.* at \*1. He then would offer prospective investors fractional undivided interests in the rights obtained under the leases. *Id.* The SEC found that his scheme constituted "a single plan of financing, the general purpose of which would be to develop the oil and gas leasehold interest acquired by Mr. Watters." *Id.* at \*4.

80. LaserFax, Inc., SEC No-Action Letter, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,136 at 76,614 (Aug. 15, 1985). In *LaserFax*, the issuer planned three offerings: a private offering; a debenture offering; and a public offering of common stock. *Id.* The SEC staff declined to take a no-action position noting in particular that: (1) the debentures were convertible into common stock; (2) the funds to be raised from the debenture offering and the proposed public offering were part of a single plan of financing; (3) the funds received from all three offerings would be used primarily for business operations; and (4) the debentures would be offered less than six months after the prior private offering and less than six months before the proposed public offering. *Id.* at 76,615.



factor remains ambiguous. Neither the SEC staff nor the courts has specified how or even whether to use any or all of this factor's various components and neither has espoused a clear definition as to what constitutes a single plan of financing. Consequently, issuers are unable to identify offerings that are part of the same plan of financing and are therefore unsure of how to structure transactions to avoid the integration of legitimately separate offerings.<sup>81</sup> This uncertainty also defeats the purpose of investor protection because it creates an opportunity for issuers to manipulate the single plan of financing factor by varying the method of distribution in slight ways to avoid the application of this factor.<sup>82</sup>

### *B. The Same General Purpose Factor*

Another determination to be made in considering whether multiple securities offerings should be integrated is whether the offerings are made for the same general purpose.<sup>83</sup> Like the single plan of financing factor, the weight of the same general purpose factor in the integration analysis is unclear. Where the SEC staff has found that an issuer's separate offerings were made for different purposes, it typically has not recommended that the offerings be integrated.<sup>84</sup> Nevertheless, in several instances where the SEC found separate offerings to have been made for the same general purpose, it recommended against integration because one or more of the remaining factors of the SEC's integration test did not apply to the offerings.<sup>85</sup> In each of these cases, either the offerings were not part of a single plan of financing, were not made at or about the same time or for the same consideration, or did not involve the same class of securities.

Adding to the confusion in the application of the same general purpose factor, the analysis of this factor often overlaps with that of the single plan of financing factor.<sup>86</sup> Additionally, like the single plan factor, the analysis of the purpose factor frequently focuses on the issuer's intent, which requires a subjective inquiry into the issuer's

---

81. See Deaktor, *supra* note 5, at 541.

82. See *id.* at 531.

83. See Securities Act Release No. 4552, 27 Fed. Reg. 11,316, 11,317, 1 Fed. Sec. L. Rep. (CCH) ¶ 2770 (1962).

84. See, e.g., *Pacific Physician Servs.*, 1985 WL 55629, at \*3; *Pittsburgh Nat'l Corp.*, 1977 WL 10903, at \*4.

85. See, e.g., Buxton's Country Shops, SEC No-Action Letter, 1976 WL 10847, at \*3-\*4 (May 25, 1976); Eastern Ill. Tel. Corp., SEC No-Action Letter [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,238, at 85,492 (Mar. 14, 1975); Industrial Dev. Bd., SEC No-Action Letter, 1973 WL 9761, at \*3-\*4 (Oct. 16, 1973).

86. See *supra* text accompanying notes 78-80.

reasons for making each offering.<sup>87</sup> This inquiry is generally satisfied by the issuer's representation of its motives for making the offerings,<sup>88</sup> illustrating how easily issuers can manipulate the application of this factor to their separated offerings.<sup>89</sup> In other instances, however, the SEC staff examined objective criteria rather than an issuer's representation of its motives for making the offerings to determine whether the offerings were made for the same general purpose. For example, where an issuer used the proceeds from separate offerings differently, the SEC staff concluded that the offerings were made for different purposes.<sup>90</sup> Similarly, the SEC concluded in another no-action letter that offerings were made for different purposes when one offering was made for financial purposes and another for non-financial purposes.<sup>91</sup>

---

87. *E.g.*, Pacific Resources, Inc., SEC No-Action Letter, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,714, at 86,846 (July 13, 1976); *see* 3 LOSS & SELIGMAN, *supra* note 35, at 1213.

88. *See, e.g.*, *Livens v. William D. Witter, Inc.*, 374 F. Supp. 1104, 1107 (D. Mass. 1974). The *Livens* court, applying the factors cited in Securities Act Release No. 4552, concluded that the plaintiff had failed to demonstrate the existence of a single plan of financing because "each successive financing was expected by the defendants to be the last which would be required to make [the issuer] self supporting." *Id.* Moreover, the court emphasized that certain events that precipitated the need for additional financing, some of which "were not contemplated at the time of . . . financing[.]" were beyond the control of the defendants. *Id.*

89. *See, e.g.*, DeLorean Motor Co., SEC No-Action Letter, 1977 WL 11174 (Aug. 15, 1977). In *DeLorean*, the SEC staff determined that integration would not be mandated with respect to private and public offerings of common stock made simultaneously. *Id.* at \*1. The staff's no-action position was based on the issuer's representation that the purpose of the public offering was to establish a network of dealers for the issuer's product, whereas the purpose of the private offering was to raise short-term working capital and to establish a relationship with an investor who would promote the issuer's product. *Id.*

90. Citicorp, SEC No-Action Letter, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,778, at 87,016 (Aug. 20, 1976). In *Citicorp*, the staff found that the purpose factor did not apply to offerings where the issuer planned to use the proceeds of one of the offerings to finance current projects and the proceeds of a second offering to finance future transactions. *Id.*

91. Stratford Employees' Cattle Program, Ltd., SEC No-Action Letter, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,761, at 84,048 (Mar. 8, 1974). In *Stratford*, the issuer sought to distinguish a proposed exempt offering to employees from concurrent registered offerings by stating that "[t]he actual consideration to be received by the [corporation from its offering to employees] . . . is the continued morale and well-being of their employees which will result from providing them with cattle feeding investments in which the possibility of loss is minimized." *Id.* at 84,052-53. The SEC staff concluded that the offerings were made for different purposes and recommended that no action be taken with respect to the proposed offering. *Id.* at 84,049. This no-action letter demonstrates the overlap between the factors in the SEC's test for integration. *See* the discussion of the same consideration factor, *infra* part III.D.; *see also* Deaktor, *supra* note 5, at 536 (noting the overlap between the same general purpose and same consideration factors).

This letter involved a case in which the SEC staff found that offerings of common

These objective approaches to determining whether the purpose factor applies to separate offerings, while initially helpful, become less helpful when a single offering is made for more than one purpose. As a result, one commentator has proposed that "when the proceeds from more than twenty-five percent of the securities offered . . . are to be used for one" purpose, "the offering [should] be deemed to have been for that purpose."<sup>92</sup>

### C. *The Same Class of Securities Factor*

Another factor to which the SEC staff and courts look in determining whether multiple securities offerings should be integrated is whether the offerings involve the same class of securities.<sup>93</sup> The cases and no-action letters offer little guidance as to the weight to be given the same class of securities factor in the integration analysis. At least one issuer placed a great deal of emphasis on this factor in its letter of inquiry to the SEC.<sup>94</sup> The issuer argued that integration was inappropriate because "the availability of the 'exempt securities' exemptions in section 3 of the Securities Act of 1933 is not dependent upon the character of the transaction in which the securities are offered for sale and sold, but rather upon the nature of the security itself."<sup>95</sup> Although the SEC staff determined, based upon the issuer's representations, that the offerings should not be integrated,<sup>96</sup> it did not specifically conclude that the offerings involved different classes of securities.<sup>97</sup>

Compounding the confusion associated with this factor, the SEC and courts have failed to articulate a precise formula to determine whether securities are of the same class.<sup>98</sup> As a result, issuers are

---

stock to an issuer's employees were made for the non-financial purpose of strengthening the employer/employee relationship, while public offerings of the same issuer's common stock were made to raise funds, clearly involving a financial purpose. Even though the offerings were made simultaneously, involving the same class of security for the same consideration, the offerings were not integrated because they were made for different purposes.

92. *Task Force on Integration*, *supra* note 43, at 636.

93. See Securities Act Release No. 4552, 27 Fed. Reg. 11,316, 11,317, 1 Fed. Sec. L. Rep. (CCH) ¶ 2770 (1962).

94. See *Liberty Nat'l Corp.*, SEC No-Action Letter, 1976 WL 12527, at \*2 (Apr. 21, 1976); see also *Task Force on Integration*, *supra* note 43, at 633 (suggesting that "[t]he nature of the securities offered is so fundamental to the integration concept that this criterion, in and of itself, should be the basis for a safe harbor").

95. *Liberty Nat'l Corp.*, 1976 WL 12527, at \*2.

96. *Id.* at \*4.

97. See *id.* at \*3-\*4.

98. One commentator suggests that the identities of the issuer and the offerees are the most relevant considerations. See Deaktor, *supra* note 5, at 531-32. His conclusion is based on the observation that: (1) different issuers offer inherently different types of

uncertain how to determine whether offerings involve the same class of securities. Generally, the courts and SEC staff have found offerings non-integrable where the types of securities offered are clearly different, such as an offering of common stock and an offering of preferred stock.<sup>99</sup> In at least one case, the SEC staff recommended that no action be taken to integrate offerings of commercial paper and unsecured promissory notes.<sup>100</sup>

Despite the apparent emphasis on distinguishing the types of securities, offerings involving classes of securities that have not been clearly and conclusively distinguished have been found to be non-integrable. In fact, when two or more securities are only slightly different, the SEC staff and courts have refrained from integrating offerings or have found that offerings did not involve the same class of securities.<sup>101</sup> Consequently, issuers seeking to manipulate this factor and evade the Act's registration requirements can simply separate offerings and avoid integration by offering securities that differ only slightly.<sup>102</sup> Even

---

securities; and (2) offerings directed at different pools of potential investors are more likely to be of different classes. *Id.*

99. *E.g.*, Agri-Quip, SEC No-Action Letter, 1974 WL 9638, at \*2-\*3 (Aug. 21, 1974) (concluding that industrial revenue bonds and common stock represent different classes of securities); *see* Stevenson, *supra* note 77, at 53.

100. *Citicorp*, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,778, at 87,017. The staff found the same class of security factor inapplicable because the securities had "completely distinctive maturity dates" and one of the securities was a "short term[,] cash equivalent investment with an emphasis on liquidity," whereas the other securities "[would] essentially be purchased for long term investment." *Id.* at 87,017.

Unfortunately, in *Citicorp* and *Agri-Quip*, the extent to which the four remaining factors contributed to the decisions not to integrate is unclear. *See generally*, *Citicorp*, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,778; *Agri-Quip*, 1974 WL 9638.

101. *E.g.*, Metropolitan Capital Corp., SEC No-Action Letter, [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,485, at 86,259-60 (Mar. 1, 1976) (concluding that the offerings of convertible debentures and subordinated debentures were not an integrated offering); *see also* S.E.C. v. Dunfee, [1966-1967 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,970, at 96,302 (W.D. Mo. 1967) (concluding that an offering of notes with an interest rate of 6% and a separate offering of notes with an interest rate of 7% by the same issuer eight months later did not require integration). *But see Task Force on Integration*, *supra* note 43, at 633-34 (criticizing narrowly drawn classes of securities and recommending that separate offerings be considered non-integrable only if each fell within a different class of four broad classes of securities: common stock; preferred stock; nonsecured debt; and secured debt).

102. *See Task Force on Integration*, *supra* note 43, at 633-35. For instance, there is nothing in the cases and no-action letters that prohibits an issuer of debentures from artificially dividing its offering by making some of the debentures convertible into another type of security. If the debenture is convertible immediately after its purchase, then the economic reality indicates that the offerings involve two different classes of securities because if the holder elects to convert immediately, she will hold two distinct types of securities. If, however, the debenture is not immediately convertible, or if it is

where the offered securities differ greatly, thereby rendering this factor inapplicable and possibly resulting in a non-integration position, investors might still benefit from the protection that registration provides.<sup>103</sup> This illustrates that the same class of security factor sometimes fails to reflect the Act's goal of investor protection.

#### *D. The Same Consideration Factor*

Another factor in the SEC's formula to determine whether separate securities offerings should be integrated is whether the securities are offered in exchange for the same consideration.<sup>104</sup> This factor is significant and sometimes dispositive of the integration question.<sup>105</sup> Unlike the single plan of financing and same general purpose factors, this factor does not require a subjective inquiry into the motives of the issuer's management. Instead, the issue of whether securities are offered in exchange for the same consideration can be determined objectively, making this factor potentially valuable in identifying separated offerings that could have been issued as one transaction.<sup>106</sup> Despite this advantage, the impact of the same consideration factor on the integration determination is uncertain. Where the consideration sought in exchange for two or more offerings differs, the courts and SEC staff often conclude that the offerings should not be integrated.<sup>107</sup> Most offerings that have been found not to involve the same consideration, however, generally also have been found to fail either the single plan of financing or the same general purpose prongs of the

---

convertible into a substantially similar instrument, then the economic reality reflects that the offerings of the debenture and the convertible debenture involve the same class of security. The Task Force on Integration has proposed that convertible securities be considered to be both the convertible security itself and the security into which it is convertible. *Id.* at 634. The adoption of this proposal would avoid manipulation of this factor, but similar manipulation could occur in other contexts. For example, an issuer could separate an offering of common stock by deeming one offering to involve non-voting common stock, thereby avoiding application of the same class of securities factor.

103. *See id.*, *supra* note 43, at 634-35. For example, offerings of common stock and long-term debt clearly do not involve the same class of security. When a company is badly in need of capital, however, there exists very little economic difference between the long-term debt and the common stock that it issues. *Id.* at 633.

104. *See* Securities Act Release No. 4552, 27 Fed. Reg. 11,316, 11,317, 1 Fed. Sec. L. Rep. (CCH) ¶ 2770 (1962).

105. Stevenson, *supra* note 77, at 54.

106. Deaktor, *supra* note 5, at 536.

107. *See, e.g.*, UST Corp., SEC No-Action Letter, 1977 WL 14485, at \*6-\*7 (Apr. 8, 1977); Remote Computing Corp., SEC No-Action Letter, [1972-73 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,182, at 82,597 (Nov. 28, 1972).

SEC's integration test.<sup>108</sup> This makes it quite difficult to determine the extent to which this one particular factor will influence the outcome of the integration question.

The same consideration factor poses an additional problem because cash is most often the consideration sought in securities offerings.<sup>109</sup> Because cash is so commonly sought as the consideration for a security, this factor may not provide an accurate and reliable indication that an issuer has artificially divided its offerings to avoid the Act's registration requirements. In one letter of inquiry to the SEC, issuer's counsel unsuccessfully argued that the applicability of the same consideration factor should be ignored where cash is the consideration for the offerings.<sup>110</sup> In another letter of inquiry, issuer's counsel proposed that the applicability of this factor should only be considered "where the consideration received in two purportedly separate offerings involves integral parts of the same asset, such as stock of the same corporation or assets which are useful only in combination with one another."<sup>111</sup> The SEC, however, declined to render an opinion on that issuer's inquiry and left the analysis of this factor in question.<sup>112</sup>

### *E. The Same Time of Offering Factor*

An additional factor to which the SEC and courts look when determining whether to integrate multiple securities offerings is whether the offerings were made at or about the same time.<sup>113</sup> Due to the potential impact on investor behavior, contemporaneous offerings may warrant

---

108. See Stevenson, *supra* note 77, at 54 (noting that most offerings typically possess all three of these factors—same consideration, single plan of financing, and same general purpose—or none of them).

109. See Deaktor, *supra* note 5, at 535.

110. A.G. Becker & Co., SEC No-Action Letter, 1975 WL 11399, at \*3 (Jan. 17, 1975). In A.G. Becker & Co., a bank holding company proposed two unregistered offerings, both of which sought cash consideration and qualified for registration exemptions. *Id.* at \*1, \*3. The first offering involved the issue of commercial paper pursuant to § 3(a)(3) of the 1933 Act. *Id.* at \*1. The second offering, which was guaranteed by the holding company, involved a § 4(2) offering of unsecured promissory notes by a subsidiary of the holding company. *Id.* The SEC agreed not to integrate the two offerings "provided that [the] proceeds of the [commercial paper] offerings made in reliance on Section 3(a)(3) are not used to honor the [holding company's] guarantee of the . . . subsidiary's paper issued in reliance on section 4(2)." *Id.* at \*4. See also *Laserfax*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,136, at 76,614 (reasoning that a similar transaction should be integrated despite arguments raised by the issuer as to the consideration factor).

111. Hawkeye Bancorporation, SEC No-Action Letter, 1976 WL 12602, at \*4 (Apr. 1, 1976).

112. See *id.* at \*7.

113. See Securities Act Release No. 4552, 27 Fed. Reg. 11,316, 11,317, 1 Fed. Sec. L. Rep. (CCH) ¶ 2770 (1962).

greater scrutiny than offerings that are not proximate in time.<sup>114</sup> The timing of the offerings, however, is perhaps the least significant of all five factors.<sup>115</sup> To provide some certainty as to the permissible timing of separate offerings, the SEC has created certain safe harbor rules that deem offerings separated by at least six months to be non-integrable.<sup>116</sup> Issuers for whom these safe harbors are unavailable, however, receive little guidance from cases and no-action letters regarding the amount of time necessary between offerings to avoid integration.<sup>117</sup> The SEC staff has only indicated that it will not apply this factor when the timing of the offerings is not interdependent or is merely "coincidental."<sup>118</sup> Beyond these observations, however, issuers cannot be certain as to when the SEC will consider offerings to be contemporaneous and therefore, possibly integrable.<sup>119</sup> Like the same consideration factor, whether offerings are made at the same time is potentially helpful because it can be objectively analyzed. The uncertainty as to the amount of time required between offerings to remove the offerings from scrutiny under this factor, however, renders its analysis inconsistent from case to case.

#### IV. ANALYSIS

Applying the SEC's integration formula has proven difficult for issuers and for the SEC itself. From 1971, the year in which the SEC's no-action letters first became publicly available, to 1979, the SEC answered almost two hundred letters from issuers and their counsel requesting clarification of the integration concept and an assessment of the doctrine's applicability to their transactions.<sup>120</sup> In 1979, the SEC announced that it would no longer respond to inquiries about the integration of securities offerings.<sup>121</sup> In 1985, the SEC resumed its

---

114. Deaktor, *supra* note 5, at 534.

115. E.g., Wellington Fund, Inc., SEC No-Action Letter, 1976 WL 12640, at \*6 (Aug. 23, 1976) (concluding that the mere fact that a mutual fund was continuously offered does not necessarily lead to the conclusion that the continuous offering should be "integrated" and subject to registration); see Deaktor, *supra* note 5, at 534.

116. See *supra* note 61.

117. See Stevenson, *supra* note 77, at 54.

118. See Deaktor, *supra* note 5, at 534-35.

119. See *Laserfax*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,136, at 76,614 (suggesting that offerings separated by less than six months risk integration).

120. See Deaktor, *supra* note 5, at 527.

121. See Clover Fin. Corp., SEC No-Action Letter, 1979 WL 13557, at \*7 (March 5, 1979). The SEC staff stated:

Because of the complexity of the proposed arrangements and the possibility that staff positions on the integration concept may be misconstrued and misapplied in other situations, we will not be issuing interpretations in this

attempt to clarify the integration question and began to respond, once again, to inquiries concerning integration.<sup>122</sup> The SEC, however, has failed to articulate a clear and precise integration policy that adequately reflects the goals of the Act and the integration doctrine. This part examines both the SEC's current formula for integration and a proposed analysis promulgated by the Committee on Federal Regulation of Securities and offers a critical review of each.

### A. *The SEC's Integration Formula*

#### 1. An Imprecise and Inconsistent Approach

When the various safe harbors from integration are unavailable, issuers must resort to the integration analysis set forth in Securities Act Release No. 4552 to determine whether two or more offerings should be integrated.<sup>123</sup> The analysis under the integration formula has been confusing and inconsistent,<sup>124</sup> and the SEC's no-action letters and the opinions of courts have provided very little guidance with respect to the analysis that must be performed under the five factor test. As a result, the SEC's test for integration is imprecise, inconsistently applied, and easily manipulated by issuers intending to evade the Act's registration requirements.<sup>125</sup>

The SEC's test is problematic because the SEC has failed to clarify how many of the five factors must apply to separate offerings to support the conclusion that they should be integrated. It is not necessary to find that all five factors are present to conclude that integration is warranted.<sup>126</sup> The exact number of affirmative answers required before offerings are integrated, however, is unclear. Integration seems unlikely unless four of the five factors are applicable,<sup>127</sup> but in some

---

area any longer. Rather, it is our position that counsel, with guidance of [Securities Act] Release No. 33-4552, should make a determination as to whether or not particular offerings should be integrated.

*Id.*

122. See 17 Sec. Reg. & L. Rep. (BNA) 403 (Mar. 8, 1985).

123. See *supra* part II.B.

124. Frame, *supra* note 55, at 864.

125. See Deaktor, *supra* note 5, at 541-42; *Task Force on Integration*, *supra* note 43, at 596; Frame, *supra* note 55, at 864-65.

126. E.g., SEC v. Murphy, 626 F.2d 633, 645-46 (9th Cir. 1980); see 3 LOSS & SELIGMAN, *supra* note 35, at 1222 & n.21; Frame, *supra* note 55, at 870; see also Exemption for Local Offerings from Registration, Securities Act Release No. 4434, 1 Fed. Sec. L. Rep. (CCH) ¶ 2272, at 2608 (Dec. 6, 1961) (commenting that "any one of the [five] factors may be determinative of the question of integration").

127. See, e.g., LaserFax, Inc., SEC No-Action Letter, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,136, at 76,615 (Aug. 15, 1985) (recommending that offer-



cases, the satisfaction of only one of the factors has led to integration.<sup>128</sup> Beyond these modest observations, however, issuers can only attempt to avoid integration by looking to ambiguous guidelines that are applied on a case-by-case basis.<sup>129</sup>

Besides the difficulty in determining the number of factors necessary to require integration, the no-action letters and opinions reveal very little about how the factors are interrelated, and there is no clear articulation as to the priority or weight to be given each factor.<sup>130</sup> The SEC's no-action letters support only the general observation that the SEC apparently considers the single plan of financing and the same general purpose factors to be important.<sup>131</sup> The plan and purpose factors are discussed more often and in greater detail than the remaining factors in the cases and no-action letters. When offerings are not made as part of a single plan or made for the same general purpose, the courts and SEC staff often take a non-integration position.<sup>132</sup> The weight of the remaining three factors, however, is entirely unclear. Offerings are often integrated even though they involve different classes of securities, are not made for the same consideration, or are not proximate in time.<sup>133</sup> Neither the cases nor the no-action letters has expressly assigned the weight to be given these three factors.

In addition to the problems involved in determining the weight of the five factors both individually and in the aggregate, the factors under the SEC's current integration analysis lack clear and consistent definitions. For instance, it is not clear when offerings will be

---

ings be integrated based on the presence of at least four of the five factors).

128. See, e.g., Charles E. Watters, SEC No-Action Letter, 1978 WL 13303, at \*4 (Apr. 24, 1978) (concluding that two offerings should be integrated solely because of the presence of a single plan of financing).

129. Determining the SEC's probable course of action solely from cases and no-action letters poses a substantial challenge to issuers and their counsel, for the cases and letters typically find that all of the factors are present, see Sonnenblick, Parker & Selvers, SEC No-Action Letter, 1986 WL 66490, at \*3 (Jan. 1, 1986), or only implicitly refer to one or two factors, see Philip Churchill & Earl Hoskins, SEC No-Action Letter, 1978 WL 12047, at \*5-\*6 (Sept. 25, 1978). Even more daunting for issuers and their counsel is the observation by one commentator that the SEC staff commonly ignores the five factors and examines other relevant factors not listed in Securities Act Release No. 4552. See Stevenson, *supra* note 77, at 50.

130. Stevenson, *supra* note 77, at 50; *Task Force on Integration*, *supra* note 43, at 596; see also Deaktor, *supra* note 5, at 503 (noting that Securities Act Release No. 4552 simply refers to all five factors as *relevant* considerations).

131. Sonnenblick, Parker & Selvers, 1986 WL 66490, at \*3.

132. See, e.g., Immune Response Corp., SEC No-Action Letter, 1987 WL 108556, at \*4-\*5 (Oct. 2, 1987); Royal LePage Ltd., SEC No-Action Letter, 1986 WL 66905, at \*4 (May 16, 1986); Pacific Physician Servs., Inc., SEC No-Action Letter, 1985 WL 55629, at \*2 (July 22, 1985).

133. See *supra* part III.C-E.

integrated because they involve a single plan of financing or are made for the same general purpose.<sup>134</sup> Also, the SEC has yet to determine the temporal boundaries defining contemporaneous offerings.<sup>135</sup> Even the inquiry as to whether offerings involve the same class of security, which ostensibly can be objectively determined, is difficult because the absence of clear boundaries between classes of securities leaves too much room for interpretation.<sup>136</sup>

A case decided in December 1992 illustrates the nebulous character of the SEC's five factor test and the failure of the courts to clarify the factors' definitions. In *Donohoe v. Consolidated Operating & Production Corp.*,<sup>137</sup> Judge Cudahy of the United States Court of Appeals for the Seventh Circuit described the case as involving "a familiar tale of an oil-drilling project come to grief."<sup>138</sup> To raise funds for its oil drilling project, the defendant, a small corporation with four shareholders, sold interests in a limited partnership, COPCO-1, to some investors.<sup>139</sup> The defendant issuer retained a broker to sell the limited partnership units in April 1983.<sup>140</sup> Later in the year, the issuer offered additional units in two newly formed limited partnerships, COPCO-2 in October, and COPCO-3 in November, to be sold by the same broker.<sup>141</sup> Each limited partnership, however, was to drill separate wells.<sup>142</sup> Upon discovering that the wells would produce no oil, several investors filed suit claiming that the defendant issuer violated section 5 of the 1933 Act by selling the unregistered limited partnership units.<sup>143</sup>

In issuing the securities without first registering them with the SEC, the issuer in *Donohoe* relied upon Rule 505, promulgated by the SEC

---

134. See *supra* text accompanying notes 78-80.

135. See *supra* part III.E.

136. See *supra* text accompanying notes 98-102.

137. 982 F.2d 1130 (7th Cir. 1992).

138. *Id.* at 1132.

139. *Id.* at 1133. The corporation was the sole general partner in COPCO-1. *Id.*

140. *Id.*

141. *Donohoe*, 982 F.2d at 1134.

142. *Id.* After the corporate issuer sold interests in the first three limited partnerships, interests were sold in a fourth limited partnership, COPCO-4. *Id.* The offering of interests in COPCO-4 was made by a different issuer since the general partner of COPCO-4 was an individual and not the corporate general partner of the first three partnerships. *Donohoe*, 982 F.2d at 1134. Even though the individual general partner of COPCO-4 was also a shareholder of the corporate general partner of COPCO-1, 2 and 3, the court held that issuer integration was not warranted. *Id.* at 1140.

143. *Donohoe*, 982 F.2d at 1135. The wells were capped because some produced excessive amounts of water, while others "developed 'gas lock'." *Id.* at 1134. The court described "gas lock," a term that the parties failed to define, as something "which appears to be good news if you want gas and bad news if you want oil." *Id.*

under the 1933 Act, which exempts from registration offers and sales of securities that do not exceed \$5,000,000.<sup>144</sup> In analyzing whether the offerings should have been registered, the court first noted that if the offerings could be considered four separate offerings, the issuer's reliance upon Rule 505 was legitimate.<sup>145</sup> The court then considered whether the four offerings should be integrated into a single offering for the purpose of determining whether the securities should have been registered.<sup>146</sup>

Weighing in favor of integration were two factors; the issuer had received the same consideration for the four offerings, and each offering involved the same class of securities.<sup>147</sup> Noting that the same time factor did not weigh either for or against integration,<sup>148</sup> the court considered whether the offerings were part of a single plan of financing and whether they had been made for the same general purpose.<sup>149</sup> Without expressly stating how it reached its conclusion, the court found that the offerings were not part of a single plan of financing.<sup>150</sup> The only guidance that the court offered in analyzing the single plan of financing factor was "that each drilling project was designed to stand or fall on its own merits."<sup>151</sup> Unfortunately, the court offered even less guidance with respect to the analysis of the remaining factor, whether the offerings were made for the same general purpose. Demonstrating the confusion that exists in analyzing the same general purpose factor, yet declining to clear up that confusion, Judge Cudahy noted that the district court considered the purposes of the offerings to be different because the partnerships did not share profits and losses.<sup>152</sup> The Seventh Circuit cast some doubt upon the district court's analysis of the purposes of the offerings. Nevertheless, it adopted the district court's holding:

We are not sure that the district court's construction of the [purpose] factor is necessarily correct. The term 'same general

---

144. SEC Rule 505, 17 C.F.R. § 230.505 (1993).

145. *Donohoe*, 982 F.2d at 1140.

146. *Id.* The issuer conceded that if the offerings were integrated into one offering, that offering would fail to qualify for an exemption under Rule 505, and the issuer would have issued the securities in violation of § 5 of the 1933 Act. *Id.*

147. *Id.*

148. *Donohoe*, 982 F.2d at 1140. Foregoing the opportunity to clarify when offerings are made at or about the same time, Judge Cudahy found the timing of the offerings to be "fairly neutral." *Id.* Six months separated the first and second offerings, and the second and third offerings were separated by one month. *Id.* at 1133-34.

149. *Id.* at 1140.

150. *Donohoe*, 982 F.2d at 1140.

151. *Id.*

152. *Id.*

purpose' suggests a level of generality to the integration analysis that may be satisfied by the observation that the purpose of each partnership was to drill for oil. But without expressing a definite opinion on that subject, we nonetheless affirm the court's holding.<sup>153</sup>

Although the Seventh Circuit had an opportunity to clarify the application of the factors in the SEC's integration formula, the *Donohoe* opinion, like many other court opinions and SEC no-action letters, failed to provide a meaningful analysis of those factors.

The court opinions and SEC no-action letters that employ a subjective inquiry into the state of mind of the issuer's management illustrate the imprecision and ambiguity that surround the SEC's five-factor integration formula.<sup>154</sup> The lack of objective criteria with which to determine whether integration is appropriate leaves too much room for subjective interpretation, increasing the possibility of confusion and, worse, manipulation of the integration doctrine by issuers attempting to evade the Act's registration requirements. For example, one newly formed company planned an unregistered offering that was exempt from registration pursuant to SEC Rule 504,<sup>155</sup> to be followed within a period of six months by a registered public offering.<sup>156</sup> In seeking the staff's interpretive advice regarding the applicability of the integration principle to these transactions, issuer's counsel argued that the components of the SEC's integration formula did not apply to its offerings.<sup>157</sup>

First, the issuer's counsel claimed that the offerings were made for different purposes, contending that the proceeds from the unregistered offering would go toward the company's start-up costs and financing the subsequent public offering, while the funds raised in the public offering would be used to commence business operations.<sup>158</sup> In an assertion that illustrates the willingness of some issuers to advance a manipulative interpretation of the factors to avoid integration, issuer's counsel suggested that the offerings involved different classes of securities because the common stock offered under Rule 504 would be unregistered, and the common stock offered to the public would be registered.<sup>159</sup> Counsel further asserted that different consideration

---

153. *Id.* (citation omitted).

154. *See supra* notes 75-77, 87-89 and accompanying text.

155. 17 C.F.R. § 230.504 (1993).

156. Sonnenblick, Parker & Selvers, 1986 WL 66490, at \*1.

157. *Id.* at \*2.

158. Sonnenblick, Parker & Selvers, 1986 WL 66490, at \*2. Counsel also used its characterization of the offerings' purposes to argue that the offerings were parts of different plans of financing. *Id.*

159. *Id.*

would be given for the two offerings because the price of the registered securities would be substantially higher than the price of the unregistered securities.<sup>160</sup>

The SEC staff concluded that the *Sonnenblick* issuer was planning to splinter a single transaction and that the offerings would be integrated so that the Rule 504 offering would be part of the registered offering.<sup>161</sup> In its reply, the staff stated that it was unable to discern a difference in the purposes of the two offerings.<sup>162</sup> The staff also determined that the offerings constituted a single plan of financing because "the issuer anticipates the need for the capital from both offerings in order to go forward with its operations."<sup>163</sup> Finally, the staff concluded that the offerings involved the same class of security (common stock), were made for the same consideration (cash), and were made at or about the same time.<sup>164</sup>

The position taken by the *Sonnenblick* issuer demonstrates at least two problems that have arisen from the imprecision and uncertainty of the SEC's current integration formula. First, a prospective issuer does not know with certainty whether the integration principle will apply to its securities transactions.<sup>165</sup> The confusing interpretations of the five factors and the lack of clear guidance with respect to the priority or weight of each factor increase the issuer's uncertainty in structuring offerings. This uncertainty seriously impedes capital formation.<sup>166</sup> Second, as the courts and SEC staff develop subjective criteria in

---

160. *Id.*

161. *Sonnenblick, Parker & Selvers*, 1986 WL 66490, at \*3.

162. *Id.*

163. *Id.*

164. *Id.*

165. See Frame, *supra* note 55, at 866.

166. Reconsideration of the integration formula would be an important step toward achieving the SEC's goal of facilitating capital formation, especially for the small issuer. Indeed, the uncertainty of the current integration formula may impact small companies the greatest. Small issuers, often unable to afford the expense of retaining counsel to determine whether the SEC's test applies to their transactions, may be the least able to delay the raising of needed funds. Emphasizing the importance of small businesses in our economy and the need to ease the burden on small companies attempting to raise funds, one commentator wrote:

In discussing the background to the . . . [small business initiatives], the SEC noted that small businesses, being the cornerstone of the U.S. economy, employ more than one-half of the domestic labor force, produce nearly half the gross domestic product, and created the vast preponderance of new jobs during the period 1988-1990. A critical factor in the viability of these small businesses, which are frequently in the vanguard of developing new technology, patents, products, and services, is access to capital.

Janvey, *supra* note 39, at 15 (citations omitted).

applying the five factor test, issuers are able to manipulate the poorly defined factors and avoid integration and registration of the offerings. This manipulation ultimately frustrates the policy of protecting investors through disclosure.

## 2. The Formula's Failure to Reflect the Goals of the 1933 Act and the Integration Doctrine

Although the SEC's current integration formula indirectly addresses one of the 1933 Act's fundamental policies, that investors need to be protected through disclosure, it does little to facilitate capital formation.<sup>167</sup> Because the current test for integration was formulated at a time when investor protection through registration was the predominant policy of the Act, it places undue emphasis on disclosure through registration.<sup>168</sup> During the past 50 years, however, many changes in the statutes and rules regulating securities offerings have augmented investor protection in a number of ways. Many of the current substantive protections that the exemptions provide for investors appeared after the integration formula was first articulated by the SEC.<sup>169</sup> As a result, the registration process has become a less important component of the overall scheme to protect investors, diminishing the necessity of an interpretive policy favoring registration. Accordingly, the SEC's current integration formula should be revised to reflect not only the Act's disclosure policy but also the emerging importance of the Act's policy to assist in capital formation where disclosure through registration would be unduly burdensome.<sup>170</sup>

The SEC has obviously concluded that the benefits of mandatory disclosure are significant. The continued application of the integration

---

167. See *supra* part II for a discussion of these competing policies.

168. *Task Force on Integration*, *supra* note 43, at 612.

169. *Id.* at 598-99; see also *supra* notes 43-48 and accompanying text discussing the substantive protections provided in the SEC's rules regarding exemptions.

170. The response of the SEC staff in a recent no-action letter illustrates the staff's growing recognition that, at times, offerees are sufficiently protected by exemption requirements. In *Black Box Inc.*, SEC No-Action Letter, 1990 WL 286633 (June 26, 1990) [hereinafter the "*Black Box* letter"], the SEC staff advised the issuer that no action would be taken on an unregistered offering to qualified institutional investors for "policy reasons." *Id.* at \*16. The staff failed to elaborate on those policy reasons, but relied on the representations of the issuer's counsel that the offerees of the particular securities could fend for themselves. *Id.* at \*16; see also *Black Box Inc.*, SEC No-Action Letter, 1992 WL 55818, at \*2 (Feb. 28, 1992) (noting that the staff's position in the *Black Box* letter "was a policy position taken primarily in consideration of the nature and number of offerees"). In presenting the argument against integration, the *Black Box* letter emphasized the SEC's underlying policy in the enactment of Rule 144A to consummate securities transactions quickly and efficiently and to avoid the expense of registration when it is not needed. *Black Box Inc.*, 1990 WL 286633, at \*14.

doctrine embodies that conclusion because the integration doctrine ensures disclosure where issuers attempt to avoid the Act's registration requirements.<sup>171</sup> A serious shortcoming of the current integration formula, however, is that the SEC might apply the doctrine to integrate separate offerings without considering whether the offerees need the protection of registration. If offerees are sufficiently protected under the exemption upon which an issuer relies in making the unregistered offering, the issuer's ability to raise funds may be needlessly hampered when offerings are integrated without considering whether investors will in fact benefit from registration.

Several of the five factors of the SEC's current integration formula do not reflect either the need for disclosure through registration or the goal of facilitating capital formation. For instance, there is no greater need for disclosure where offerings are part of the same plan of financing as compared to different plans of financing.<sup>172</sup> The mere fact that several offerings are part of an issuer's financial plans does not warrant the conclusion that the offerees will not receive sufficient protection under the exemptions upon which the issuer relied.<sup>173</sup> Separate offerings made for the same general purpose or the same consideration do not indicate that disclosure through registration is needed any more than offerings made for different purposes or different consideration.<sup>174</sup> Where these factors apply to two or more offerings and the offerees are nevertheless sufficiently protected by an exemption upon which the issuer has relied, integration of the offerings unnecessarily impedes capital formation by requiring integration even though investors do not need the protection afforded by registration.<sup>175</sup>

The SEC's current integration formula also fails to distinguish between offerings that have been artificially separated to evade the

---

171. See *supra* text accompanying notes 53-59.

172. Stevenson, *supra* note 77, at 51.

173. See *supra* text accompanying notes 43-48 discussing the substantive protections that exemptions provide for investors.

174. In contrast, the fact that offerings are made contemporaneously or involve the same class of security may bear some relationship to the need for disclosure through registration under the Act. One commentator suggests that offerings made at or about the same time have a greater impact on investors than offerings that are not contemporaneous. Deaktor, *supra* note 5, at 534. Arguably, the larger the number of offerees and the more securities offered and sold, the greater the impact will be on the market, thereby warranting enhanced disclosure. See *id.*

175. Requests for no-action letters often contain opinions by inquiring counsel that integration is not necessary to protect investors. See, e.g., Hawkeye Bancorporation, SEC No-Action Letter, 1976 WL 12602, at \*6 (Apr. 1, 1976); Safeguard Mini-Storage, SEC No-Action Letter, 1974 WL 11055, at \*3 (Jul. 29, 1974).

registration process and offerings that are legitimately separate. A fundamental aim of the integration doctrine is to combine offerings that have been artificially separated in an attempt to evade the Act's registration requirements.<sup>176</sup> Offerings should be integrated only when issuers have abused the Act's exemptions by splintering their offerings to take advantage of exemptions that would otherwise not have been available for a single offering. Under the current integration formula, however, offerings that are separated for legitimate business reasons may be combined because the inquiry made under the five factor test does not involve an evaluation of the issuer's need to make separate offerings.

None of the five factors in the SEC's integration formula is directly relevant to the question of whether an issuer divided its securities offerings to take advantage of exemptions that otherwise would not have been available. For example, the fact that offerings are part of the same plan of financing or are made for the same purpose does not necessarily indicate that the offerings were made separately to avoid registration. Similarly, an issuer that has made two or more offerings contemporaneously, for the same consideration, or involving the same class of security has not necessarily divided the offerings to use otherwise unavailable exemptions. The test in no way indicates whether an issuer has misused the Act's exemptions. Even where all five factors apply, an issuer may have made separate offerings for reasons that do not involve an attempt to evade the Act's registration requirements. When an issuer has not abused the Act's exemptions, but the application of the SEC's integration formula nevertheless results in the combination of separate offerings, the integration doctrine hampers the issuer's ability to raise capital even though there may be no corresponding benefit to potential investors.

In essence, the SEC's current integration formula merely indicates that the issuer could have structured the offerings as one transaction. The factors enable the SEC to "look behind ostensibly separate issues or transactions to see if, in economic reality, they are really a single issue."<sup>177</sup> The sole fact that the factors apply to two or more offerings, however, should not determine the integration question; rather, such a determination should only be used to identify offerings that could have been made as one offering in economic terms. Once this identification has been made, the transactions should be further analyzed before offerings are integrated, keeping in mind the Act's competing policies

---

176. See *supra* text accompanying notes 53-56.

177. Weiss, Peck, and Greer Venture Assocs. II, SEC No-Action Letter, 1990 WL 286380, at \*8 (Apr. 10, 1990).



and the fundamental goal of integration.<sup>178</sup> In sum, the SEC's test for integration must work so legitimately separate offerings will not be combined.

*B. The Proposal of the Task Force on Integration*

The profound changes in the area of securities regulation<sup>179</sup> prompted the American Bar Association's Committee on Federal Regulation of Securities to create a Task Force on Integration (the "Task Force"), which was instructed "to examine the entire integration area and to make proposals that would help the Commission and the securities bar to answer questions of integration."<sup>180</sup> The Task Force set out to articulate an analytical formula for determining when securities offerings should be integrated. The Task Force abandoned this goal, however, and instead proposed a series of safe harbor protections from integration.<sup>181</sup> These safe harbor provisions are useful, and they should be adopted. The safe harbor provisions alone, however, will not sufficiently resolve the integration problem. Issuers for whom no safe harbors from integration are available would still be forced to resort to the SEC's five factor integration formula.<sup>182</sup>

Recognizing that the SEC's current integration formula does not promote both of the countervailing policies of the 1933 Act, the Task Force sought to resolve some of the problems that frequently arise under the current regime. For example, the Task Force noted that "the [integration] concept could cause numerous sales to be integrated (and thereby registered) when their registration would not significantly enhance investor protection and could seriously impair the issuer's capital formation and operating plans."<sup>183</sup> The Task Force also recognized that many of the exemptions upon which issuers rely "have their own means for ensuring investor protection," rendering integration and registration of the offerings unnecessary.<sup>184</sup> The Task Force, attempting to resolve some of the problems that it addressed, sought to articulate objective criteria to determine whether offerings should be integrated. The Task Force proposed six safe harbors from integration: (1) an issuer safe harbor; (2) a temporal safe harbor; (3) a

---

178. See *infra* part V.

179. See *supra* text accompanying notes 167-70.

180. *Task Force on Integration*, *supra* note 43, at 596.

181. *Id.* at 596-97.

182. Safe harbors provide limited relief to the integration dilemma, for the provisions fail to address many transactions. See *supra* note 61.

183. *Task Force on Integration*, *supra* note 43, at 596.

184. *Id.*

securities safe harbor; (4) a purpose safe harbor; (5) a policy safe harbor; and (6) a foreign offering safe harbor.<sup>185</sup>

The Task Force's temporal safe harbor guarantees that offerings separated by periods of six months or greater will not be integrated.<sup>186</sup> Under this proposal, the timing of the offerings would be the sole consideration in determining whether the offerings are integrable. The Task Force also proposed a safe harbor under which offerings made for different purposes would not be integrated. The Task Force enumerated four specific purposes for which offerings could be made in reliance upon this safe harbor: raising working capital; eliminating specific indebtedness through an exchange offering; fostering relations with employees and officers; and acquiring specific properties or businesses.<sup>187</sup> Under the Task Force's proposal, two or more offerings that are made for different purposes among the four articulated will not be integrated.<sup>188</sup> Adoption of this safe harbor would solve several problems. First, it would eliminate the need to determine the weight of the same general purpose factor because the sole inquiry would be whether the purposes of the offerings differ. Second, the bright-line distinctions between the four categories of purposes would eliminate the inconsistent analyses of the same general purpose factor and the confusing overlap between it and the single plan of financing

---

185. *Id.* at 624. The safe harbors pertaining to issuer integration and the integration of domestic and foreign offerings are beyond the scope of this Article. Problems of issuer integration, which involve a determination that two business enterprises should be deemed a single issuer, are primarily found in the context of franchising or licensing arrangements and arise less frequently than problems of offering or venture integration. Also, the SEC has already provided significant guidance on the integration of foreign offerings with offerings made by the same issuer in the United States. The Task Force commented that:

Although the [1933] Act appears on its face to apply to offerings made by U.S. issuers outside the territorial jurisdiction of the United States, the Commission has taken the position that "the registration requirements of section 5 of the Act are primarily intended to protect the American investors." Accordingly, the Commission has not taken any action for failure to register securities of U.S. corporations distributed abroad to foreign nationals, even though use through jurisdictional means may be involved in the offering.

*Id.* at 639 (footnotes omitted). This Article only analyzes the Task Force's temporal, purpose, and securities safe harbor provisions.

186. *Task Force on Integration*, *supra* note 43, at 632-33. The Task Force's temporal safe harbor reflects the SEC's safe harbor provision embodied in SEC Rule 502, which protects Regulation D offerings made six months apart from integration. See *supra* note 61 discussing the SEC's safe harbor provisions. The Task Force acknowledged that the six-month period is arbitrary but found no compelling reason to select a different time period. *Task Force on Integration*, *supra* note 43, at 633.

187. *Task Force on Integration*, *supra* note 43, at 635.

188. *Id.*

factor in the SEC's current integration approach. Third, the Task Force's analysis would make possible an objective inquiry into whether the offerings were made for the same purpose. Because an objective determination does not depend upon the issuer's representation of its motives for making the offerings, there would be little room for an issuer to evade registration by manipulating its analysis of this factor.

The Task Force proposed a third safe harbor based on the type of securities offered, which would protect offerings involving different classes of securities from integration.<sup>189</sup> The Task Force proposed that four non-integrable classifications of securities be recognized: common stock; preferred stock; non-secured debt; and secured debt.<sup>190</sup> Issuers offering two or more securities that fall into separate categories among these four can take advantage of this safe harbor provision. Because the Task Force clearly defined the classes of securities, its security safe harbor alleviates much of the uncertainty encountered when analyzing the same class of security factor under the current integration test and reduces the ability of issuers to manipulate the same class of security factor to avoid integration by offering securities that vary in minor ways.<sup>191</sup>

The Task Force also proposed three policy safe harbors for offerings made in reliance on the exemptions from registration contained in sections 3(a)(9) and 3(a)(10) of the 1933 Act.<sup>192</sup> Under section 3(a)(9), securities "exchanged by the issuer with its existing security holders" are exempt from registration if no remuneration is given for soliciting the exchange.<sup>193</sup> Section 3(a)(10) exempts securities issued in an exchange offering where "the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness of such terms and conditions at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear" by any governmental authority authorized to grant such approval.<sup>194</sup> Adoption of these policy safe harbors would mean that reliance on the exemptions granted under sections 3(a)(9) and 3(a)(10) would not be undermined by the integration doctrine.

---

189. *Id.* at 633.

190. *Id.* at 633-34.

191. *See supra* notes 101-02 and accompanying text.

192. *Task Force on Integration, supra* note 43, at 636.

193. 1933 Act § 3(a)(9), 15 U.S.C. § 77c(a)(9) (1988). In essence, the offerees in a § 3(a)(9) transaction are deemed to be sufficiently familiar with the issuer and therefore do not require the disclosure that registration provides.

194. 1933 Act § 3(a)(10), 15 U.S.C. § 77c(a)(10) (1988).

The Task Force also recommended a third policy safe harbor precluding the integration of any exempt offering with any registered offering.<sup>195</sup> The Task Force reasoned that offerees of "otherwise exempt offerings are no worse off . . . than if the public offering had not taken place" and concluded that "an exempt offering made in close proximity to a public offering does not in any way diminish the protections afforded investors in the public offering."<sup>196</sup> These proposed policy safe harbors from integration reflect the Task Force's recognition that in at least three contexts, investor protection through registration is not necessary.<sup>197</sup>

Overall, the Task Force's proposed safe harbors appear to be helpful. When available, these safe harbors would allow prospective issuers to structure their transactions free from the uncertainties of the SEC's current integration formula. Under the safe harbor proposals, issuers would not be forced to discern the meaning of the poorly defined components of the current test. Nor would this approach require issuers to attempt to determine the number of factors needed to warrant integration or the weight that will be given to each factor. The proposed safe harbors would enable many prospective issuers to structure their transactions with certainty, thereby avoiding the expense and delay that issuers now incur in attempting to decipher the SEC's integration formula.

These safe harbor proposals, however, fail to resolve many of the problems associated with the SEC's integration policy.<sup>198</sup> The Task Force was unable to formulate a series of objective tests both comprehensive and flexible enough to govern the great variety of complex transactions that can be structured, and, as a result, the proposed safe harbors may not apply to many legitimately separated offerings. For

---

195. *Task Force on Integration*, *supra* note 43, at 638.

196. *Id.* The Task Force did note, however, that if an issuer failed to disclose to offerees of a registered public offering the issuer's plans for a subsequent exempt offering, the purchasers of the public offering may be able to seek relief under the Act's anti-fraud provisions. *Id.*; *see supra* note 11.

197. Many members of the Task Force supported additional policy safe harbors because they believed that there are other contexts in which statutory exemptions adequately protect offerees, making the applicability of the integration principle and resulting registration an unnecessary obstacle to capital formation. *See Task Force on Integration*, *supra* note 43, at 638 (noting that the exemptions available pursuant to SEC Rules 505 and 506 provide substantive protection for investors adequate to justify additional safe harbor provisions). Additional policy safe harbors, however, were not proposed due to the Task Force's fears that the proposals were too "controversial" and of "minimal importance." *Id.*

198. Indeed, the Task Force concedes that these safe harbor proposals provide only a "partial" solution to the integration problem. *Id.* at 641.

example, because the proposed securities safe harbor provides an arbitrary and broad categorization of types of securities, this safe harbor might not apply to offerings involving "differences among classes of securities that support, in a principled way, non-integration treatment."<sup>199</sup> If no other safe harbor were available, issuers that offered the same type of security in legitimately separate offerings could not rely on the proposed safe harbor, but would instead need to resort to the SEC's problematic integration formula to determine whether the offerings were integrable.<sup>200</sup> The same result would occur where an issuer offered securities belonging to types other than the four enumerated categories.

Similarly, the proposed purpose and temporal safe harbors would be unavailable to many issuers. For instance, the Task Force recognized three general purposes for securities offerings, one of which is "to raise funds for general purposes."<sup>201</sup> The Task Force noted, however, that a majority of a company's offerings could fall into this category.<sup>202</sup> Consequently, the issuers of those offerings must resort to the SEC's five factor integration formula to determine whether its offerings are integrable if no other safe harbor is available. Likewise, the temporal safe harbor only protects issuers that separate their offerings by a six month period.<sup>203</sup> Because many issuers must frequently and unexpectedly raise capital more than once within a six month period, however, the temporal safe harbor would not be available to them. This circumstance would force such issuers to analyze their transactions under the SEC's current integration formula, which is plagued with uncertainty and inconsistency.<sup>204</sup> As a consequence, these issuers would face the possibility of having their offerings integrated even though registration is not needed to protect investors and only serves to impede capital formation.

Like the SEC's current test for integration, analysis under the Task Force's proposed safe harbors involves neither a consideration of the need for investor protection nor an assessment of whether offerings have been splintered to avoid the Act's disclosure requirements. The proposed securities safe harbor fails to consider the policies behind the disclosure requirement in its integration analysis. In support of the

---

199. *Id.* at 634-35.

200. *Task Force on Integration*, *supra* note 43, at 635.

201. *Id.*

202. *Id.*

203. *Id.* at 632-33.

204. The Task Force refrained from commenting on or attempting to clarify the SEC's five factor test.

securities safe harbor, the Task Force stated that "[t]he nature of the securities offered is so fundamental to the integration concept that this criterion, in and of itself, should be the basis for a safe harbor."<sup>205</sup>

Yet, a fundamental principle embodied in the integration doctrine is that offerings that have been artificially separated to evade the Act's registration requirements should be combined in the interest of fulfilling the Act's purpose of investor protection.<sup>206</sup> Under the Task Force's safe harbors, an issuer's offerings might be integrated even though the issuer did not divide the offerings to avoid the costs of registration. The Task Force's consideration of the nature of the classes of securities offered is therefore insufficient because it can only assist the SEC and the courts in identifying whether offerings *could* have been combined as a single issue. In contrast, a more appropriate test would determine whether separate offerings *should* be integrated. Such a test would more appropriately consider the Act's goals of investor protection and facilitating commerce and would turn on whether the issuer deliberately splintered an offering in an attempt to evade the Act's registration requirements.

## V. PROPOSAL

The difficulty of the integration question must not preclude an articulation of a comprehensive formula for determining when offerings should be integrated. In response to an extremely unstable economy and incidents of fraud perpetrated against the investing public, Congress passed the Securities Act of 1933 in an attempt to restore investor confidence by requiring that issuers of securities disclose information relating to their business and their offerings.<sup>207</sup> Once again, a troubled economy calls for action in securities regulation. Investors must be protected from manipulation of the SEC's integration formula by issuers seeking to evade the Act's registration requirements.<sup>208</sup> At the same time, issuers, especially the smaller issuers that must raise capital frequently and in the most cost-efficient manner, must be able to determine with certainty whether their securities offerings must be registered. Formulating a clear test to determine whether offerings are to be integrated, a test that cannot be manipulated by issuers and that addresses the policies of the Act and the underlying policy of the integration doctrine itself, is a difficult task.

---

205. *Task Force on Integration*, *supra* note 43, at 633.

206. *See supra* text accompanying notes 53-56.

207. *See Keller & Gehlmann*, *supra* note 9, at 330.

208. *See supra* text accompanying notes 53-56, 87-89, 125.

In this Article, I propose a less easily manipulated and better defined integration analysis to replace the SEC's current integration formula. The proposed analysis (the "Proposal") would establish a two-part inquiry to determine whether offerings warrant integration. This analysis is flexible enough to accommodate a great variety of transactions and would not be as susceptible to manipulation by issuers attempting to avoid the Act's registration requirements.

*A. Step One: Consideration of the Task Force's Safe Harbors*

As an initial step, the SEC should adopt all the safe harbors proposed by the Task Force to alleviate the considerable confusion and uncertainty created under the current integration analysis. In addition, the SEC should adopt a safe harbor for issuers that make separate offerings that do not involve the same type of consideration. Four types of consideration can be enumerated: cash, services, securities, and assets. The fact that different consideration is given for two or more offerings, such as cash for one offering and services for another offering, generally indicates that the offerings have not been artificially divided to avoid registration. Where an issuer makes separate offerings for different consideration, there is typically a legitimate business reason for not structuring the offerings as one transaction.<sup>209</sup> When offerings raise different types of consideration, structuring the transactions as a single offering may cause undue complication and confusion.

Adopting these safe harbors under the first step of this Proposal will form the basis of an analysis that provides clarity and certainty for issuers. The availability of any one of these safe harbors can be objectively determined by either an issuer, the SEC, or the courts, thereby eliminating the need to perform a subjective inquiry into an issuer's intent. Although it may be possible to manipulate such objective criteria, the broad categories defining different purposes, consideration, and classes of securities under the safe harbor provisions will make it difficult for issuers to engage in the type of manipulative abuses that are possible under the narrow and ill-defined categories articulated under the current test.<sup>210</sup>

---

209. This intuitive assertion is derived from the observation that cash is ordinarily the consideration for most offerings. See *supra* text accompanying notes 109-11. Where cash is not the chosen consideration, the issuer may very well have a rational business reason for requiring the other type of consideration, thereby making separate offerings a more practical alternative.

210. Even though this Proposal does not consider the SEC's five factor test in determining whether offerings warrant integration, the analysis under the Proposal's safe harbors parallels the SEC's current integration formula in considering the timing and

Still, there are several deficiencies in the Task Force's proposal that make these safe harbors insufficient, on their own, to serve as the *sole* criteria on which to base the integration determination. First, these safe harbors fail to consider whether the offerees actually need the protection that registration affords and the extent to which integration will unnecessarily hamper an issuer's ability to raise funds.<sup>211</sup> Moreover, these safe harbors do not assess whether offerings have in fact been artificially separated to avoid registration.<sup>212</sup> Third, the Task Force itself acknowledged that the categories that it created to group, for example, types of securities or the timing of protected offerings within the safe harbors involved arbitrary line drawing that could not be justified in light of the purposes of the 1933 Act.<sup>213</sup> For instance, regarding the temporal safe harbor, one might ask why the offerees of offerings made seven months apart would be in less need of protection through registration than the offerees of offerings made six months apart, and whether this safe harbor could accomplish anything other than making it more difficult for issuers to raise money.

The safe harbors should not be the sole consideration in determining whether offerings warrant integration. Accordingly, the unavailability of any of the proposed safe harbors to a particular issuer should not alone lead to integration, but rather, it should only serve to identify offerings that could have been made as a single issue.<sup>214</sup> For example, contemporaneous offerings made for the same purpose and consideration and that involve the same class of security are offerings that could have been made as one transaction. Such offerings, however, are not

---

purpose of multiple offerings, the consideration given for the offerings, and the class of security offered. This Proposal and its preliminary step of examining various safe harbors would not, however, consider whether the offerings are part of a single plan of financing. Requiring integration because offerings form part of a single plan of financing penalizes issuers that plan ahead and unnecessarily hampers the raising of capital. Furthermore, there seems to be no objective method of determining whether offerings are part of a single plan of financing. The single plan of financing factor, which has not been clearly defined by the SEC, may require a determination of the issuer's intent to make a series of offerings at the time the first offering is made. Moreover, the analysis of this factor under the current test, which requires a determination of whether the offerings have been coordinated as to amount and timing or whether the offerings are independent, is too nebulous to be helpful. *See supra* part III.A. Discarding this factor eliminates some of the subjective ambiguity of the SEC's test as it now exists.

211. *See supra* text accompanying notes 201-06.

212. *See supra id.*

213. *Task Force on Integration, supra* note 43, at 633-35.

214. *See* Deaktor, *supra* note 5, at 541. Professor Deaktor suggested that the SEC's integration formula should be employed as a "sorting mechanism" to determine which offerings warrant scrutiny. *Id.* However, Professor Deaktor did not clarify how to resolve the integration issue once potentially artificially divided offerings had been identified.



necessarily transactions that an issuer has splintered to avoid registration. The unavailability of any of the proposed safe harbors should therefore only be used as a first step to inquire whether the transactions merit further scrutiny for integration.<sup>215</sup>

*B. Step Two: Consideration of a Rational Business Reason*

The second step of this Proposal requires a balancing of the 1933 Act's goal of protecting investors through registration with the countervailing goal of fostering capital formation. When an issuer satisfies the requirements of an exemption, the Act's goal of investor protection is deemed to be satisfied. In this situation, it is the policy of the Act to give more weight to the goal of facilitating commerce, and thus registration is not required. Accordingly, under the Proposal, offerings would not be integrated when registration would impede capital formation and the investor protection that registration affords has already been deemed unnecessary, unless of course, it is determined that the sole reason for splintering an offering into separate transactions was to avoid registration. Therefore, it is necessary to consider not only whether an issuer has satisfied the requirements of any of the safe harbors, but also whether the issuer has frustrated the Act's goals of investor protection and the facilitation of commerce by seeking to thwart the purposes behind the integration doctrine.

The purpose of the integration doctrine is to determine whether an issuer has artificially separated a securities offering solely to evade the 1933 Act's registration requirement. If the issuer can articulate a rational business reason for dividing its offerings, the issuer has not artificially separated its offerings for the purpose of evading the registration requirement. Because the inquiry into whether an issuer has a rational business reason for making separate offerings goes directly to the heart of the integration doctrine, it is necessary under this Proposal's second step to inquire into the issuer's reason for dividing its offerings. Where an issuer provides a rational business reason for the separate offerings, the purpose of the integration principle has not been frustrated, and the offerings therefore need not be integrated. If, however, the issuer's management cannot articulate a rational business reason for dividing the transaction, the issuer has failed to demonstrate that it did not separate its offerings solely to avoid registration, and the offerings must therefore be integrated.

---

215. This examination may be made by the issuer in structuring its transactions or by the SEC or courts in examining whether two or more offerings could have been structured as one transaction.

Moreover, the expression of a rational business reason satisfies the Act's goals of investor protection and the facilitation of commerce. Obviously, if an issuer has a rational business reason for dividing offerings, it is likely that the issuer chose to separate the offerings because it would help the issuer to raise money. Also, because the articulation of a rational business purpose makes it clear that an offering has not been artificially separated, the goal of investor protection has been satisfied. This can be explained by considering the purposes behind the exemptions from registration. If an exemption from registration is legitimately available to an issuer, then one may safely assume Congress has already determined that the offerees are adequately protected and that an offering was not artificially separated. Consequently, registration would be an unnecessary impediment to capital formation. Where an issuer has a rational business reason for splintering an offering, it is similarly clear that the offering was not artificially separated and that investors do not need the protection of registration. Thus, the expression of a rational business reason for multiple securities offerings satisfies both of the Act's goals of investor protection and the facilitation of capital formation.

I offer several examples of rational business reasons for making separate securities offerings. First, to raise working capital, an issuer might make an offering to a limited number of sophisticated investors having access to all the information relevant to the issuer and the offering. Shortly thereafter, the issuer might unexpectedly be forced to make a subsequent offering to a similar group for the same purpose. The issuer that must make several offerings to raise funds for unforeseen financial needs in a short period of time has a rational business reason for having structured separate transactions. Second, an issuer that plans to use different methods of distribution<sup>216</sup> has a rational business reason for making separate offerings. Structuring the transaction as a single offering will in most instances be unduly confusing. Because the issuers in these examples have rational business reasons for making separate transactions and did not splinter the transactions to avoid registration, integration would not be warranted under the analysis proposed in this Article. Although the application of the SEC's current integration formula to these examples might yield the same result, depending on the number of factors deemed applicable, it is also possible that the offerings would be integrated under the SEC formula. Integration in these instances, however, would impede capital formation where the exemptions from

---

216. An underwritten offering, for example, involves a different method of distribution than an offering that is not underwritten.

registration have been properly employed.

Arguably, one could compose a non-exclusive list of business reasons for separating transactions that are made contemporaneously or for the same purpose, or that involve the same consideration or class of security. Such a list would help an issuer that must make several contemporaneous offerings to plan its offerings by determining whether its reason for making the separate offerings comports with one of the listed reasons. This would provide issuers with certainty that the offerings will not be integrated. Additionally, a list of acceptable rational business reasons would preclude issuers from manipulating this test by fabricating business reasons for making separate offerings. For instance, an issuer that splinters one offering because it claims that registration would have been too expensive and time consuming has not stated a rational business reason for separating its transactions. Costliness in terms of time and money is a good business reason for relying on legitimately available exemptions, but not for separating offerings to avoid registration. The list, however, must not arbitrarily exclude other legitimate and rational business reasons. A non-exclusive list will retain the flexibility needed in an integration formula.

Requiring a rational business reason for making separate offerings will not entirely resolve the uncertainty that confronts issuers when structuring securities transactions. Issuers that legitimately separate transactions and have a rational business reason for doing so, however, can be assured that even where offerings involve the same class of security, are made for the same purpose and consideration, and are made at or about the same time, their offerings will not be automatically integrated without further analysis under this Proposal.

## VI. CONCLUSION

The ability of issuers to manipulate the factors of the SEC's current integration formula allows them to avoid the application of the integration doctrine and thereby successfully evade the Act's registration requirements. Such practices leave investors without the protection that the Securities Act of 1933 was intended to provide. Under the integration analysis proposed in this Article, the benefits of disclosure are retained when exemptions from registration are unavailable because issuers are not able to avoid integration easily by manipulating the factors. Not all potential manipulation to evade integration is eliminated under this Proposal. Issuers might attempt to manipulate the more objective components of the sorting mechanism identified in this Proposal's first step. There is also the possibility that some

issuers will fabricate a business reason for separating offerings. This type of deception, however, is more easily detected than the subtle type of manipulation that can occur under the current SEC test. Under the second step of this Proposal, the honest issuer, the issuer that is not deliberately attempting to evade the Act's registration requirements, can be certain that its securities offerings will not be integrated if it has a rational business reason for making separate offerings.

The first step of the Proposal provides some degree of certainty for issuers that structure their securities transaction by focusing on the objective requirements of the safe harbors from integration. The fact that offerings were made contemporaneously, that offerings involve the same class of security, or that offerings were made for the same purpose or consideration will not determine the integration question, but will instead merely identify offerings that may have been artificially divided. Through the balancing that must be performed under the second step, this Proposal examines whether offerings should be integrated. Offerings would be integrated only when the issuer failed to advance a rational business reason for separate offerings. This process would avoid integration and subsequent registration where integration of the offerings would only impede capital formation and do nothing to protect investors.

Most importantly, this Proposal expressly addresses both of the Act's countervailing policies, investor protection and the facilitation of commerce. The integration doctrine has changed little since its inception in 1933. Since then, many substantive protections have been added to the Act's exemptions.<sup>217</sup> Registration is not always required for investors to be protected. Now that investors are protected by the requirements of the exemptions themselves, securities offerings should not be integrated when registration is unnecessary for investor protection and when registration would only hamper the ability of investors to raise funds.

---

217. *Task Force on Integration*, *supra* note 43, at 598.

