The Integration Conundrum: Debilitating Failures of the Securities and Exchange Commission Must Be Addressed as Corporate Malfeasance is 'Getting Serious, So Serious'

andré douglas pond cummings

Recommended Citation


andré douglas pond cummings†

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†Visiting Assistant Professor of Law, Syracuse University College of Law. J.D., 1997, Howard University School of Law; B.S., 1994, Brigham Young University.

Many thanks to Azin Lotfi (Kirkland & Ellis, San Francisco), Justin Evans (United States District Court, Oklahoma City) and Ben Bates (Kirkland & Ellis, Chicago), successful and intelligent corporate and securities practitioners, for reading and making excellent comments to early drafts of this Article. Gratitude also to Associate Dean Leslie Bender, Syracuse University College of Law and Professor Margaret Harding, Syracuse University College of Law for superb and helpful comments to subsequent drafts of this article. Thanks to Heather Campbell and Rebekah Bina, Syracuse University College of Law class of 2004, for excellent and able research assistance. Enormous thanks also to Jo Davies for her usual excellence in editing assistance and for loyal friendship. Finally, thanks to Lavinia Mann Cummings, my singular inspiration, for encouragement and unbelievable support. Of course, as usual, the politics and errata of this article belong exclusively to me.

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I. INTRODUCTION

The Securities and Exchange Commission (SEC) has come under intense scrutiny in recent months as the United States capital markets have...
vacillated wildly on the heels of the collapse of U.S. corporate giants Enron Corporation and WorldCom Inc. and big five accounting firm Arthur Andersen LLP. Enron’s board of directors and management have been

All of those CEOs who received million-dollar deals at the expense of their stockholders have no fear of reprisal from our government.”); see also infra note 9.

In response to various criticisms of the SEC’s failure to police the accounting profession, former SEC chairperson Harvey Pitt openly admitted the critical need for SEC reform in stating “[t]his commission cannot and . . . will not . . . tolerate a pattern of growing restatements, audit failures, corporate failures and massive investor losses. Somehow we have got to put a stop to the vicious cycle that has now been in evidence for far too many years.” Chairman Harvey L. Pitt (transcript Public Statement by SEC Chairman: Regulation of the Accounting Profession, Jan. 17, 2002, available at http://www.sec.gov (accessed from homepage by selecting Speeches and Public Statements from the News and Public Statements list, and then selecting Speeches and Statements by the Chairman and Commissioners and scrolling down to the link for the Jan. 27, 2002 speech) (last visited Feb. 10, 2003)). Pitt has openly admitted that:

[o]ver the last decade or so, this Country’s vaunted system of disclosure, financial reporting, corporate governance and accounting practices has shown serious signs of failing to keep up with the needs of today’s investors, our economy, and new technology that makes rapid communications not only possible but essential. The latest example—a most tragic and unprecedented one—is the failure of Enron . . . . Our disclosure and financial reporting system is still the best in the world, but it has long needed improvement. Its inadequacies are more visible after Enron’s failure, and the need for change cannot be ignored any longer. This is not a problem that arose overnight.

Id.; see also infra note 9.

In October 2002, despite open admissions of SEC inadequacy by then SEC chairperson Pitt, a U.S. Senate committee, following an exacting investigation, formally found that the SEC “dropped the ball on Enron” and “failed to discover and prevent the massive accounting failure at Enron Corp.” See Panel: SEC Dropped the Ball on Enron, CNN MONEY, Oct. 7, 2002, available at http://money.cnn.com/2002/10/07/news/companies/enron_senate.asp/index.htm (accessed from homepage by entering title into CNN/Money) (last visited Mar. 13, 2003) (“The Senate Governmental Affairs Committee, which has investigated the role of the [SEC] and industry watchdogs in [Enron’s] stunning collapse since early summer, said oversight must be tighter. It said the failures could be pinned on financial analysts, credit rating agencies and auditors, as well as the SEC.”).

4. See Justin Lahart, The Crash of 2002, CNN MONEY, July 19, 2002, available at http://money.cnn.com (accessed from homepage by entering the search terms “Crash of 2002” into the CNN/money search engine) (last visited Feb. 10, 2003) (“Ten trading days, 1,360 points off the Dow. Let’s start calling the ‘sell off’ what it is. Let’s call it a panic. Let’s call it a crash. Indeed, after rallying following Sept. 11, the markets topped out in March [2002], and have been careening downward ever since.”); see also Market Update: A Modest Recovery, MONEYWHYS (The Vanguard Group, Inc., Valley Forge, P.A.), Spring 2002, at 5. The Vanguard Group, in a quarterly newsletter to its investors, details the recent “volatile” and “unsettling” market swings brought about through “concern about the integrity of corporate financial statements in the wake of the Enron accounting scandal.” Id. at 2, 5; see also Jake Ulick, Stocks: Can It Get Worse?, CNN MONEY, June 8, 2002,
criminal charged and vilified and the energy giant has, for all intents and

available at http://money.cnn.com/2002/06/07/markets/sun_lookahead/index.htm (accessed from homepage by entering title in CNN/Money search engine) (last visited Feb. 10, 2003) (theorizing that market volatility will continue into the foreseeable future as “major indexes continue to see short, violent surges amid long term declines”); Adam Shell, Stocks Continue to Sink, With No Bottom in Sight, USA TODAY, June 24, 2002, at 1B (“[A]nxiety is running high on Wall Street. Cries of ‘Where’s the bottom?’ and ‘How low is low?’ have resurfaced. . . . Confidence has been rocked by steadily falling stock prices and highly publicized scandals that have ‘outed’ crooked accounting firms, greedy CEOs and biased equity analysts.”).

Former SEC Chairperson, Harold Williams, responding to a request for reform recommendations from the Senate Banking Committee, stated “that recent events have resulted in a crisis of confidence unlike any [he has] experienced in over 50 years.” Former SEC Chairmen Offer Views on Problems Raised by Enron’s Collapse, SEC TODAY (CCH Washington Service Bureau), Feb. 21, 2002, at 1 (emphasis added); see also Robert J. Samuelson, Optimists—Or Just Dreamers?, NEWSWEEK, Jan. 14, 2002, at 39. “So many unfamiliar forces are now tugging at the economy that a coherent outlook is hard, maybe impossible. No one truly knows what will happen—especially, how long it will take consumers and businesses to recover . . . .” Id.

As fraudulent accounting practice admissions mount, and as corporations collapse under the weight of their own deceptions, the U.S. capital markets are held hostage, waiting for the next enormous collapse. See David Saito-Chung & Jonah Keri, Stocks Undercut Lows on WorldCom Worries, But Recover at Close, INV. BUS. DAILY, June 27, 2002, at A1 (“WorldCom’s admission of financial wrongdoing rocked the stock market Wednesday [June 26, 2002] and left investors wondering how and when the epidemic of sickly accounting will be cured.”). See generally Joseph Nocera, System Failure: Corporate America, We Have a Crisis, FORTUNE, June 24, 2002, at 62.

5. See Louisa Beltran, Lay Signed Off On Deal: Former Enron CEO Stays Silent at Hearing, Document Appears to Tie Him to LJM2, CNN MONEY, Feb. 12, 2002, available at http://money.cnn.com/2002/02/12/news/enron_lay/index.htm (accessed from homepage by entering “Lay Signed Off on Deal” into the CNN/money search engine) (last visited Feb. 10, 2003) (stating that former Enron Corp. Chairman and CEO Kenneth “Lay . . . sat through 90 minutes of attacks from congressional investigators . . . before he declined to testify” before a Senate panel probing the collapse of the former energy trader). Kenneth Lay, who had been considered as a possible Energy Secretary for the Bush administration, invoked his Fifth Amendment privilege against self-incrimination when he refused to testify before the Senate Commerce Committee. Id. Enormous criticism has been leveled against the management and board of directors of Enron as evidence surfaced linking Enron leadership to various accounting smoking guns. See Enron Board Aware of Moves, CNN MONEY, Jan. 31, 2002, available at http://money.cnn.com/2002/01/31/news/enron_board (accessed from homepage by entering “Enron Board Aware of Moves” in the CNN/money search engine) (last visited Feb. 10, 2003) (“Enron board members received detailed information about the controversial partnerships that the collapsed energy trader used to inflate profits and hide debt as early as four years ago, according to a newspaper article [Washington Post] . . . that cites minutes from four board meetings.”). These smoking guns eventually exposed stunning depths of corporate officer fraud leading to high profile arrests and indictments of former Enron officers Andrew Fastow (chief financial officer) and Michael Kopper (assistant chief financial officer). See Enron Ex-CFO Indicted: Andrew Fastow Hit With 78-Count
purposes, collapsed; Arthur Andersen, Enron’s accountant, has been criminally charged, convicted and ruined; and WorldCom has had fraud charges


As Chicago-based Andersen fights for its corporate life in a Houston courtroom, the accounting giant has been hemorrhaging clients at a breathtaking rate, reinforcing serious questions about what, if anything, will be left to carry on, even if it wins its legal battle. Since the scandal surrounding Enron Corp. exploded and Andersen was indicted on a federal obstruction-of-justice charge, auditing clients have been leaving in droves—nearly 600 in the past three months alone.

levied against it by the SEC and faces a grueling bankruptcy,\(^8\) and at the same time the SEC has similarly come under severe criticism. The harsh

Investigation of Enron Failure, Chl. TRIB., June 16, 2002, at 1-1 ("In an inglorious end to its 89-year history as the country’s pre-eminent accounting firm, Chicago-based Andersen was convicted Saturday of obstruction of justice for interfering with a federal investigation of its failed client, Enron Corp.").


8. Tammy Williamson & Francine Knowles, Faith In Corporate America Crumbles: Bush Comes Out Firing: SEC Files Fraud Charges, Chl. SUN-TIMES, June 27, 2002, at 7. ("As investors around the world choked on the news that long-distance giant WorldCom, Inc. improperly hid losses of $3.8 billion and could go bankrupt, President Bush called its accounting practices ‘outrageous.’"). Further, then-SEC chairperson Harvey Pitt announced, "the agency had filed fraud charges against WorldCom in federal district court in New York." Id. After revelations of accounting fraud surfaced, WorldCom CFO Scott Sullivan was summarily dismissed. Scandal, Inc.: Wrong Numbers at WorldCom, Chl. SUN-TIMES, June 27, 2002, at 1 ("Fired: CFO Scott Sullivan for hiding expenses."); see also infra notes 9, 10, 314.

In an eerily familiar scene, reminiscent of Enron’s congressional hearings, WorldCom’s senior management, when called to testify before the House Financial Services Committee to account for management action or inaction in light of the company’s collapse, refused to testify. WorldCom Execs Stay Mum: A House Panel Begins WorldCom Hearings, CNN MONEY, July 8, 2002, available at http://money.cnn.com/2002/07/08/news/companies/worldcom/index.htm (accessed from homepage by entering title on the CNN/Money search engine) (last visited Feb. 10, 2003) ("Two former executives who led WorldCom when it overstated profits declined to testify Monday [July 8, 2002] before federal lawmakers angered by Corporate America’s widening accounting scandals."). WorldCom management silence “outraged” members of the House Committee trying to get to the bottom of the scandal that bankrupted the nation’s number-two long distance telephone provider. See id.; see also infra note 10.
criticisms lodged against the SEC malign the government agency for its failure to appropriately monitor the accounting profession, detect particular reporting illegalities or irregularities in various collapsing public companies, and ultimately for its failure to honor its charge to protect the

9. See supra note 3. Senator Tom Daschle (D., South Dakota) upon learning of the enormous fraudulent financial misstatements of WorldCom Inc., publicly blasted then SEC chairperson Harvey Pitt and the SEC for failure to monitor, discover fraud and appropriately punish corporate wrongdoers. MSNBC Live (MSNBC television broadcast, June 26, 2002); see also Tom Hamburger et al., WorldCom Scandal Spurs Congress, WALL ST. J., June 27, 2002, at A8 ("Sen. Daschle directly criticized Mr. Pitt yesterday as ‘not doing the job.’"). Criticism of both Harvey Pitt and the failures of the SEC have been bipartisan in nature, as both Republicans and Democrats blasted President Bush's former SEC director. See President to Take Wall Street to Task (July 9, 2002), available at http://www.cnn.com/2002/ALLPOLITICS/07/08/bush.corporate.abuse/index.html (last visited Feb. 9, 2003) ("Members of both parties have singled out SEC Chairman Harvey Pitt, a former securities industry lawyer whose clients once included the now embattled accounting firm Arthur Andersen. The White House has vigorously defended him, claiming Pitt has done a ‘great job,’ but some lawmakers disagree."). One prominent Republican Senate leader called upon then-Chairperson Pitt to resign his position as SEC head, in order to take a step toward regaining investor confidence in U.S. corporate practice. John McCain, The Free Market Needs New Rules, N.Y. TIMES, July 8, 2002, at A19 ("Congress and the president must move quickly to frame legislation and reform corporate governance and government oversight. And I would add one more suggestion: they should ask for the resignation of Harvey Pitt. . . . While Mr. Pitt may be a fine man, he has appeared slow and tepid in addressing accounting abuses, and concerns remain that he has not distanced himself enough from former clients."). But see SEC's Pitt Lashes Out at Critics, CNN MONEY, July 16, 2002, available at http://money.cnn.com/2002/07/15/news/pitt/index.htm (accessed from homepage by entering title into CNN/Money search engine) (last visited Feb. 9, 2003) ("[SEC] Chairman Harvey Pitt lashed out at his detractors Monday [July 15, 2002], suggesting their calls for his resignation are politically motivated.").

Finally, succumbing to unrelenting criticism, embattled SEC Chairperson Harvey Pitt announced his resignation on November 5, 2002. SEC Chairman Pitt Resigns: Embattled Chairman Resigns, Faced Criticism Throughout Tenure (Nov. 5, 2002), available at http://abcnews.go.com/sections/us/dailynews/pitt021105.html (accessed from homepage by entering title in search engine) (last visited Feb. 10, 2003) ("Pitt, who first worked at the SEC in the late 1960s and built his career as an attorney in . . . Washington, has been criticized for meeting with the heads of companies under SEC investigation. . . .").

10. See supra notes 4, 8; see also David Greising, Enough Already: Reform Now, From the Top, CHI. TRIB., June 9, 2002, at 5-1 (detailing the recent surge in corporate scandal resulting in related stock drops). In reporting on the recent accounting misrepresentations of such companies as Kmart, Abbot Laboratories, Cendant Corp., and General Electric, among others, Greising writes that:

There was a time when all it took to follow business was a good eye for strategy and a good head for numbers. Now we need a good nose for a scandal and a strong stomach for indigestion. . . . By some estimates, investors have lost $4 trillion in market value in scandal-related stock drops.

Id. (emphasis added).
United States investing public and secure the integrity of the U.S. capital markets.11


Further, the former chairperson and two former senior executives of Rite Aid Corporation were recently indicted "in what authorities described as a far-reaching securities and accounting fraud that prompted the largest restatement of corporate earnings in American history." Former Rite Aid Executives Charged With Defrauding Investors, N.Y. TIMES, June 21, 2002, available at http://www.nytimes.com/aponline/business/ap-rite-aid.html ("'The charges announced today reveal a disturbing picture of dishonesty and misconduct at the highest level of a major corporation,' said Wayne M. Carlin, northeast regional director of the SEC. 'Rite Aid's former senior management employed an extensive bag of tricks to manipulate the company's reported earnings and defraud its investors.'").

Further, with what has been modestly deemed "creative accounting," WorldCom Inc. duped investors for over fifteen months claiming large profit margins when in fact the company was losing money steadily. Jared Sandberg, Sorry, Wrong Number: Inside WorldCom's Unearthing of a Vast Accounting Scandal, WALL ST. J., June 27, 2002, at A1 (detailing the unorthodox hiding of expenses as capital expenditures by WorldCom's Chief Financial Officer, Scott Sullivan, in effect misstating over $3.8 billion of expenses that were improperly booked and must now be restated); see also supra note 8. In fact, such corporate malfeasance had many commentators correctly predicting that WorldCom would file for bankruptcy, making it the largest corporate failing of its kind, leading to serious problems for the "nation's long-distance phone industry." Reinhardt Krause, WorldCom Collapse is Likely to Force a Rethinking of U.S. Telecom Policies, Others to Feel Squeeze, Too, INV. BUS. DAILY, June 27, 2002, at A1 ("The No. 2 long-distance firm, WorldCom is near bankruptcy. It disclosed a multibillion-dollar accounting fraud . . . sending shock waves through an already sick industry."); see also Simon Rivero & Riva D. Atlas, WorldCom Files for Bankruptcy; Largest U.S. Case, N.Y. TIMES, July 22, 2002, at A1 (detailing WorldCom's Chapter 11 bankruptcy filing); see also infra note 314.

Further, the deluge of corporate accounting misrepresentation includes enormous overstated earnings by Xerox Corp., wherein Xerox settled fraud charges with the SEC by agreeing to restate five years of revenue and pay a $10 million fine, "the largest ever involving alleged financial reporting fraud." Kathleen Day, Xerox Restates 5 Years of Revenue: '97-'01 Figures Were Off by $6.4 Billion, WASH. POST, June 29, 2002, at A1 ("Xerox Corp. announced yesterday [June 28, 2002] that accounting errors forced it to restate $6.4 billion in revenue for the past five years, more than twice the $3 billion anticipated. . .").

11. See The Investor's Advocate: How the SEC Protects Investors and Maintains Market Integrity (December 1999), available at http://www.sec.gov/about/whatiswd.html (last visited Feb. 8, 2003) ("The primary mission of the U.S. Securities and Exchange Commission (SEC) is to protect investors and maintain the integrity of the securities markets. As more and more first-time investors turn to the markets to help secure their
At this volatile economic time and at a time when consumer and investor confidence is severely shaken, former SEC chairperson Harvey L. Pitt futures, . . . these goals are more compelling than ever.”). The SEC, on its website, declares that its primary responsibility is to protect those that invest in the United States capital markets. *Id.* The SEC describes its conceptual mandate as follows:

The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public, which provides a common pool of knowledge for all investors to use to judge for themselves if a company’s securities are a good investment. Only through the steady flow of timely, comprehensive and accurate information can people make sound investment decisions.

*Id.* Following the dual collapse of Enron and Arthur Andersen, and acknowledging the criticism and need for reform, the SEC has begun to take steps to address the issues and problems that allowed Enron’s ultimate failure. *Pitt Says SEC Plans to Respond Swiftly to Recent Crises*, SEC TODAY (CCH Washington Service Bureau), Feb. 25, 2002, at 1 (“The SEC cannot wait for Congressional action, which could take too long, so the Commission is proceeding with an ambitious program of rulemaking and an overhaul of its present system. . . . Every profession needs diligent and vigorous oversight and quality control and accountants are no exception. Pitt said a regulatory system for accountants should have been put in place years ago and the SEC intends to put one in place as soon as possible.”); see also *Former SEC Chairmen Offer Views On Problems Raised by Enron’s Collapse*, supra note 4, at 1 (“Five former SEC chairmen last week offered their views on accounting and investor protection issues that have arisen in the aftermath of Enron Corp.’s collapse. The chairmen outlined a number of recommendations for reform in written statements submitted to the Senate Banking Committee.”).

Despite pledges of reform, the SEC continues to be starkly criticized for its breakdowns in the wake of “stunning corporate failures that exposed the severe regulatory shortcomings” of the agency once considered “one of the brightest stars in the constellation of federal regulatory agencies.” Stephen Labaton, *In Stormy Time, S.E.C. Is Facing Deeper Trouble*, N.Y. TIMES, Dec. 1, 2002, at A1 (hereinafter Labaton, *S.E.C. Is Facing Deeper Trouble*) (“The Securities and Exchange Commission, still reeling from the recent resignation of its chairman, Harvey L. Pitt, and other top officials, is plagued by problems that go deeper than its leadership difficulties and have undermined its ability to police companies and markets. . . .”).

Additional censure of the SEC and former chairperson Pitt has come from the General Accounting Office (an investigative arm of Congress) who, following an investigation into the SEC’s efforts to organize and seat an accounting oversight board, determined that the SEC under Pitt has been an “agency in chaos.” Stephen Labaton, *Government Report Details a Chaotic S.E.C. Under Pitt*, N.Y. TIMES, Dec. 12, 2002, available at http://www.nytimes.com/2002/12/20/business/20PITT.html (“The Securities and Exchange Commission under Harvey L. Pitt was described today as dysfunctional by a government report examining the agency’s selection of a new accounting oversight board.” (emphasis added)).

12. See supra notes 3, 4. In a rare public appearance, and in an even rarer admission, Henry M. Paulson, Jr., the chairman and chief executive of Goldman Sachs admitted that “faith in corporate executives was at a low and was forestalling a recovery in financial
openly acknowledged the weaknesses of the SEC and the need for immediate reforms within his agency, particularly with regard to monitoring and regulating the accounting profession. Former chairman Pitt has stated decisively that "restoring public confidence" is one of the SEC's most urgent priorities. Meanwhile, others have pointedly brought to light the "regulatory black hole[s]" that currently exist within the securities laws, which basically allow public companies to "shield volatile assets from quarterly financial reporting and to artificially inflate the[ir] value." One such identifiable regulatory black hole essentially facilitated the Enron debacle, as carefully orchestrated by its management.

markets." Patrick McGeehan, Goldman Chief Urges Reforms in Corporations, N.Y. TIMES, June 6, 2002, at A1. Paulson continued by tracing the financial market crisis back to the collapse of the Enron Corporation last fall, and saying "I cannot think of a time when business over all has been held in less repute." 

13. See supra notes 3, 11.
14. See SEC Seeks Accounting Reform, supra note 3.
15. Enron's Use of Derivatives Examined, in 4 CORPORATE SECRETARY'S GUIDE 52 (CCH Apr. 9, 2002) (reporting that the fall of Enron involved derivatives trading where Enron was compared to an OTC (over the counter) derivatives trading firm operating within a "regulatory black hole"). Testifying before the Senate Governmental Affairs Committee, University of San Diego law professor Frank Partnoy testified that it "appears that some Enron employees systematically used 'dummy accounts' and 'rigged valuation methodologies' to create false profit and loss entries for the derivatives Enron traded." Id. Professor Partnoy continued by noting "that the OTC derivatives markets are largely unregulated and Enron's trading operations were not regulated, or even recently audited, by securities regulators." Id. Professor Partnoy also described Enron's complex use of this regulatory black hole as follows:

Specifically, Enron used derivatives and special purpose vehicles to manipulate its financial statements in three ways. First, it hid losses it suffered on technology stocks. Second, it hid huge debts incurred to finance unprofitable new businesses, including retail energy services for new customers. Third, it inflated the value of other troubled businesses, including its new ventures in fiber-optic bandwidth.

With regard to hiding losses, a critical piece of the puzzle, the element that made it all work, was a derivative transaction called a price swap derivative between Enron and a special purpose entity, or SPE.

Id. Enron's management was able to deftly hide massive losses from investors and shareholders using complex partnership structures, thereby artificially inflating company value. Id.

16. Id.
17. See generally supra notes 5, 6. The massive failure of the Enron Corporation may very well represent an unparalleled corporate collapse in United States history. As recent commentators noted:

It seems hard to believe now, but Enron (ENE) used to be the envy of corporate America. In less than a decade, the Houston company transformed itself from stodgy gas-pipeline operation to natural gas and electricity trading powerhouse.
Dazzled by sizzling earning growth, giddy investors bid up Enron's shares 312% in two years to a high of $90.75 in 2000. Then someone turned out the lights. Beset by marketplace woes and management mishaps, the stock already had tumbled 53% when chief executive Jeffrey Skilling stunned investors by resigning last August. After that, the bad news came at hyperspeed: $1.2 billion in shareholder equity zapped by risky hedging deals, a Securities and Exchange Commission probe, a last-chance merger with rival Dynegy called off and, finally, a bankruptcy filing. By the end of November [2001], the stock had plummeted to 26 [cents], obliterating $67 billion in market cap—a shocking fall for a company that just last year occupied the No. 7 spot on the Fortune 500.

Lisa Gibbs et al., Enron: The Lessons for Investors, MONEY, Jan. 2002, at 30. Despite the collapse and mounting evidence to the contrary, various board members and management figures continually denied knowledge of the impending doom awaiting Enron. Id. at 30-31 ("When pushed to reveal more, management was often tight lipped and unprofessional. During one famous conference call last April [2001], [CEO] Skilling called an analyst an 'asshole' for complaining about the company's failure to provide a balance sheet with its earnings announcement.").

A U.S. Senate report belied Enron management's professed ignorance to circumstances leading up to the Enron collapse; specifically, it found that the Enron board of directors clearly knew of Enron's "high-risk accounting and off-the-books deceptions." Carrie Johnson, Senate Report Criticizes Enron Board in Collapse, CHI. TRIB., July 7, 2002, at 1-11 ("The members of Enron Corp.'s board of directors contributed to the company's collapse by failing to curb the Houston energy trader's risky accounting tactics, approving conflicts of interest, and rubber-stamping enormous cash payouts to executives, according to a harshly worded Senate report to be released Sunday."). The Senate report determined that "[t]he board witnessed numerous indications of questionable practices by Enron management over several years, but chose to ignore them to the detriment of Enron shareholders, employees and business associates." Id.


In the year before the Enron Corporation collapsed last December, about 100 executives and energy traders collected more than $300 million in cash payments from the company, according to documents filed today [June 18, 2002] in bankruptcy court.

More than $100 million . . . went to Kenneth L. Lay, the company's former chairman and chief executive.

A majority of the cash payments went to employees of units whose profitability has been called into question since the company's collapse . . .

The disclosure of scores of large cash payments is certain to increase the ire of former lower-level employees who have long complained about how high-level executives sold more than $1 billion in Enron shares in the year before the company filed for bankruptcy protection.
The SEC has pledged to address such regulatory problems as it seeks to reform its decades old system of periodic disclosure and financial reporting. Ultimately, much needed reform will necessarily fall on the shoulders of the SEC as Congress struggles to address corporate malfeasance through legislation. In this atmosphere of shaken public confidence and congressional bickering amid cautious congressional revision, the SEC is now under intense pressure to move forward quickly.

Yet even as the company was hurtling toward bankruptcy, some . . . executives were showered with huge retention bonuses worth nearly $100 million. Id.

18. See Pitt, supra note 3 ("Our system of periodic disclosure . . . is old and not good enough. Today, disclosures are made not to inform, but to avoid liability. We need to move to a system of 'current' disclosure. The present system, which has been in effect for 67 years, doesn't provide for 'current disclosure.' Financial disclosures are dense, impenetrable.").

19. See Stephen Labaton & Richard A. Oppel, Jr., Enthusiasm Ebbs for Tough Reform in Wake of Enron, N.Y. TIMES, June 10, 2002, at A1 ("Six months after the collapse of Enron, a wave of enthusiasm for overhauling the nation's corporate and accounting laws has ebbed and the toughest proposals for change are all but dead."). The New York Times reported that a powerful group of lobbyists, using partisan disagreements in Congress as its tool, appears to have killed congressional efforts to "impose tight new controls on corporate conduct." Id. ("Bills imposing more stringent accounting standards, changing the tax and accounting treatment of employee stock options and setting tougher conflict-of-interest rules for stock analysts and accounting firms have all fallen victim to political gridlock."). But see Hamburger et al., supra note 9 (indicating that Congress may be spurred to action based on the WorldCom scandal, after the reform furor had died down over Enron). "The giant WorldCom accounting scandal is giving a powerful boost of energy to the drive in Congress to clean up business practices, accelerating legislation reining in the accounting industry and shooting new life into a range of other corporate-reform proposals." Id.

In the midst of market chaos, some on Wall Street are trying to persuade Congress to eviscerate certain state power over securities regulation. Gretchen Morgenson, A Wall St. Push to Water Down Securities Laws, N.Y. TIMES, June 18, 2002, available at http://www.nytimes.com (accessed from homepage by selecting Search and entering "Gretchen Morgenson and Securities Regulation") (last visited Feb. 11, 2003). ("Some members of the securities industry are pushing Congress to prevent states from pursuing those who violate securities laws, including Wall Street firms now under investigation for conflicts of interest by their stock analysts. . . . [T]he draft of the amendment . . . would block the states' current investigation of stock analysts and would severely restrict their enforcement of securities laws in the future. . . .")

20. See David E. Sanger & Richard A. Oppel, Jr., Senate Unanimously Passes Corporate Reform Measure, N.Y. TIMES, July 16, 2002, available at http://www.nytimes.com/2002/07/16/business/16SENA.html (last visited Feb. 11, 2003) ("The Senate tonight [July 15, 2002] unanimously passed a broad overhaul of corporate fraud, accounting and securities laws to curb the abuses that have rocked Wall Street, and President Bush strongly hinted that he was inclined to sign almost any bill that emerged from negotiations by the Senate and the House."). The "Sarbanes Bill," that was "passed by the Senate tonight would
with its pledged reforms.21

One reason why the SEC must move forward with its pledged overhaul is because the agency is notorious for its refusal to clearly articulate the rules it establishes or the doctrines it promulgates.22 Because the SEC has historically been secretive and still chooses to shroud itself and its rules in mystery and ambiguity, the investing public is often skeptical as to the intentions and directions of the agency.23 Of further consequence, beyond

create a new regulatory board with investigative and enforcement powers to oversee the accounting industry, limit the amount of consulting work auditors can perform and prohibit Wall Street investment firms from punishing honest research analysts whose reports anger clients of the firm. "Id. Despite these measures, it is unclear what kind of bill will emerge once the House of Representatives and the Senate negotiates legislation that can be forwarded to the President for signature as various lawmakers already indicate that this bill may go to far. See id.; see also Avoiding Future Enrons and WorldComs, WALL ST. J., July 10, 2002, at A1 (detailing the various corporate reform actions being considered by the U.S. Congress including overseeing accountants, punishing wayward CEOs, increasing CEO responsibility, restricting stock options, funding the SEC, improving financial disclosure and protecting pensions); see generally Jim Drinkard, Sweeping Corporate Overhaul OK'd '97-0, USA TODAY, July 16, 2002, at 1A (reporting that corporate reform bill, while nearly dead three weeks earlier, was revived and passed due to further corporate scandal, particularly WorldCom, and the volatility of the capital markets). "‘It’s not an exaggeration to say the crisis in our markets has put the plans and hopes and dreams of millions of Americans at risk,’ said Senate banking committee Chairman Paul Sarbanes, D-Md. The bill is ‘an essential step toward restoring confidence.’" Id.; see also discussion infra note 59. In depth analysis of the Sarbanes-Oxley Act and the proposed reforms therein is beyond the scope of this article.

21. See supra notes 3, 11.

22. See infra notes 54, 55, 276, 277 and accompanying text. Admittedly, the SEC must, at times, believe that vagueness and ambiguity in its rules allows it a certain flexibility in applying its standards. In a fast paced economy, where technological breakthroughs astonish at times, perhaps the SEC believes that introducing no clear guidelines or standards allows it to be mobile in addressing unforeseen issues thereby protecting its ability to patrol novel transactions.

23. See id.; see also Owens, supra note 3; Mitch Glaser, Voice of the People, Corporate Truth, CHI. TRIB., July 28, 2002, at 2-8 (“Financial analysts claiming that false balance sheets are the exception goes in one ear and out the other. I want proof.”). In expressing dissatisfaction with the current corporate scandals and the SEC’s failure to protect investors physician Glaser writes:

Rumors are out there, which I think are true, that fake balance sheets have become standard and are not limited to Andersen-audited business. Until we investors know about all the past accounting trickery, and that now things have changed, we are going to stay out of the markets. Neither Congress passing new laws nor the president giving speeches will persuade me to buy stocks or corporate bonds.

Id.; see also Walter Goldberg, Voices of the People, Corporate Culprits, CHI. TRIB., July 28, 2002, at 2-8 (“With a sagging stock market, why aren't those corporate culprits who caused the problems in jail where they belong? The American public is tired of listening to the
investor distrust, is the reality that because the SEC creates confusion and ambiguity in its rules and established doctrines, it must spend significant agency resources in providing clarifications and guidelines for issuers and practitioners. The SEC must begin to provide coherent, specific guidelines to the markets, not only for the new rules it promulgates, but also for the cumbersome doctrines and rules that have existed for many years.

In light of the criminal manipulations of financial statements and the purposeful deception of investors by numerous U.S. corporations, and because of the SEC's admitted weak policing of corporate financial statements, the issue must now be raised: How much more time would the politicians (including our president) giving meaningless speeches on corporate responsibilities while these scoundrels are enjoying the fruits of their thievery.

24. See generally infra note 151 and accompanying text (describing the deluge of no-action requests the SEC received from 1970 to 1979 where issuers sought integration doctrine guidance).

25. See infra notes 52-55 and accompanying text.

26. See Klaus Eppler, Overview of SEC and Other Developments Affecting the Preparation of Annual Disclosure Documents: Bases for the Public Company's Year-End Disclosure Obligations, in 1 Preparation of Annual Disclosure Documents 11, 17 (Practising Law Institute 2002). Eppler announces:

[w]ith the decline in IPO filings and, generally, transactional filings... the Staff of Division of Corporation Finance has indicated an intention to allocate greater Staff resources to the review of '34 Act periodic filings.

1. For many years the aspirational goal... has been to review a public company's filings at least once every three years. . . .

3. With almost 16,000 companies registered under the '34 Act and with a large volume of IPO and other transactional filings, the Staff in 2000 reportedly reviewed only a very small fraction of Form 10-Ks. The Staff has indicated that it expects to review a much larger percentage of Form 10-Ks but still less than one-third of the companies required to file them.

Id. at 17; see also Labaton, S.E.C. Is Facing Deeper Trouble, supra note 11. On December 1, 2002, the New York Times described the SEC as a federal agency in serious trouble based on its inability to handle the corporate crises of the past two years because of its failure to conduct the actual detailed examination of public filings of over 15,000 corporations each year. Id. The SEC's corporate finance division, which for years never examined in detail the filings of
SEC have devoted to reviewing financial statements of public companies were it not spending so much of its time clarifying and defining its own guidelines and doctrines?

If the SEC is devoting valuable time and resources to responding, clarifying and explaining its own rules, doctrines and intentions, then the agency is not spending that particular time reviewing financial statements or policing corporate disclosures. Nor is the SEC protecting investors from unscrupulous corporate pirates, a list that now includes Enron, WorldCom, Adelphia, Xerox, Rite Aid, Tyco International, Global Crossing, Nicor, Merck, Johnson & Johnson, Sunbeam, ImClone and Qwest Communications, amongst many others.27

Now that cries for overhaul have been heard and acknowledged by the agency and by Congress, a complete renovation must include a reordering of priorities, focuses and resource allocation. The SEC must first address the current “crisis of confidence”28 by responding to the torrent of false corporate financial statements. In order to do so effectively, the SEC must overhaul the inadequacies in its financial reporting system.29 Next, by simply reforming some of its ambiguous rules and clarifying, by official release, some of its confounding doctrines, the SEC could positively reorder its focus and free an extensive amount of time for the more critical functions of policing corporate America and protecting the U.S. investing

Id. Noted securities expert and historian Joel Seligman maintains that other forces have contributed to the collapse of the U.S. capital markets recently:

The two periods of greatest political controversy in the history of the Securities and Exchange Commission were the initial years, when the statute to create the commission and its full mandate were adopted, and the last period since the 1994 elections, when Newt Gingrich’s Contract With America attempted as part of a broad deregulatory effort to roll back the registration and enforcement mechanisms of the commission. ... We have seen a wild roller-coaster ride since 1994.

Id.

27. See supra notes 10, 15, 17; see also infra notes 56, 314, 324, 344.
28. Former SEC Chairmen Offer Views on Problems Raised by Enron’s Collapse, supra note 4 and accompanying text (describing the corporate scandals rocking the U.S. markets as the impetus for the current “crisis of confidence”).
29. See generally infra note 59.
In this current overhaul atmosphere, where a furor has arisen to reform the SEC and the securities laws, there exists an obscure but crucial securities doctrine that must not be forgotten amidst the reform wave: that one decades-old doctrine in immediate need of alteration attention from the SEC is the securities "integration doctrine." Whereas, from its inception in 1933 until today, the doctrine has been plagued by confusion, ambiguity and indiscernible interpretation, over the past quarter-century, a number of securities scholars have written clearly and intelligently about this integration problem. Most of those authors have brutally criticized the doctrine and fervently petitioned the SEC to reform its approach to integration doctrine analysis. The criticisms have become so strong that


31. See *Campbell, The Overwhelming Case*, *supra* note 30, at 291, 303-04 n.46, 307-10. Campbell argues compellingly that the ambiguities and uncertainties of the integration doctrine are nothing short of exasperating and that "[e]ssentially, everyone concedes the ambiguity in the common law criteria of integration and the difficulty of applying the criteria." *Id.* at 310. Further, Campbell opines that the courts have misunderstood and misinterpreted the integration doctrine. *Id.* at 303 n.46 ("For example, the court's treatment of the integration issue in *Shaw v. United States*, 131 F.2d 476 (9th Cir. 1942), is essentially unintelligible. The cases following *Shaw*, while broadly intelligible, are nonetheless confusing and based on uncertain principles and fail to articulate with clarity the criteria of integration." (emphasis added)).


33. See *supra* notes 30-32; see also Bradford, *Expanding the Non-Transactional Revolution*, *supra* note 30, at 471 nn.214-18 (listing modification suggestions that various scholars and practitioners have posited over the years in hopes that adoption by the SEC would address and ultimately eliminate the integration problem). Bradford writes that
recent articles call upon the SEC to abolish the integration doctrine altogether.\textsuperscript{34}

Conceptually, the securities law integration doctrine was introduced to protect the investing public from certain issuers that might improperly avoid public disclosure by splintering security issuances into separate, distinct exemptions not requiring registration.\textsuperscript{35} In order to legitimately avoid registration as mandated by the Securities Act of 1933 (1933 Securities Act),\textsuperscript{36} an offering of securities must meet the requirements of a single available exemption, as detailed in the 1933 Securities Act and other SEC rules and regulations.\textsuperscript{37} If a 1933 Securities Act exemption is not available to an issuer proposing to offer securities to the public, then that offering must be registered with the SEC, thereby making crucial company information available to the agency and the general public for close review.

numerous scholars have suggested modification to the integration doctrine for many years. "[A]uthors have suggested . . . modifications to the integration doctrine. Some . . . have called for adoption of the ABA tests, sometimes with modifications. A few have proposed temporal safe harbors shorter than six months. Others have proposed modifications to the SEC's five-factor test for integration. Some have suggested multiple approaches." \textit{Id.} at 471 (citations omitted).

34. \textit{See} Campbell, \textit{The Overwhelming Case}, \textit{supra} note 30, at 294-95 ("The thesis of this Article is that the Commission should entirely eliminate the integration doctrine from the 1933 Act. The doctrine is expensive for society and furthers no valid policy of the 1933 Act. More specifically, the doctrine does not promote investor protection but does retard capital formation, an outcome that is contrary to the presently articulated purposes of the 1933 Act.") (citations omitted).

35. \textit{See} Wade, \textit{supra} note 30, at 199. When discussing the original goal of protecting investors, Wade notes:

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.

\textit{Id.} at 200. The integration doctrine was originally announced by the Federal Trade Commission in December 1933 wherein it held that an issuer could not sell part of an offering using the intrastate offering exemption and then sell the rest of the issue in a registered interstate offering. \textit{See} Securities Act Release No. 97, 1 Fed. Sec. L. Rep. (CCH) ¶¶ 1021-1029 (Dec. 28, 1933), available at 11 Fed. Reg. 10,949.


and scrutiny. To that end, an issuer may never use two or more exemptions to avoid registration of what is really a single transaction. The SEC created the integration doctrine in order to establish what constitutes a single offering for purposes of registration.

If an issuer proposes to offer two securities issuances and is seeking to permissibly avoid the registration of each offering by claiming exemptions to the registration process, the SEC will test both offerings to determine whether the issuances are really part of a single transaction as established by the integration doctrine. If two sets of issuances are in fact “part of the same transaction,” they will be “‘integrated’ and treated as a single offering, and the entire integrated offering must then qualify for a single exemption,” or it must be registered. The integration doctrine is designed to prevent issuers from improperly separating a single offering into two or more parts and using a separate exemption for each part of the offering, thereby avoiding registration of the single transaction.

Essentially then, the integration doctrine “is used to combine two or more otherwise exempt securities sales into a single offering” that is not qualified under any of the 1933 Securities Act’s available exemptions from registration. The integration” concept may also be used to “integrate” an exempt sale with a registered sale, resulting in the” first sale “losing its registration exemption.”

The historical battle that is at the heart of the integration problem concerns investor protection (through registration) versus capital formation (and the obstacles that restrict such formation). The integration doctrine

38. See Wade, supra note 30, at 199-200.
39. See Bradford, Expanding the Non-Transactional Revolution, supra note 30, at 460 (citing J. William Hicks, The Concept of Transaction as a Restraint on Resale Limitations, 49 Ohio St. L. J. 417, 431 (1988)).
40. Id.
41. See Wade, supra note 30, at 209-10. Wade notes that:
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. If the SEC 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.
Id. (citing Deaktor, supra note 32, at 492) (citations omitted).
42. Bradford, Expanding the Non-Transactional Revolution, supra note 30, at 460.
43. Id.
45. See Campbell, The Plight of Small Issuers, supra note 32, at 134 (“The Commission, within the structure of Regulation D, apparently attempted to balance the need
conceptually, was created to protect investors from unscrupulous securities issuers. At the time the doctrine was initiated, investor protection was an urgent priority of the U.S. government and the newly formed SEC. In spite of positive intentions, the integration doctrine has, over the years, unquestionably caused difficulty, particularly for small businesses who are attempting to raise needed capital. Despite these duel concerns that must be weighed, the integration doctrine’s most exasperating component is its imprecise, vague test and its incoherent application.

In an environment ripe for securities law reform, the SEC should genuinely consider, once and for all, ending the legacy of ambiguity, confusion and exasperation that is the securities integration doctrine. Indeed, one of the many ways that the SEC can begin to meet its stated goal for investor protection with the need to provide cost efficient access to the capital markets.

46. Integration of Abandoned Offerings, Securities Act Release No. 33,7943 (Feb. 5, 2001), available at 17 C.F.R. 230.155 (2002). The SEC explained in its release announcing new Rule 155: The integration doctrine, which has existed since 1933, prevents an issuer from improperly avoiding registration by artificially dividing a single offering so that Securities Act exemptions appear to apply to the individual parts where none would be available for the whole. Improper reliance on an exemption can harm investors by depriving them of the benefits of full and fair disclosure or of the civil remedies that flow from registration for material misstatements and omissions of fact.

47. See CHARLES J. JOHNSON JR. & JOSEPH MCLAUGHLIN, CORPORATE FINANCE AND THE SECURITIES LAWS (1997); see also infra note 77 and accompanying text.

48. Campbell, The Plight of Small Issuers, supra note 32, at 135 ("Issuers attempting to qualify for an exemption under Regulation D are required to meet a number of requirements that significantly add to the cost of compliance without any corresponding increase in investor protections. These problems are especially difficult for small issuers.").

49. See supra notes 30-33 and accompanying text; see also infra Parts III.A-B.
of repairing broken public and private confidences is through careful reformation of the integration doctrine.\(^{50}\)

The SEC has existed, since its Depression-era creation, as a theoretical watchdog over the U.S. securities markets and as a protector of investors' rights and market integrity.\(^{51}\) Unfortunately, the SEC has conducted itself at various times through its history and in many regulatory circumstances, as if functioning under a cloak of secrecy by refusing to explain its positions or the doctrines upon which it bases its decisions. In fact, the SEC has perpetuated particular ambiguities in the securities laws for many years, by arrogantly refusing to address concerns that have repeatedly been brought to its attention.\(^{52}\) For many years, the SEC has simply ignored (or rejected) the reform requests of scholars and practitioners on a variety of matters.\(^{53}\) The integration doctrine is one example of the SEC's "cloak of secrecy" approach described above.\(^{54}\) Despite repeated requests and careful analytical attacks upon the integration doctrine by scholars and practitioners, the SEC has staunchly refused and continues to refuse to

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50. See supra notes 3, 11 and accompanying text.
51. See supra note 11.
52. See generally supra notes 30-33 and accompanying text; see also infra note 61. But see supra note 22.
53. See generally Bradford, Expanding the Non-Transaction Revolution, supra note 30, at 463-64 ("The integration doctrine has been thoroughly criticized. A number of authors have documented the problems the integration concept causes issuers in various contexts.... The most charitable view that can be taken of the doctrine is that it has some basis in economic theory, but simply is not worth its cost.").
54. Bradford, The New Safe Harbor, supra note 32, at 284 ("Once again, the SEC's unwillingness to acknowledge or explain what it was doing has led to unnecessary uncertainty."); see also supra note 31, infra notes 274-78 and accompanying text.
provide definitive guidance or clarification in this muddled doctrinal morass.  

In this troubled and precarious economic time, with capital markets reeling under the weight of accounting fraud, financial restatement and admitted executive management dishonesty, the SEC has lost investor confidence and continues to lose its reputation as a competent protector of the financial markets; the agency is being harshly criticized and attacked by both elected legislators and the general public. The SEC can no longer exist in a world of self-inflicted criticism and skepticism based on ambiguity and subterfuge. It is time for the SEC to begin to reform, to drop

55. See Stephen I. Glover, The Offerings That Precede an Initial Public Offering—How to Preserve Exemptions and Avoid Integration, 24 SEC. REG. L.J. 3, 10-12 (1996) (“The SEC has never provided solutions to these puzzles.”). But see infra Part II.C (discussing integration safe harbors established by the SEC over the past twenty-five years in part to respond to integration ambiguities).

56. See supra notes 4, 8; see also Armeet Sachdev, Dow Dives to 4-Year Low: Sell-Off Deepens; ‘People Are Really Feeling Pain Now,’ Chi. TRIB., July 20, 2002, at 1-1 (“The Dow Jones Industrial average shattered its post-Sept. 11 low Friday [July 19, 2002] in a dramatic 390-point sell-off, adding to the already gloomy atmosphere on Wall Street soured by accounting scandals and company collapses.”). Reacting to executive dishonesty and corporate scandal, including new revelations that Johnson & Johnson and Chicago based Nicor Inc. had engaged in new corporate misbehavior, the U.S. capital markets plunged to four year lows as investors seem unwilling to invest in a market that appears capable of further volatility. See id.; see also Jon Van, Accounting Woes Fuel Nicor Stock Plunge, Chi. TRIB., July 20, 2002, at 1-1 (“Nicor Inc. became another victim of Wall Street’s wrath Friday [July 19, 2002], as its shares plunged to a 10-year low after it revealed questionable accounting practices that will lead to a restatement of earnings.”).


The White House has been slow to respond to the corporate scandals that have rocked the U.S. markets, but Treasury Secretary Paul O’Neill and President George W. Bush seemed poised to take a stand:

Angered by news of yet another major accounting scandal, this time at long-distance-telephone giant WorldCom, O’Neill urged Bush to make greedy CEOs pay for their crimes. “A kid caught with half a pound of marijuana gets more jail time than a corporate executive,” he said. “That’s not square.” Bush emphatically agreed. . . . O’Neill went on to detail how WorldCom executives played with the numbers, hiding nearly $4 billion in losses. “Can you imagine that?” he asked.

The president frowned. The two men sat, shaking their heads.


58. See supra notes 3, 9, 11, 53.
the secrecy cloak and allow practitioners and scholars to understand the reasoning and ambiguities of its approaches. In truth, now is the time for the SEC to overhaul its antiquated systems and fix the areas of the law that are in need of significant repair, including importantly, reforming the integration doctrine. 59

Significantly repairing and reforming the securities reporting system would be an important step for the SEC in winning back U.S. investor confidence in the capital markets and in the disclosure system through which those markets are protected. Further, resolving the integration conundrum would show that the agency is responsive to the concerns of securities practitioners and is not deaf to the concerns of scholars who thoughtfully criticize specific SEC doctrines and actions. Bringing about such reforms now would serve to preserve two important non-competing interests: restoring consumer and investor confidence and clarifying the capital raising process for issuers of securities.

In this Article, I will first briefly discuss the background of the integration doctrine and describe the U.S. market conditions at the time the doctrine was created. Second, I will turn my attention to the current peculiarities of the integration doctrine and discuss the criteria the SEC uses when applying the integration doctrine test. Third, I will add my voice to the chorus of criticisms levied against the SEC, its integration doctrine, and the tests that the doctrine requires. Fourth, I will briefly review what has been written and proposed by various scholars and securities practitioners who have virtually pled with the SEC to alter its integration approach. I will argue fifth that the integration doctrine can be useful and is still necessary, despite recent and strenuous calls for the doctrine’s abolition. Finally, after arguing that integration is still a useful doctrine, I will propose various remedies that the SEC should consider adopting in order to mend the regulatory nightmare that is the integration doctrine, and

59. Admittedly, reforming the integration doctrine, while important, is not the most pressing area of securities law reform needed. Unquestionably, establishing a system of accounting accountability seems to be an area most in need of immediate attention and reform. In fact, the recently passed Sarbanes-Oxley Act addresses various areas of corporate reform including prison terms for up to ten years for individuals “using any scheme or artifice to defraud investors” and prison terms for up to ten years for senior corporate executives who “recklessly” or “willfully” publish misleading financial statements.” Sanger & Oppel, supra note 20 (“The Senate bill passed tonight was a result of a frenzy of bill writing in which Republicans and Democrats seemed to compete to show who could be tougher on corporate malfeasance. Amendments that were considered dead only a few weeks ago passed by comfortable margins.”); see also supra note 20 and accompanying text. Analysis of such reform and ideas for accountability are beyond the scope of this article.
ultimately to move toward improving investor confidence and public and private issuer understanding of this conundrum.

Therefore, I argue here that the securities law integration doctrine is a useful regulatory instrument, albeit one that is riddled with ambiguities and confusion, and as such, is justly criticized. Nevertheless, calls for abolition of the doctrine go too far; rather, aggressive revision of the doctrine by the SEC will allow integration to continue to serve its purpose of protecting investors from unscrupulous issuers seeking to avoid valid, required registration. Further, in this era of sophisticated corporate malfeasance and market scandal, the integration doctrine places an important check on issuers, both large and small. In response to recent scandal, the SEC should be tightening the reins on corporate disclosure through registration, not abolishing a viable doctrine, even if the ambiguity in the doctrine is maddening. This Article proposes to fix the integration doctrine.

II. HISTORICAL BACKGROUND

Indeed, some may wonder why so much is being made of the integration doctrine, an obscure securities law dilemma. Is it much ado about nothing?\(^\text{60}\) A cursory review of the literature reveals that much has been written about this conundrum.\(^\text{61}\) The integration doctrine has been passionately attacked, and attacked often.\(^\text{62}\) What is it about this doctrine that raises the ire of so many scholars and practitioners?

An example might appropriately illustrate:

While working as a young associate at a major international law firm in Chicago, Illinois, I was approached by a senior partner in the corporate department, who was also the securities law subgroup leader, and was assigned a project that dealt with what was termed an “integration issue.” A client of the firm had recently decided to issue an offering of its common stock and we had begun

\(^{60}\) William Shakespeare, Much Ado About Nothing (1600).

\(^{61}\) See supra notes 30-33, 44, 55 and accompanying text; see also Kathryn Taylor Frame, Note, Securities Regulation: Integration of Securities Offerings, 34 Okla. L. Rev. 864 (1981); J. William Hicks, The Concept of Transaction as a Restraint on Resale Limitations, 49 Ohio St. L.J. 417 (1988); Ronald M. Shapiro & Alan R. Sachs, Integration Under the Securities Act: Once an Exemption, Not Always..., 31 Md. L. Rev. 3 (1971); Perry E. Wallace, Jr., Integration of Securities Offerings: Obstacles to Capital Formation Remain for Small Businesses, 45 Wash & Lee L. Rev. 935 (1988).

\(^{62}\) See generally Frame, supra note 61, Hicks, supra note 61, Shapiro & Sachs, supra note 61, Wallace, supra note 61.
to prepare the appropriate form for purposes of filing it with the SEC prior to offering and selling the proposed underwritten offering. The client was intending to raise capital with the common stock transaction in order to effectuate particular corporate improvements within the company. While in the midst of preparing the required forms, an opportunity arose for the company to become involved in a distinct pooled transaction organized by a major underwriter, wherein certain warrants would be purchased by a number of participating banks.

The senior partner, confessing that she knew the "basics" when it came to integration, needed me to dig into the details and instructed me to hit the books and return in a day or two with a definite answer as to whether the two proposed offerings would be integrated for purposes of registration. I was told that the client would be expecting a concrete answer from us as to whether it could participate in the pooled vehicle without worrying that its issuance of common stock would be tainted by the subsequent issuance of warrants in the pooled transaction. Essentially, I needed to determine whether the issuance of warrants would be integrated into the offering of common stock.

Two days later, and admittedly beginning at ground zero as far as previous integration knowledge was concerned, I returned with a battery of scenarios that basically provided no plain answer to the integration question. I had learned that two simultaneous (or thereabout) offerings had to fit into two discrete exemptions in order to avoid integration. I had learned that a registered offering could be integrated into a subsequent unregistered offering if the subsequent offering did not fit into a discrete exemption. I had learned that various integration "safe harbors" existed, wherein specific simultaneous offerings would be spared integration. I had learned that our offerings at hand did not correspond to any distinct safe harbor. I had learned that a "five-factor" test would be applied to offerings that did not fit into discrete exemptions or safe harbors. I had learned that the five-factor test is ambiguous and inconsistently applied. I had searched through previous SEC no-action letters seeking that one exact match to the scenario at hand wherein the SEC had decided clearly whether the offerings would be integrated. What I did not learn, and now realize could never have learned, was whether the SEC would definitively integrate the two offerings being sold by our client.
I returned to the assigning partner with this result. I discussed the ambiguity of the five-factor test. I discussed the absence of direction the SEC provides to the general public regarding integration questions. I relayed the fact that no SEC no-action letters were on point to our question of integration. I then stated that the best answer we could give our client was that the integration answer is not at all clear. I offered that we could guess that, after applying the five-factor test, the SEC might determine that the two offerings did not need to be integrated.

Needless to say, I was then verbally accosted by the subgroup leader for failing to come up with a definite yes or no answer to the question of whether the offerings would be integrated. The assigning partner demanded that I return to the books and come up with a definite answer. I headed straight to the offices of fellow securities associates and junior partners and queried each as to their integration knowledge. I posed the scenario and received nothing concrete or remotely helpful in return.

I spent another day in the books and online, reading treatises and SEC releases, which yielded absolutely nothing further, except for more questions and confusion. I gently suggested the possibility of petitioning the SEC for guidance through a no-action letter, and was sternly rebuffed by the senior partner based on time considerations and cost concerns. Finally, close to the eleventh hour, and with the client waiting impatiently for our response, I crafted our integration response, including a memorandum, by awkwardly and unwieldily forcing the facts of the transaction at hand into a discrete integration carve-out announced in Black Box\textsuperscript{63} and Squadron,\textsuperscript{64} both published SEC no-action letters.

\textsuperscript{63} See Black Box Inc., SEC No-Action Letter, 1990 SEC No-Act LEXIS 926, 43 (June 26, 1990) (carving out on policy grounds an exception to registration for a private offering, during the pendency of a registration statement, to "qualified institutional buyers" and a limited number of "participating institutional investors.").

\textsuperscript{64} See Squadron, Ellenoff, Plesent, & Lehrer, SEC No-Action Letter, 1992 SEC No-Act LEXIS 363 (Feb. 28, 1992) (clarifying SEC policy position announced in Black Box, \textit{supra} note 63, as being based primarily on the nature and number of offerees, not on the unstable financial condition of Black Box). The SEC made clear in its Squadron pronouncement that its determination not to integrate the public offering and subsequent private placement in the Black Box decision was limited in its applicability to situations where an unregistered offering is made to persons who would be qualified institutional buyers and to no more than two or three large institutional accredited investors. \textit{See} Squadron, \textit{supra}. 
In creating this awkward carve-out, the best answer we could give our client was ambiguous without question. Our client was left in the position of having to decide whether or not to involve hundreds of millions of dollars in transactions without any recognizably coherent or dependable integration answer. As I continued to work on both securities issuances for this client, I was mystified later to learn that the underwriters in the pooled transaction required the lawyers representing the issuer to opine in a Legal Opinion that no integration issues would arise as to the issuer and that integration would not be required by the SEC with any other offering outstanding. This integration wild goose chase was repeated at least four additional times over a six-month period as the senior partner/subgroup leader called on me to answer similar integration scenarios for assorted clients.\(^6\)

Therein lies the integration conundrum from a practical perspective. Issuers who know very little about the integration doctrine, but know that serious penalties will attach if two fairly simultaneous offerings are integrated,\(^6\) want their attorneys to tell them definitively whether their

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\(^5\) In using this very personal narrative to illustrate a practical law firm integration problem, I choose to infer here that it is extremely likely that similar experiences occur frequently in the corporate departments of law firms throughout the United States. See generally Richard Delgado, *Storytelling for Oppositionists and Others: A Plea for Narrative*, 87 Mich. L. Rev. 2411, 2413 (1989) ("Stories, parables, chronicles and narratives are powerful means for destroying mindset—the bundle of presuppositions, received wisoms, and shared understandings against a background of which legal and political discourse takes place. These matters are rarely focused on.") (footnote omitted). See, e.g., Derrick Bell, *After We’re Gone: Prudent Speculation on America in a Post-Racial Epoch*, 34 St. Louis U. L.J. 393 (1990); Michael A. Olivas, *The Chronicles, My Grandfather’s Stories, and Immigration Law: The Slave Traders Chronicle as Racial History*, 34 St. Louis L.J. 425 (1990); Patricia J. Williams, *Alchemical Notes: Reconstructing Ideals from Deconstructed Rights*, 22 Harv. C.R.-C.L.L. Rev. 401 (1987). Even if, standing alone, this personal account is the only integration difficulty of its kind, the value of the experience is still important in that it relates a genuine personal experience that should cause concern and reflection in regulators, practitioners, issuers/clients, and scholars similarly situated. See generally Taunya Lovell Banks, *Two Life Stories: Reflections of One Black Woman Law Professor*, 6 Berkeley Women’s L.J. 46 (1990-91); Angela Mae Kupenda, *Making Traditional Courses More Inclusive: Confessions of an African American Female Professor Who Attempted to Crash All the Barriers at Once*, 31 U.S.F. L. Rev. 975 (1997); André Douglas Pond Cummings, "Lions and Tigers and Bears, Oh My" or "Redskins and Braves and Indians, Oh Why": Ruminations on McBride v. Utah State Tax Commission, *Political Correctness, and the Reasonable Person*, 36 Cal. W. L. Rev. 11 (1999).

\(^6\) See Wade, *supra* note 30, at 200 ("When the integrated offering fails to satisfy the requirements of any of the 1933 Act’s exemptions from registration, the issuer faces serious
multiple proposed public offerings will be integrated.\textsuperscript{67} Senior partners, who know about integration, but are not very familiar with the inherent details and ambiguities, demand from young associates clear-cut answers as to whether separate issuances will be integrated. Associates spend countless billable hours probing through a fog of unfortunate history trying to ascertain, through analyzing various exemptions and contemplating the five-factor test, whether the client is safe to make both issuances or should complete a subsequent issuance after a previous offering has already gone public. The associate then bills additional hours searching for the proverbial needle in a haystack, as he or she leafs through hundreds of SEC no-action letters looking for a fact pattern at least remotely close to the transaction at hand.

The conundrum from a small issuer's practical perspective arises in numerous circumstances, but it particularly arises when an infusion of quick capital is needed to fund ongoing business concerns or when an unexpected opportunity is presented to raise inexpensive capital, and the need or opportunity is constrained based on an integration concern.\textsuperscript{68} Thus, an issuer is restricted from freely raising needed capital or from joining pooled transactions when an issuer has previously sold registered securities within a certain time frame or has recently sold securities under discrete registration exemptions.\textsuperscript{69}

\textsuperscript{67} Of course, the attorney can provide little guidance to issuers, because while he or she might know a great deal about securities integration, the doctrine remains muddled, hazy and confusing. All an integration savvy attorney can genuinely do is relay the quagmire of confusion to his or her client.

\textsuperscript{68} See Wallace, supra note 61, at 935-36 (describing that federal securities laws recognize two things about small issuers of securities: "(1) when regulation is burdensome and inefficient, small issuers of securities suffer inordinately, and thus unfairly, compared with larger companies; and (2) these small issuers confer significant economic benefits upon American society, making them particularly deserving of relief from unnecessary legal strictures") (footnotes omitted); see also Campbell, The Plight of Small Issuers, supra note 32, at 136-37 (detailing the specific problems encountered by small business owners (small issuers) in raising capital by the sale of stock including severe difficulty attracting investment bankers for underwriting services, being forced to bear the burden of selling their own issued securities and the hardships imposed by the prohibition against general advertising).

\textsuperscript{69} See Wallace, supra note 61, at 937; see also Campbell, The Plight of Small Issuers, supra note 32, at 162-64 (describing the "significantly more harmful" impact the integration
Before initiating a securities offering, an issuer must consult with its attorneys to ask for guidance as to whether simultaneous securities offerings will be integrated. After spending a measure of money for integration-related legal fees, an issuer must state clearly in its offering certificates that the current offering will not be integrated with any previous or simultaneous offering currently in existence. Finally, the issuer must obtain a legal opinion from its lawyers, wherein its lawyers opine that, among other things, integration will not be required in the case at hand. Of course, the client knows that a no integration opinion is hypothetical and that the SEC can inexplicably integrate offerings if it so deems. For this counsel, the issuer will pay considerable legal fees.\(^\text{70}\)

Despite the above-mentioned practical insensibility attendant to the integration doctrine, the doctrine’s initial creation was steeped in practical sensibilities and protection-oriented intentions.

### A. Historical Review of Integration Doctrine Creation

In the decade leading up to the Great Depression, securities issuers and stock speculators hustled the U.S. investing public into dire circumstances.\(^\text{71}\) At the time the U.S. capital markets collapsed in the late 1920s and early 1930s, various estimates conclude that fully fifty percent of the stock issued in the decade previous to the Depression had no value and was proven worthless.\(^\text{72}\) In fact, prior to the market collapse preceding doctrine has on small issuers as opposed to larger issuers that are more likely to have “an array of financing alternatives” not available to the smaller issuer making the “tangles and snares of the doctrine” less troublesome to larger issuers).

\(^\text{70.}\) See Bradford, *An Economic Analysis*, supra note 45, at 602-03 (detailing fees, including attorneys fees attendant to preparing for and registering securities). In describing the direct expenses of preparing, filing and distributing registered securities, Bradford notes:

- Attorneys must draft the registration statement and shepherd it through the SEC review process. Accountants must prepare and audit the company’s financial statements. The company must print the registration statement and distribute the prospectus to potential investors. In an initial public offering, these costs directly associated with the preparation of the registration statement could total from $200,000 to $500,000.

*Id.* at 603.

\(^\text{71.}\) See Johnson & McLaughlin, *supra* note 47, at 1-3.

\(^\text{72.}\) H.R. REP. NO. 73-85, at 2 (1933). “Some $50 billion of new securities had been floated in the United States during the decade following World War I, of which fully half had proved to be worthless.” Johnson & McLaughlin, *supra* note 47, at 2. The House of Representatives committee placed much of the blame of the market crash, “unique in financial history,” squarely on the securities industry. *Id.* (citation omitted). The House committee reported:
the Depression, few federal safeguards were in place and available to investors when they were approached with an opportunity to invest in the stock of emerging companies in the early twentieth century. This lack of regulatory safeguards proved to be disastrous as scores of the U.S. investing public lost fortunes during the Great Depression.

President Franklin Delano Roosevelt and the U.S. Congress decided, as the nation reeled from the effects of the market collapse and Depression, that the capital markets in the U.S. had to be safeguarded through congressional federal regulatory enactment. The U.S. investing public

The floatation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealing that should be basic to the encouragement of investment in any enterprise. Alluring promises of easy wealth were ... made with little or no attempt to bring to the investor's attention those facts essential to estimating the worth of any security.

Id. (citing H.R. REP. No. 73-85, at 2 (1933)).

73. JOHNSON & MCLAUGHLIN, supra note 47, at 2. Historically: Securities regulation had been the exclusive province of the states. This had been the case since 1911 when the first blue sky law was enacted in Kansas. In the aftermath of the crash, however, state securities laws were perceived to be inadequate, resulting in growing pressure for regulation on the Federal level.

Id.

74. Id. at 1 (referring to the enormous loss suffered by investors due to the market crash of 1929). Johnson & McLaughlin report:

Between September 1, 1929 and July 1, 1932, the aggregate market value of all stocks listed on the New York Stock Exchange ... had declined from an all-time high of close to $90 billion to less than $16 billion, a loss to which, in the words of the Senate Banking and Currency Committee, “the annals of finance present no counterpart.”

Id. (citing S. REP. NO. 73-1455, at 7 (1934)).

75. Id. at 3. One of the first things President Roosevelt did upon being inaugurated was call upon Congress to create remedial legislation that would protect U.S. investors:

I recommend to the Congress legislation for Federal supervision of traffic in investment securities in interstate commerce.

In spite of many State statutes the public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities.

Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn profit.

There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.

Id. (quoting H.R. REP. No. 73-85, at 1-2 (1933)). The drafting of legislation eventually fell
needed to be protected from unscrupulous sellers and fraudulent issuers of securities whose duplicity had precipitated the Depression.\textsuperscript{76} In order to protect the investing public, Congress enacted the 1933 Securities Act, which became, for the most part, an act of disclosure.\textsuperscript{77} The President, the Congress and the drafters believed that required disclosure of pertinent and crucial business information, including profits, debts and earnings, would give the investing public protection and knowledge.\textsuperscript{78}

The 1933 Securities Act needed an agency to police the required disclosure of information that would be forthcoming as required by the new law. Initially, the 1933 Securities Act assigned original administrative responsibility for enforcement to the Federal Trade Commission (FTC).\textsuperscript{79} The SEC soon thereafter became the regulatory agency with primary responsibility for administration of the 1933 Securities Act,\textsuperscript{80} but not before the FTC promulgated the securities integration doctrine concept in an early interpretation of the 1933 Securities Act disclosure requirements.\textsuperscript{81}

primarily on the shoulders of then professor Felix Frankfurter, and after a number of revisions and consultations with Wall Street lawyers, the draft legislation became the Securities Act of 1933, officially enacted May 27, 1933. \textit{Id.} at 4.

\textsuperscript{76} See supra notes 72-74.

\textsuperscript{77} See 15 U.S.C. §§ 77a-77aa (2000). Johnson and McLaughlin report that: The essential elements of the 1933 [Securities] Act consist of (a) mandatory full disclosure in a registration statement filed with the Federal Trade Commission (later the SEC), (b) SEC review during a “waiting period,” at the end of which sales could commence, (c) mandatory delivery of a prospectus at or before the delivery of the security, and (d) civil liabilities for untrue statements and for certain omissions.

\textsuperscript{78} Johnson \& McLaughlin, \textit{supra} note 47, at 4. Ultimately, the 1933 Securities Act can best be categorized as a disclosure statute. “Its principal purpose, as set forth in its preamble, is to provide ‘full and fair disclosure’ of the character of securities sold in interstate and foreign commerce and through the mails.” \textit{Id.} at 6; see also \textit{id.} at 3-6. Professor Frankfurter explained the disclosure of information afforded through the 1933 Securities Act as follows: “Unlike the theory on which state blue-sky laws are based, the Federal Securities Act does not place the government’s imprimatur upon securities. It is designed merely to secure essential facts for the investor, not to substitute the government’s judgment for his own.” \textit{Id.} at 6 (quoting Felix Frankfurter, \textit{The Federal Securities Act: II}, FORTUNE, Aug. 1933, at 53, 108) (emphasis added).

\textsuperscript{79} Campbell, \textit{The Overwhelming Case}, \textit{supra} note 30, at 300 n.34.

\textsuperscript{80} Securities Exchange Act of 1934, ch. 404, 48 Stat. 881, 908-09; see also Campbell, \textit{The Overwhelming Case, supra} note 30, at 302 & n.41.

\textsuperscript{81} Campbell, \textit{The Overwhelming Case, supra} note 30, at 300. Campbell wrote that: Over time, the task of interpreting the provisions of the 1933 Act fell to administrative agencies and to courts. Not surprisingly, it was an administrative agency, specifically the [FTC] . . . that first constructed and promulgated the integration concept, and, significantly, this occurred within the first year of the
The integration doctrine originated in 1933, shortly after the passage of the 1933 Securities Act. The FTC determined that an issuer could not sell part of an issue using the intrastate offering exemption\(^2\) and then sell the rest of the issue in an interstate registered public offering.\(^3\) The FTC decided that although a portion of the offering would be registered in an interstate offering, thereby presumably protecting the investing public with required disclosure of pertinent information, the transaction in total could not be broken up into two parts, where one part of the transaction would rely on a registration exemption thereby presumably removing the investors in that part of the offering from the protections of required disclosure.\(^4\)

The FTC, and later the SEC, were both interested in protecting the public disclosure requirements of the 1933 Securities Act, by determining that offerings or transactions that were, by nature, single transactions, could not be splintered into multiple transactions frustrating the investor protection goals of the 1933 Securities Act.\(^5\) Therefore, the integration doctrine eventually became an “analytical framework for determining whether multiple securities transactions should be considered part of the same offering. This analysis helps to determine whether registration under section 5 of the Securities Act is required or an exemption is available for the entire offering.”\(^6\)

Upon the heels of the FTC ruling responsible for originating the integration doctrine, the SEC held that even a single sale to a non-resident could destroy the section 3(a)(11) registration exemption.\(^7\) In 1938, the SEC reaffirmed the FTC’s previous integration decision by combining

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**Notes:**

82. 15 U.S.C. § 77c(a)(11) (1994). Section 77c(a)(11) of the 1933 Securities Act exempts securities offerings that are “part of an issue offered and sold only to persons resident within a single State or Territory.” *Id.*


85. *See supra* notes 79-84 and accompanying text. *But see* Campbell, *The Overwhelming Case*, *supra* note 30, at 305 (arguing that statutory language, history and precedent provide no compelling support for initiation of or continuation of the integration doctrine).


87. *In re* Petersen Engine Co., 2 S.E.C. 893, 899 (1937); *see also* Bradford, *Expanding the Non-Transactional Revolution*, *supra* note 30, at 461.
separate private and public offerings of company stock that had been sold to a single private investor under section 3(b) of the 1933 Securities Act and then registered for sale to the general public several months later. In deciding to integrate the two offerings, the SEC easily found that the section 3(b) sale was part of the same issue as the registered offering, and upon integration, the section 3(b) exemption was destroyed. This 1938 SEC decision reaffirming the FTC's integration concept articulated the criteria the SEC would use in the future when considering integration questions. It was at this point that the integration concept became firmly entrenched as a SEC doctrine, and since then the SEC has not vacillated in its position that the integration doctrine is a fundamental part of the 1933 Securities Act.

The SEC later decided in 1939 that the word "exclusively" as used in section 3(a)(9) of the 1933 Securities Act and the phrase "not involving any public offering" in section 4(2) of the 1933 Securities Act definitively required that an entire securities offering fall within a single exemption. By 1939, the concept of integration in the securities law setting had been firmly established by the FTC and the SEC. In sum, "[s]hortly after the adoption of the Securities Act of 1933, the [SEC]'s Staff embraced the 'integration' concept as a means of ensuring investor protection [through prevention of] issuers . . . circumventing the Act's registration

89. Id.; see also Campbell, The Overwhelming Case, supra note 30, at n.42; Deaktor, supra note 32, at 494-95.
90. Campbell, The Overwhelming Case, supra note 30, at 302-03. In making its integration determination in the Unity Gold case, the SEC articulated for the first time a series of considerations that it would weigh when trying to establish whether to integrate separate offerings, including:

1. the plan of distribution, i.e., whether the plan to distribute the securities includes as well the distribution of other securities;
2. the means of distribution, i.e., the methods of sale and distribution;
3. the classes of securities offered;
4. the general terms on which the securities were offered;
5. the timing of the offerings; and
6. the use of the proceeds from the offerings.

Deaktor, supra note 32, at 495. The SEC did not, when articulating the above factors in Unity Gold, specify the relative weight to be accorded each factor, but these factors have since provided the framework for integration analysis since that time and provide the foundation for the current SEC integration test. See id.

provisions."92

B. Historical Review of Integration Doctrine Applications

Following a flurry of FTC and SEC activity from 1933 to 1939, which served to establish the integration doctrine in the securities law arena,93 silence prevailed for the next twenty years as far as integration was concerned.94 Just two cases addressing integration issues are on record between 1939 and 1959, where the SEC in one case relied on the Unity Gold standard to integrate two offerings.95 The federal courts offered little enlightenment with respect to the integration doctrine over that same dormant time period.96 The courts likely had little familiarity with securities laws at that time, and they encountered the integration question infrequently. When the courts did entertain the integration question, they were later criticized for offering "essentially unintelligible," "confusing," and "useless" interpretations of the doctrine and for failing to rely upon prior interpretations of the SEC.97

"Interestingly, [U.S.] courts did not get involved in any significant integration matters until" the late 1950s, and even then when the courts did get involved their contribution was limited to the acceptance of the integration doctrine "as developed previously by the [SEC]."98 These early judicial decisions seem to "reflect the inherent difficulty" that unspecialized tribunals of general jurisdiction have "in dealing with matters as technical and complex as integration, [as] courts without hesitation accepted the integration doctrine [basically] as it had been developed by the [SEC] and continue to apply the doctrine [on that basis] today."99

In the early 1960s, the SEC promulgated two infamous releases that fashioned and shaped the integration five-factor test that issuers,
practitioners and scholars have grappled with for over forty years.\textsuperscript{100} In response to the “burgeoning popularity of the intrastate exemption”\textsuperscript{101} and aware of its “potential for abuse,”\textsuperscript{102} and in response to “an increasing tendency [among issuers] to rely upon the [private offering] exemption for offering of speculative issues to unrelated and uninformed persons,”\textsuperscript{103} the SEC issued two official releases intended to “reaffirm[] the applicability of integration to both intrastate issues and private placements.”\textsuperscript{104} At the time the agency issued these important releases, the chairman was taking aggressive steps to revitalize the SEC, and thus seized upon the integration doctrine as one subject wherein decisive action could be administered.\textsuperscript{105}

With the release in 1961 of Securities Act Release No. 33-4434,\textsuperscript{106} the SEC sought to clarify specific principles underlying the section 3(a)(11) exemption to registration. In explaining the relationship of integration to intrastate exemptions, the release stated decisively:

Any one or more of the following factors may be determinative of the question of integration: (1) are the offerings part of a single plan of financing; (2) do the offerings involve issuance of the same class of security; (3) are the offerings made at or about the same time; (4) is the same type of consideration to be received; and (5) are the offerings made for the same general purpose.\textsuperscript{107}

Thus, the integration doctrine five-factor test was born.

\textsuperscript{100} Exemption for Local Offerings from Registration, Exchange Act Release No. 33-4434, 1 Fed. Sec. L. Rep. (CCH) ¶ 2270, at 2608 (Dec. 6, 1961), \textit{available at} 26 Fed. Reg. 11896; Non-Public Offering Exemption, Exchange Act Release No. 33,4552, 1 Fed. Sec. L. Rep. (CCH) ¶ 2770, at 2918 (Nov. 6, 1962), \textit{available at} 27 Fed. Reg. 1316; see also Glover, \textit{supra} note 55, at 10 (“Release No. 33-4352, which was issued in 1962, remains the SEC’s most important pronouncement on integration. In this release, the SEC identified several factors that should be taken into account in determining whether separate securities offerings should be integrated and treated as part of the same offering.”).

\textsuperscript{101} Deaktor, \textit{supra} note 32, at 501.

\textsuperscript{102} Id.

\textsuperscript{103} Id. at 503 (alterations in original) (citing 27 Fed. Reg. 11, 316 (Nov. 6, 1962)).

\textsuperscript{104} Morrissey, \textit{supra} note 32, at 56 (footnote omitted).

\textsuperscript{105} See generally id. at 56 & n.147 (citing R. CARMEL, REGULATION BY PROSECUTION 52-59 (1982)) (explaining that in the early 1960s, President John F. Kennedy’s SEC chairman, William L. Cary, aggressively revitalized the SEC).


\textsuperscript{107} Id.
In a development stunning to practitioners at the time, the SEC announced that "any one of the factors could be controlling," when considering integration questions, thereby allowing that any one of the five enumerated factors alone could be conclusive in integration deliberation. Also remarkable to practitioners and scholars, then and now, was the SEC's failure to provide any insight regarding the interrelationship between the five factors or the weight that should be afforded each when conducting integration analysis.

With the second release in 1962, Securities Act Release No. 33-4552, the SEC sought to describe the limitations on the availability of the section 4(2) private offering exemption to registration. In explaining the relationship between integration and the private offering exemption, the SEC reiterated the exact five-factor test it had enumerated in the 1961 release. Interestingly, however, the introductory comments to the five-factor test stated "[t]he following factors are relevant to the question of integration..." The SEC did not comment on this language disparity, and any conclusions drawn by practitioners, commentators or issuers were only speculative as to whether any significance should be attached to the language disparity.

108. See Deaktor, supra note 32, at 502 ("Beyond this recitation the SEC did not provide any insight into the definition or interrelationship of the factors denominated as determinative, nor did it offer any reason for its exclusion of the method of distribution as a factor. Even more significant was the unprecedented pronouncement that any one of the factors could be controlling.") (footnotes omitted).

109. Id.

110. Id. at 502-03 ("Such a general guideline, without further refinement, engendered maximum theoretical uncertainty.") (footnotes omitted); see also Morrissey, supra note 32, at 56-57.

111. Glover, supra note 55, at 11 ("The SEC has never... [g]iven any clear guidance as to the relative weight that should be assigned to each factor. The SEC has indicated that transactions may be integrated even if all five factors are not present."); see also infra Parts III.A-B.


113. Id. ¶ 2918.

114. Id; see also Deaktor, supra note 32, at 503 ("Less than one year later, the SEC repeated almost verbatim the formula for applying integration enunciated in Securities Act Release No. 4434. The occasion was Securities Act Release No. 4552... . Significantly, the SEC introduced in Securities Act Release No. 4552 the five factors adopted in Securities Act Release No. 4334 with markedly different language: "The following factors are relevant to [the] question of integration...""); see also infra Parts III.A-B.

Again, remarkably, when given the opportunity in its 1962 Release to elaborate on the interrelationship between the five factors and the relevance and weight each factor might carry, the SEC refused to provide any insight or guidance.116 Much of the criticism lodged against the SEC with regard to the integration doctrine stems from the SEC's initial, and now subsequent refusal to provide clear guidelines to its five-factor test, and whether weight or relevance should attach where some, but not all, factors are present in different issuances.117

While the SEC is harshly criticized for its refusal to provide guidance with respect to its integration doctrine five-factor test,118 and has been plainly criticized for even initiating the integration doctrine,119 it has provided some guidance in the integration minefield by promulgating various safe harbor rulings that definitively state circumstances in which various simultaneous offerings will not be integrated.

C. Integration Safe Harbors

The SEC may have consciously balanced the vague nature of its integration criteria against various clear-cut safe harbor provisions designed to lend some certainty to the integration problem.120 Such safe harbor rules give careful issuers and practitioners certain assurances that particular financings, when arranged to take advantage of the safe harbor, will not be integrated, despite the five-factor test.

The SEC's integration safe harbors appear in Rule 152,121 Rule 147,122 Regulation D,123 Regulation A,124 Regulation S,125 Rule 701,126 and Rule

116. Deaktor, supra note 32, at 505 (“As in Securities Act Release No. 4334, the SEC in Securities Act Release No. 4552 refused to elaborate on the substantive nature of each of the five factors; nor did it indicate the degrees of 'relevance' which should be accorded them.”); see also Morrissey, supra note 32, at 57 (“In neither of the releases did the SEC expand on the meaning of the five factors, nor did it indicate how they should be weighted when applied to a series of offerings where some but not all the factors were present.”).

117. See supra notes 108-16; see also infra Parts III.A-B. But see supra note 22 (describing the impetus the SEC may have in initiating vague rules and doctrines in order to maintain a certain flexibility).

118. See generally infra Parts III.A-B.

119. See infra Part IV.A.1.

120. See Morrissey, supra note 32, at 57.


If an issuer can place its offerings comfortably within a safe harbor from integration, then the five-factor test does not apply. If a safe harbor is not available for simultaneous offerings, the offerings are not automatically integrated, but are then subjected to five-factor scrutiny.\(^\text{128}\)

The first integration safe harbor, Rule 152, was adopted in 1935 and purposed to protect discrete section 4(2) private offerings from integration if “subsequently thereto the issuer decides to make a public offering and/or files a registration statement.”\(^\text{129}\) Rule 152, which remains in force today, permits “those who have contemplated or begun to undertake a private offering to register the securities without incurring any risk of liability as a consequence of having first contemplated or begun to undertake a private offering.”\(^\text{130}\)

Rule 147, “the intrastate offering safe harbor,” creates a six-month safe harbor before and after Rule 147 offers and sales.\(^\text{131}\) “The safe harbor protects the Rule 147 offering against integration with registered or exempted offers and sales outside the envelope [six-month window].”\(^\text{132}\) Nevertheless, the Rule 147 safe harbor is unavailable, “even for offers and sales outside the [six-month period], if any securities of the same or a similar class as those in the Rule 147 offering are offered or sold within the [six-month period].”\(^\text{133}\)

Regulation D’s safe harbor, Rule 502(a),\(^\text{134}\) is similar to Rule 147, and provides for a six-month window before and after Regulation D offers and sales.\(^\text{135}\) “If two offerings are more than six months apart and there are no other issuances or sales of the same security during that six-month period, the two offerings will not be integrated.”\(^\text{136}\) Therefore, Rule 502 under

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127. 17 C.F.R. § 230.144A(e)(1999); see also Bradford, An Economic Analysis, supra note 45, at 652.


129. 17 C.F.R. § 230.152 (1999); see also Bradford, An Economic Analysis, supra note 45, at 652; Bradford, Expanding the Non-Transactional Revolution, supra note 30, at 464.


131. 17 C.F.R. § 230.147 (1999); see also Bradford, An Economic Analysis, supra note 45, at 653.


133. Id. at 653-54.


Professor Bradford explains:

These integration safe harbors [Rule 147 and Regulation D] are “one-sided.” They protect from integration only the offering pursuant to the regulation in which the safe harbor appears. The other offering that presents the integration problem is still
Regulation D provides that offers and sales that originate more than six months before the beginning of a Regulation D offering or originate six months after the conclusion of a Regulation D offering will not be considered a piece of the Regulation D offering so long as during the six-month window there are no offers or sales of securities of the same or a similar class, except offers and sales under an employee benefit plan.\textsuperscript{137}

The Regulation A safe harbor provision is captured in Rule 251(c) and protects three categories of securities offerings from integration with Regulation A offerings.\textsuperscript{138} Regulation A offerings will not be integrated with:

(1) Prior offers or sales of securities; (2) Subsequent offers or sales of securities that are: (i) registered under the Securities Act, except as provided in §230.254(d); (ii) Made in reliance on §230.701; (iii) Made pursuant to an employee benefit plan; (iv) Made in reliance on Regulation S; or (v) Made more than six months after the completion of the Regulation A offering.\textsuperscript{139}

Regulation S protects domestic issuers from integration through a long-standing SEC position which provides that particular offerings made solely to foreign investors (persons outside the United States) will not be integrated with domestic offerings, even if those offerings are simultaneous, provided that no selling effort is undertaken within the U.S.\textsuperscript{140} Regulation S and Rules 901 through 904\textsuperscript{141} contain "no formal integration safe harbor [language], but the SEC has long [maintained] that it will not integrate domestic offerings with simultaneous [issuances] made abroad solely to foreign investors."\textsuperscript{142}

Rule 701 exempts securities offerings made pursuant to specific compensatory benefit plans or compensation contracts.\textsuperscript{143} Rule 701(b)(6),\textsuperscript{144}

subject to integration and loss of its exemption, unless it has its own integration safe harbor.


\textsuperscript{137} 17 C.F.R. § 230.502(a) (1999).

\textsuperscript{138} 17 C.F.R. § 230.251(c) (1999).

\textsuperscript{139} Id.


\textsuperscript{141} 17 C.F.R. §§ 230.901-904 (1999).

\textsuperscript{142} Bradford, \textit{An Economic Analysis}, supra note 45, at 656.


\textsuperscript{144} 17 C.F.R. § 230.701(b)(6) (1999).
an exceptionally broad integration safe harbor, protects Rule 701 offerings from integration with "any other offering or sale whether registered under the Act or otherwise exempt from the registration requirements of the Act."\textsuperscript{145}

Rule 144(A), which serves to exempt resales of previously issued securities to discrete qualified institutional buyers, also contains an integration safe harbor which may, in limited cases, protect an original offering of securities from integration with other offerings.\textsuperscript{146}

Aside from the various safe harbors created by the SEC, the federal courts are often looked to for insight into the integration scenario. Unfortunately, those who look to the courts for guidance are met with further confusion, dissension and ambiguity.\textsuperscript{147} By in large, U.S. courts have done little more than adopt the integration doctrine as developed by the SEC.\textsuperscript{148} In fact, it has been stated plainly that "[m]ost of the wisdom on the integration concept is found in the Commission's rules and regulations and the no-action interpretive letters of the Staff. The courts have been asked only infrequently to apply the concept in order to hold offerings in violation of the registration provisions of the Act."\textsuperscript{149}

Further integration guidance is often sought through examination of the SEC's staff interpretations, commonly referred to as no-action letters, as described in the narrative above.\textsuperscript{150} The SEC began publishing its no-action letters in 1971 and by 1979 had "answered almost two hundred [inquiries that] requested interpretations of the integration doctrine."\textsuperscript{151} An American Bar Association Task Force on Integration found that the SEC's no-action responses

\textsuperscript{145.} Bradford, An Economic Analysis, supra note 45, at 655.
\textsuperscript{146.} 17 C.F.R. § 230.144A(e) (1999).
\textsuperscript{147.} See Campbell, The Overwhelming Case, supra note 30, at 303-04.
\textsuperscript{148.} See supra notes 98-99 and accompanying text.
\textsuperscript{149.} Task Force, supra note 44, at 614. The 1986 Integration Task Force Committee further explained that most of the integration cases brought into the U.S. courts were brought by the SEC seeking to enjoin further violations of the 1933 Securities Act, while other integration cases were brought by purchasers seeking to rescind their purchases of the offeror's securities. \textit{Id.}
\textsuperscript{150.} See generally supra note 65 and accompanying text.
\textsuperscript{151.} Task Force, supra note 44, at 617. In March 1979, the SEC announced that it would no longer issue responses to integration of securities offerings questions, because it had been flooded with response requests and believed that the fact intensive integration analysis would afford greater confusion on the subject. \textit{Id.} In 1985, the SEC resumed answering integration questions in no-action letters. See Wade, supra note 30, at 220-21 ("In 1985, the SEC resumed its attempt to clarify the integration question and began to respond, once again, to inquiries concerning integration.") (citing 17 Sec. Reg. & L. Rep. (BNA) 403 (Mar. 8, 1985)).
are less useful than one might hope, due to the complexity of the facts examined, the conflicting responses to similar inquiries, and the Staff's insistence on articulating its decisions through the five criteria of Release No. 4552, even in cases in which that formula did not adequately describe the offerings' distinctive elements.\textsuperscript{152}

While no-action analysis is useful on a case-by-case basis, little useful clarity has been added to the integration quandary by the staff interpretations of the SEC.

The safe harbor concept created by the SEC, wherein the agency delineates circumstances under which various and simultaneous offerings will not be integrated, represent what could be interpreted as a casual nod from the SEC acknowledging that perhaps some of the criticisms hailed upon it are actually heard.\textsuperscript{153} Nevertheless, the safe harbors do little to provide certainty and clarity when it comes to simultaneous offerings and the prospect of those offerings being integrated. Most simultaneous offerings will not fit neatly into a safe harbor and will, by default, fall to the five-factor test analysis. This five-factor analysis can be described as nothing short of a bane to the existence of securities practitioners and securities teachers and scholars.\textsuperscript{154}

III. BRIEF REVIEW OF INTEGRATION EVALUATION FACTORS

Apart from the contentions that the integration doctrine is conceptually flawed and is not grounded in 1933 Securities Act language or intent,\textsuperscript{155} the flashpoint where all commentators seem to agree is in criticism of the five-factor test the SEC announced in the 1960s, as detailed above.\textsuperscript{156} One scholar, referring to the five-factor test, wrote:

Everyone seems to agree that these criteria are nearly impossible to apply, principally because neither the Commission nor the courts

\textsuperscript{152} Task Force, supra note 44, at 617.
\textsuperscript{153} See Bradford, Expanding the Non-Transactional Revolution, supra note 30, at 470 ("The integration safe harbors show that the SEC recognizes and is trying to correct at least some of the problems with the integration doctrine. And the integration safe harbors do ameliorate the problems transactional exemptions create, although they do not solve them completely.").
\textsuperscript{154} See supra notes 30-34 and accompanying text.
\textsuperscript{155} See infra Part IV.A.1.
\textsuperscript{156} See supra notes 100, 107-17 and accompanying text.
have ever adequately articulated how these factors are to be weighed or how many factors must be present in order for integration to occur. As a result, the area remains confusing and dangerous.  

A. Five-Factor Test

Perhaps the most maligned component of the five-factor test is the ambiguity resulting from the SEC's refusal to give weight to the five factors or to describe in any comprehensible detail the relevance of each factor when compared against the others. One author explained that:

All five factors do not need to be met in order for two offerings to be integrated; according to the SEC, "[a]ny one or more" of the factors may be determinative. In practice, the SEC seems to give more weight to some of the factors than to others, and some SEC interpretations of the integration doctrine seem to utilize factors other than the five listed.

Each of the five factors has been broken down and criticized numerous times by various scholars in both law review articles and treatises. In analyzing the factors once again, I will briefly critique them and offer my own solutions.

1. The Different Offerings Are Part of a Single Plan of Financing

When the SEC is considering whether to integrate two simultaneous securities offerings it will closely scrutinize if the two offerings are part of a single financing plan. Despite the SEC's seeming reliance on this factor, there is little judicial or administrative interpretive guidance. Neither the courts nor the SEC has specified how, or even whether, to use any or all of the various components associated with the "single plan of

158. JOHNSON & MCLAUGHLIN, supra note 47, at 415-16 ("The five factors stated in SEC Release No. 33-4552 and in the note to Rule 502 provide little help in applying the integration doctrine. The SEC has provided no formal advice as to the weight to be afforded to each of the enumerated factors."); see also supra notes 108-17 and accompanying text.
159. Bradford, Expanding the Non-Transactional Revolution, supra note 30, at 462.
161. See Wade, supra note 30, at 213-14.
The SEC has not instituted an explicit method of deciding when two or more securities issuances constitute a single plan of financing. However, some cases and no-action letters seem to establish three distinct components when considering the single plan of financing factor: (1) the method through which an issuer offers securities; (2) the timing of the offerings; and (3) whether the offerings are financially interdependent. The intent of the issuer at the time of origination of the first offering seems to be determinative when determining whether a single plan of financing was contemplated at initiation. Of course, analyzing issuer intent is problematic in its own right. While it is uncertain whether these three components are necessary or even mandatory for single plan of financing analysis, further ambiguities are present as neither the SEC nor the courts have provided any definition or consistent application method for the three suggested components.

To add to the confusion, the SEC and the courts have seemingly joined consideration of the “single plan of financing” factor with the “same general purpose” factor without informative discussion for so doing. After nearly forty years of integration factor analysis, it is still unclear what constitutes a single plan of financing and how important this one factor is in considering an overall question of integration.

It seems clear that one reform step the SEC should take, and could take easily, would be to adopt a simple and clear definition of the term “single

162. See id. at 214.
164. See Bradford, An Economic Analysis, supra note 45, at 651.
165. See Deaktor, supra note 32, at 530-31 (“Suggestions have also been advanced that ‘single plan of financing’ encompasses consideration of the methods of sale and distribution. . . . The method of distribution is too readily manipulated to warrant significance as a determinative factor.”); see also Wade, supra note 30, at 212 (“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 integration by stating the it did not intend to make subsequent offerings.”).
166. See Wade, supra note 30, at 212; see also Bradford, An Economic Analysis, supra note 45, at 651 (“[T]two of the factors—whether there is a single plan of financing and whether the offerings are for the same general purpose—are generally given greater weight than the others. These two factors tend to overlap.”).
167. See Wade, supra note 30, at 213 (“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.” (emphasis added)).
plan of financing." The SEC could also officially adopt the three relevant components to the single plan of financing factor and provide concise guidelines for application of these components. If a clear-cut definition or model were made available, issuers, securities lawyers, and commentators would be better able to consider if two or more offerings should be integrated.

2. The Offerings Involve Issuance of the Same Class of Security

The SEC and courts, when analyzing integration questions, examine whether the multiple offerings are of the same class of security.\textsuperscript{168} In the past, when different classes of securities are offered, such as common stock in one offering and preferred stock in a second offering, the SEC and the courts have not integrated the two offerings.\textsuperscript{169} While this factor seems straightforward, commentators have argued that securities of different types, i.e., common versus preferred versus convertible, does not necessarily mean that they are of different classes.\textsuperscript{170} One leading scholar declared that if the identity of the issuers initiating the simultaneous offerings are different (meaning separate), then their securities are "irrebatably dissimilar and nonintegration would appear to be mandatory."\textsuperscript{171} Further, the argument posits that in analyzing whether the same class of securities is being offered in simultaneous offerings, a second consideration must be the identity of the offerees.\textsuperscript{172} If the simultaneous "offerings are not directed to the same pool of potential investors, this will be supportive of a position that the classes of securities are different."\textsuperscript{173}

The cases, SEC releases, and no-action letters offer scant guidance as to the relevance of this "same class of security" factor in the overall

\begin{itemize}
  \item[169.] See Loss & Seligman, supra note 163, at 1240 ("At times, slight differences between two securities have nonetheless been held to justify nonintegration.").
  \item[170.] See generally Deaktor, supra note 32, at 531-33 (describing analysis where identities of issuer and offerees are the most germane considerations to identifying same class of security).
  \item[171.] Id. at 531. Furthermore, "in determining whether two entities are in fact separate, their financial independence appears to be most important. The fact that the entities have one or more controlling persons in common will not automatically result in their being treated as a single issuer." Id.
  \item[172.] Id. at 532.
  \item[173.] Id. at 532-33. Moreover, "[b]ecause the same class of security factor is traditionally significant, the identity of the issuers and of the offeree pool is apt to be of substantial importance in the final integration decision." Id.
\end{itemize}
integration analysis. A further frustration is the failure of the SEC or the courts to clearly articulate a formula to follow when actually determining whether the securities are of the same class.\textsuperscript{174} The ambiguity is exacerbated by some scholarly analysis that the "same class of security" scrutiny is simply a consideration of the type of security, whether the securities are common, preferred, convertible, etc. If different, they are not the same class of security.\textsuperscript{175} Conversely, scholars argue that the class of security, regardless of its type, must be measured by identifying the issuer and the offeree.\textsuperscript{176}

It has been suggested that because the SEC refuses to clearly articulate what actually constitutes the "same class of securities," issuers are free to manipulate the registration system by offering securities that are only different in order to avoid integration.\textsuperscript{177} This represents a failure to appropriately protect investors.

Again, a simple reform the SEC should make, and could make easily, would be to adopt a simple and clear definition of the term "same class of security." The agency could officially adopt the position that it will always consider the identity of the issuer and offeree when making "same class of security" integration determinations, and decisively state that different issuers or dissimilar pools of investors will result in a non-integration determination. The SEC could also clearly state what types of securities will be considered and compared, and make official the presumption that different types of securities will lead to a determination that they are not the "same class of security." If clear-cut definitions were made available,

\textsuperscript{174} See Wade, supra note 30, at 216.


\textsuperscript{176} See supra notes 18-73 and accompanying text. One commentator seems to indicate that this "same class of security" analysis would best be undertaken by first identifying the type of security in both offerings, and then, if the same type of security is being offered in both issuances, before integrating the transactions, identifying the issuers and the investors to determine if varying offerors and offerees saves the offering from integration. \textit{See} LOSS & SELIGMAN, supra note 163, at 1240-41 (noting that "[t]he fact that two or more offerings are of the same class will not automatically lead to integration, for example, if the securities involve separate projects and have separate investors or if the balance of other factors does not favor integration.") (citation omitted).

\textsuperscript{177} See Wade, supra note 30, at 217-18 (describing that "[e]ven 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. This illustrates that the same class of security factor sometimes fails to reflect the Act's goal of investor protection") (citations omitted).
issuers, securities lawyers and commentators would be better able to consider if two or more offerings should be integrated.

3. The Offerings Are Made at or About the Same Time

Another factor the SEC and courts will examine when determining if two or more securities offerings should be integrated is whether they were made at or about the same time. Because the SEC has created various safe harbors that allow for integration-free offerings when the multiple offerings are separated by at least six months, or are outside the six-month window, this "at or about the same time" factor is perhaps the least weighty of the five factors.

Still, the SEC has provided no insight into the weight or relevance of this timing factor, leaving issuers and issuer counsel to deal blindly with an assortment of safe harbors and timing concerns. "Issuers for whom these safe harbors are unavailable . . . receive little guidance from cases and no-action letters regarding the amount of time necessary between offerings to avoid integration." Outside the safety of the six-month safe harbors, it is unclear how close in time two offerings must be made in order to constitute "at or about the same time." Based on safe harbor analysis and simple logic, it appears that a six-month separation between initiation of securities offerings may create a presumption against integration.

4. The Same Type of Consideration Is to Be Received

An additional factor in the test to determine if separate securities offerings will be integrated is whether the securities are being offered in

179. See supra Part II.C.
180. See Deaktor, supra note 32, at 534 (noting that "[p]roximity in time . . . has seldom been determinative; even if simultaneous, one or more of the other integration factors often will be viewed as more important") (citation omitted).
181. Wade, supra note 30, at 220 (citation omitted).
183. See JAMES COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 437 (1991); see also LOSS & SELIGMAN, supra note 163, at 1241 (describing that "[t]he adoption by the Commission of integration safe harbor rules for intrastate and Regulation D offerings separated by six months or more from other ostensibly exempt offers suggests that a six month period before and after an offering will be necessary to demonstrate that it was not made "at or about the same time"") (citation omitted).
exchange for the same type of consideration. While some argue that this “same type of consideration” factor can be valuable in integration analysis because it is based on an objective inquiry (rather than on the subjective query required in other factors), the “same type of consideration” factor is actually rarely helpful. Because cash is almost universally sought in securities offerings, the type of consideration used in two distinct securities offerings is rarely different, making this factor almost a non-factor. One commentator noted that “[c]ertainly, whether the same type of consideration is received is a meaningless factor.”

Arguments that the “same type of consideration” factor is still useful as an element in the integration test are generally made by commentators who observe that this element overlaps significantly with other factors, most often overlapping with the factor relating to the general purposes of the offering, and that the probative value of the “same type of consideration” factor must be properly limited through a holistic comparison to the other four elements of the test. Notwithstanding this argument, many commentators argue that the “same type of consideration” is a useless consideration in the five-factor test.

5. The Offerings Are Made for the Same General Purpose

The final factor the SEC and courts examine before deciding to

185. See Wade, supra note 30, at 218.
186. See LOSS & SELIGMAN, supra note 163, at 1242 (describing that “[t]he final factor, ‘same types of consideration,’ has rarely been of much significance in resolving whether two or more issues should be integrated for the simple reason that cash is the normal consideration in both integrable and nonintegrable offers”).
187. See id.; see also Wade, supra note 30, at 219 (noting that “[b]ecause 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”).
188. JOHNSON & McLAUGHLIN, supra note 47, at 415.
189. See Deaktor, supra note 32, at 535-36; see also Wade, supra note 30, at 218-19. Wade states that:
Where the consideration sought in exchange for two or more offerings differs, the courts and the SEC staff often conclude that the offerings should not be integrated. 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 SEC’s integration test.
Id. (citations omitted).
190. See Wade, supra note 30, at 218-19; see also supra notes 186-87 and accompanying text.
integrate multiple securities offerings is whether the offerings are being made for the same general purpose. Although SEC no-action letters and court interpretations are not consistent, the "same general purpose" consideration typically refers to the use of the proceeds gained in the securities offering. The SEC has determined that when proceeds from different offerings were used for different purposes, those offerings were not made for the same general purpose, including situations where proceeds from one offering were used for financial purposes and proceeds from a second offering were used for non-financial purposes. The practical approach of weighing different offerings' uses of proceeds against one another in two separate issuances loses its appeal when the proceeds from a single offering are used for more than one purpose. Multiple uses of proceeds by issuers in single offerings makes analyzing the same general purpose factor in integration contexts difficult at best.

Nevertheless, great confusion accompanies this "same general purpose" factor because of its analytical overlap with the "same plan of financing" factor. Like with each of the other five factors, the SEC has never formally indicated the weight that should be assigned the "same general purpose" factor when analyzing integration questions. Despite the lack of formal guidance, "[t]here have been recent indications that the SEC staff considers the 'single plan' and 'general purpose' tests to be somewhat more important than the other three tests." Even if recent indications

192. See LOSS & SELIGMAN, supra note 163, at 1235.
194. See Wade, supra note 30, at 216.
195. See id.; see also id. at 216 n.92.
196. See supra notes 166-67 and accompanying text. The SEC and courts will often analyze the "single plan of financing" and the "same general purpose" factors in such a way that blurs the individual characteristics of each factor. See LOSS & SELIGMAN, supra note 163, at 1235 (noting that "when the Commission staff or a court finds a 'single plan of financing,' the discussion will not be analytically distinct from a finding of 'same general purpose'.")
197. See Wade, supra note 30, at 214.
198. JOHNSON & MCLAUGHLIN, supra note 47, at 416 n.58. While acknowledging that the SEC has failed in providing guidance in integration analysis, close review of SEC action by scholars indicates that:

[n]either the Commission nor the courts have provided express guidance on how to weigh these factors when analyzing an integration problem. A review of the
demonstrate that the "single plan of financing" and "same general purpose" factors are now given greater consideration, it is still the case that not all of the factors must be present to justify integration.199

Again, it seems clear that one reform the SEC should make and could make easily, would be to adopt a simple and clear definition of the term "same general purpose." If the "same general purpose" factor relates exclusively to use of proceeds generated in a securities offering, the SEC should so formally specify and then adopt guidelines that would identify the similar uses of proceeds that would ultimately constitute the same general purpose. Explicit definitions of "same general purpose" and "single plan of financing" would clear the blurred line that exists between the two factors and allow issuers more certainty in deciding when to offer securities issuances. If a clear-cut definition or model were made available, issuers, securities lawyers and commentators would be better able to consider whether two or more offerings should be integrated.

Unfortunately, the integration problem is vastly more complex and far reaching than the simple adoption of clear definitions, as proposed above, could possibly hope to resolve. While the adoption of clear definitions would be a first step in addressing the integration conundrum, much more is needed to repair the integration quandary.

B. Criticisms, Ambiguities and Misunderstandings

The integration doctrine has been ridiculed and scorned by issuers, securities lawyers, scholars, professors and judges, almost since its inception.200 It has drawn this attention and derision because at its root, the doctrine is misleading, confusing and ambiguous,201 leading to unnecessary time spent analyzing it, cost in dealing with it and frustration in being perplexed by it.202 While criticism of the integration doctrine is varied,203

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199. See Loss & Seligman, supra note 163, at 1242.
200. See supra notes 108-19 and accompanying text; see also infra notes 207-15 and accompanying text.
201. See supra notes 30, 32, 44, 108-19; see also infra note 237 and accompanying text.
202. See Johnson & Patterson, supra note 1, at 542 (noting that "while today the concept of integration is much maligned and remains a continuing source of frustration because of its admittedly crude and hazy configuration, the notion of integration is a
the foundation of the strongest criticism probably lies in the ambiguous nature of the five-factor test articulated in 1962.204 When a securities issuer decides to initiate two or more different offerings within a short period of time205 and deems that the various safe harbors from integration are unavailable, that issuer must then resort to a five-factor integration analysis, as set forth in Securities Act Release No. 4552, in order to determine whether the multiple offerings will be integrated.206

Regrettably for the issuer and issuers' counsel, the five-factor integration test is a mishmash of undefined terms,207 overlapping considerations,208 "meaningless factor[s],"209 imprecise elements,210 and inconsistently interpreted applications.211 Further complicating this muddled doctrinal test is the SEC's original failure, and its continued refusal, to provide guidance or clarity as to how the five-factor test should be applied, weighted or defined.212 Every accessible commentator has criticized the SEC's "imprecise and inconsistent approach,"213 some with harsh attacks214 and others with supportive reform suggestions.215

Because the SEC states in its release announcing the five-factor test that any one or any combination of factors may result in the integration of multiple securities offerings, it is not necessary to find all factors present to integrate an offering; indeed, integration has been directed in situations when only one of the five factors was present.216 Conversely, non-integration has applied in cases where as many as three and four factors

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Based on this baffling structure, the integration analysis can only be conducted on a case-by-case, fact-intensive basis. Even more inexplicable is that in some instances the SEC, in its no-action integration responses, ignores the five factors and examines other relevant points not listed in the integration doctrine test. Issuers and their counsel are therefore left to apprehensively determine the SEC's probable course of integration action by relying awkwardly on the amorphous five-factor test and comparing enigmatic precedent as enumerated above. The opening narrative related in this Article, detailing the experiences of a young associate in an international law firm's securities department struggling to deal with securities issuances and integration analysis, is optimally illustrative.

IV. LITERATURE ANALYSIS

As noted herein, nearly every author who has written about the securities integration doctrine, either in law review articles, treatises or textbooks, has criticized the doctrine and its five-factor test. Even those authors that are generally supportive of the doctrine and take the time to describe its useful purposes, still write about it critically. Censure of the integration doctrine ranges from demand for its outright abolition to suggestion for various reforms. Each of the suggested reforms has been patently ignored by the SEC, despite the fact that many of the proposals seem meritorious.

A. Criticism of the Integration Doctrine

The two leading scholarly voices in the securities law integration doctrine arena are Professors Steven Bradford and Rutheford Campbell.
Both scholars have written intellectual pieces in the securities law area and both have written extensively about the integration conundrum. Many other scholarly voices have weighed in on the integration problem and have added richly to the debate that continues to rage. Nevertheless, of those two leading voices, one writes passionately and persuasively (and often) that the integration doctrine should be forsaken and annihilated; the other voice criticizes the doctrine repeatedly and harshly, but at the same time defends it as potentially useful economically and instead offers an alternative system which rejects the traditional transactional approach and suggests a weighted exemption scheme that would make more economic sense than integration.

While many have criticized the integration doctrine and numerous reforms have been proposed and carefully articulated, few commentators have suggested the outright abandonment of the doctrine. Most have noted the usefulness of integration and have tried to add clarity to the muddled picture of five-factor tests, various confusing safe harbors and a non-responsive SEC, by suggesting ways that the agency can straighten out the chaos it has created with its integration puzzle.

1. Calls for Elimination of the Integration Doctrine

Perhaps the earliest call for elimination of the integration doctrine, or in this case, partial elimination, occurred in 1979. Citing the nebulous five-factor formula that failed to function efficiently as a tool for resolving integration problems, Professor Darryl Deaktor called upon the SEC to "discard[] the formula." Further, Deaktor argued "the SEC should exercise its rulemaking authority to eliminate the applicability of integration to all offerings made pursuant to a transactional exemption other than section 3(a)(9) [exemption for intrastate offerings]."

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227. See supra note 45; Bradford, Expanding the Non-Transactional Revolution, supra note 30; see also Campbell, The Plight of Small Issuers, supra note 32; Campbell, The Overwhelming Case, supra note 30.

228. See supra notes 30, 32, 44, 47, 55, 61, 163.

229. See supra notes 30, 32, 44, 47, 55, 61, 163.

230. See supra notes 30, 32, 44, 47, 55, 61, 163.

231. See supra notes 30, 32, 44, 47, 55, 61, 163.

232. Id.
Professor Campbell began suggesting as early as 1985 that the integration doctrine should be eliminated entirely.233 In 2001, Campbell authored an article devoted exclusively to the abolition of the integration doctrine.234 This call for eradication was based on a careful review of the doctrine's historical roots and an argument that the 1933 Securities Act does not lend itself, in language or intent, to the formulation of an integration concept.235 According to Campbell, the FTC (and later the SEC) simply got it wrong and through agency exuberance to give teeth to the new 1933 Securities Act, created a doctrine where one was never intended.236 The FTC and SEC are therein held responsible for developing and promulgating a doctrine that "at its core . . . makes no sense" and is "utterly unsupported by any valid policy."237 Campbell continues: "[a]s originally signed into law, the 1933 Act contained no clear statement of an integration doctrine. Thus, while at various points in the original 1933 Act one finds words that can be interpreted as relevant to the matter of integration, the statutory language is inconclusive."238 According to Campbell, the integration doctrine, economically and practically, weighs down the effective functioning of U.S. capital markets.239

233. See Campbell, The Plight of Small Issuers, supra note 32, at 167 ("The solution to these problems is not to send the staff of the Commission scurrying about to adjust the safe harbor criteria. Instead, the proper solution is to eradicate the concept of integration.").
234. See Campbell, The Overwhelming Case, supra note 30.
235. See id. at 295-300, 305. Campbell offers:
[T]wo observations from [my] examination of the history of the integration doctrine. The first is that the original statutory language of the 1933 Act provided a less than compelling mandate for agencies or courts ever to adopt the integration doctrine in the first place. . . . The second observation is that the entire integration doctrine goes back to an administrative opinion rendered by the FTC only a few months after the 1933 Act passed. Thus, the doctrine was created approximately seventy years ago in the middle of the Great Depression by a completely inexperienced agency interpreting a new, highly technical statutory regime.
Id. at 305; see also infra notes 238-39 and accompanying text.
236. See Campbell, The Overwhelming Case, supra note 30, at 301-02. Discussing the FTC's decision to create the integration doctrine in 1933, Campbell writes "[u]nfortunately, it was a wrong decision and one that since 1933 has generated confusion and inappropriate outcomes. To make matters even more unfortunate, the decision was one that was not required by the words of the Act." Id. at 301.
237. See id. at 293 ("The fundamental problem with integration is not its terms; rather, the problem lies in the essential vacuousness of the doctrine itself. At its core, the doctrine makes no sense. Indeed, the doctrine is so utterly unsupported by any valid policy that one can only marvel that it has existed essentially unchallenged since 1933.") (citations omitted).
238. Id. at 295.
239. See id. at 321-22. Campbell describes the delicate balance struck by the 1933 Securities Act between investor protection and capital formation and then concludes:
Others have suggested that near total elimination of the integration doctrine would remove some of the "dead wood" from the SEC's disclosure system. Despite these hostile criticisms of the integration doctrine and the passionate call for the doctrine's elimination as useless and nonsensical, most commentators accept the integration doctrine as useful, if not necessary, and write conscientiously about how best to reform the flawed doctrine.

2. Calls for Revision of the Integration Doctrine

Most securities scholars and practitioners agree that the integration doctrine is a flawed and imperfect regulatory instrument. In 1986, the American Bar Association's Committee on Federal Regulation of Securities went so far as to commission a task force to review the history and uncertainty of the integration doctrine and propose reform initiatives. Originally, the Task Force began with the ambitious goal of formulating "an analytical matrix, based upon objective criteria, for resolving all integration problems." Despite its determined launch, the Task Force surrendered its objective because it could not reach a general consensus regarding appropriate reform initiatives and because they did not suppose the SEC would welcome such a wide-ranging approach. The Task Force eventually concurred with critical securities scholars and practitioners, that the integration doctrine was flawed and imperfect, and proposed a series of broader safe harbors intended to simplify the integration maze.

With these basic ideas in hand, one is able to demonstrate that the integration doctrine is antithetical to the balances struck within the 1933 Act and thus leads to a mandatory disclosure regime in instances where Congress indicated that the proper balance between investor protection and capital formation called for investors and issuers to bargain for investment information.

_id. at 322.

241. See Campbell, The Overwhelming Case, supra note 30, at 293.
242. See infra Part IV.A.2.
243. See supra note 222 and accompanying text.
244. See Task Force, supra note 44, at 596 (explaining that the task force was created "to examine the entire integration area and to make proposals that would help the Commission and the securities bar to answer questions of integration").
245. Id. at 597.
246. See id.
247. See generally id.
248. See id. at 631-38. The Task Force first proposed a new safe harbor based on distinctions between issuers, essentially adopting an issuer integration proposal made four
been its practice, the SEC essentially ignored the Task Force’s reform proposals as well.  

For over twenty years, and despite the obvious flaws and imperfections, numerous constructive ideas have been forwarded which sought to repair the integration doctrine’s flaws and imperfections. Apart from the ABA Task Force’s detailed review of the integration doctrine and its carefully presented reform initiatives in 1986, scholars, commentators and practitioners have all forwarded additional reform proposals and have called specifically for revision of the integration doctrine.

In 1971, Ronald Shapiro and Alan Sachs brought one of the first integration reform ideas to light when they suggested that a twelve-month temporal safe harbor be initiated for multiple securities offerings. They proposed limiting the safe harbor to no more than two offerings in a thirty-six month period. This integration reform proposal fell on deaf ears at the SEC.

Professor Deaktor, in a complex and thorough 1979 securities article, called for liberalized integration safe harbors, including a three-month temporal safe harbor. In order to bring peace to the integration problem, Deaktor proposed the following:

Several alternatives are available. The simplest would be to work years earlier by a different ABA committee wherein a three-part test for determining whether an offering of interests in a partnership should be regarded as part of a larger offering was projected. See id. at 631-32. The Task Force proposed that, akin to the six-month safe harbors in Rule 147 and Regulation D, no two offerings would be integrated if they were more than six months apart. See id. at 632-33. The Task Force further proposed that all securities be categorized into four distinct classes: (1) common stock; (2) preferred stock; (3) unsecured debt; and (4) secured debt, whereby simultaneous offerings would not be integrated if they were of different classes. See id. at 633-35. The Task Force also proposed that the purposes for securities offerings be divided into four basic categories: “(1) to raise funds for general purposes; (2) to eliminate specific indebtedness through an exchange offering; (3) to obtain human resources; and (4) to acquire specific properties or businesses,” whereby offerings would not be integrated if they were made for different purposes. Id. at 635-36. Finally, the Task Force proposed a number of “policy safe harbors” wherein various exempt offerings would be protected from integration when offered with other discrete simultaneous offerings. See id. at 636-41.

249. See generally Wade, supra note 30, at 221-22.
250. See infra notes 253-59.
251. See supra note 248.
252. See infra notes 253-92 and accompanying text.
254. See id.
255. See Deaktor, supra note 32, at 543.
within the existing regulatory framework by retaining the five-factor formula, but continue investor protection by moderately liberalizing the integration safe harbor of the rules. Along these lines, a suggestion to reduce the "dry" period required before and after a rule offering from six to three months has already been developed.\footnote{256}

Unfortunately, this integration reform proposition was ignored by the SEC. Kathryn Taylor Frame, in 1981, protested that the existing analysis under the securities integration formula had simply been confusing and inconsistent.\footnote{257} Frame, in suggesting integration formula reform, called upon the SEC and various state securities commissioners to "develop a specific objective test or definition for securities integration."\footnote{258} This integration protest found no sympathy at the SEC.

In 1982, Ronald Fein and Brian Jacobs proposed that the integration doctrine analysis be altered to treat all securities offerings as discrete and non-integrable unless the two offerings are part of a single plan of financing, involve the same class of securities, and are made contemporaneously.\footnote{259} Again, the SEC refused this reform invitation.

Professor Daniel Morrissey, in 1984, wrote comprehensively about the integration doctrine in the context of limited partnership offerings.\footnote{260} The ABA's Section of Corporation, Banking and Business Law and subcommittee on Partnerships, Trusts and Unincorporated Associations in 1982 produced a position paper wherein it proposed its own standards for the integration of limited partnership offerings.\footnote{261} Professor Morrissey opposed the recommendations of the ABA committee as subversive of the registration process and the integration doctrine claiming "[t]he American investor and the capital markets have been well served by the great reforms of the 1930s, and it would be unfortunate to have them eroded by the

\footnote{256. \textit{Id.} Deaktor continued that "[t]hese changes would constitute significant improvements, even though retention of the five-factor formula would perpetuate an irrational approach to integrating securities offerings. Moreover, the 'dry' periods of the rules would continue to impose arbitrary restrictions on financing without demonstrable commensurate benefit to investors." \textit{Id.} at 544.}
\footnote{257. Frame, \textit{supra} note 61, at 864.}
\footnote{258. \textit{Id.} at 886.}
\footnote{260. Morrissey, \textit{supra} note 32, at 45-46.}
\footnote{261. \textit{Id.} at 45-46.}
ABA's ill-advised proposal."

In 1986, the ABA's Committee on Federal Regulation of Securities Task Force on integration published its report and recommendations. As outlined above, the Task Force set an aggressive agenda, and proposed significant revisions to the integration test. Notwithstanding the scope of the proposals, the SEC was not convinced to reform the doctrine.

Professor Perry Wallace, Jr., in 1988, authored an article outlining obstacles to capital formation faced by small businesses, specifically mentioning the integration doctrine as one such barrier. To address this obstacle, Wallace strongly urged the SEC to adopt the Task Force safe harbor proposals announced in 1986. Aside from urging the SEC to adopt the Task Force initiatives, Wallace proposed adoption of more aggressive modifications to the Task Force safe harbor reforms, such as a shorter temporal safe harbor. This integration reform bid was shunned at the SEC.

In 1989, Professor Lyman Johnson and Steve Patterson took issue with the SEC's use of safe harbors, in this case Rule 152, as a means of clarifying the "irksome" integration doctrine. Johnson and Patterson

262. Id. at 77.
264. See supra note 248.
265. Wallace, supra note 61, at 937. Wallace wrote: Many existing legal requirements and limitations inject undue restrictiveness and uncertainty into the capital formation regulatory structure, which means that small issuers attempting to distribute securities still must proceed in fear of substantial adverse legal and economic consequences. And of the various sources of angst facing the small issuer, none has proved more frustrating and elusive than the doctrine of integration of securities offerings. Id. (footnotes omitted) (emphasis added).
266. Id. at 989 (noting that "[o]f the various proposals to improve the [integration] doctrine, those submitted by the task force of the ABA Committee on Federal Regulation of Securities are the most comprehensive and promising").
267. Id. Wallace argues that: [t]he modifications to the ABA proposals that this Article recommends are offered in the interest of the many small businesses that are particularly and inherently disadvantaged in the capital formation arena. The recommendations are at times less conservative than the ABA proposals, but they still represent a balance of the interests of investor protection and capital formation that furthers the public interest.
268. Johnson & Patterson, supra note 1, at 539-40. Johnson and Patterson recognize that Rule 152 created a safe harbor for issuers as follows: Essentially, the SEC now interprets rule 152 as precluding integration of a section 4(2) private placement of securities with a subsequent registered public offering
argued that the "SEC should approach the whole notion of integration in a more forthright and punctilious fashion,"\textsuperscript{269} reforming the doctrine directly rather than through the enactment of various safe harbors.\textsuperscript{270} This recommended approach has been ignored by the SEC.

Professor Cheryl Wade, in 1994, critically deconstructed the SEC's five-factor test for integration and found it wanting in numerous respects.\textsuperscript{271} Wade further opined that the five-factor formula failed to reflect the goals of the 1933 Securities Act and the intent of the integration doctrine.\textsuperscript{272} To bring integration in line with the goals of the 1933 Securities Act and the intent of the integration doctrine, Wade recommended that the SEC initiate a two-part integration inquiry where it: (1) adopts the safe harbor proposals of the 1986 Task Force, adding a separate safe harbor for offerings that do not involve the same type of consideration; and (2) adopts a "rational business reason" test for division of offerings as protection from integration.\textsuperscript{273} Wade's reform proposals have been disregarded at the SEC.

Also in 1994, Professor Steven Bradford analyzed a new Regulation A integration safe harbor created by the SEC.\textsuperscript{274} Bradford noted that in

\begin{itemize}
\item of additional securities even if the issuer contemplated the public offering at the time the private placement commenced and undertook the public offering shortly after completing the private placement.
\end{itemize}

\textit{Id.} at 539 (footnotes omitted).
\textsuperscript{269} \textit{Id.} at 540.
\textsuperscript{270} \textit{Id.} The article further suggests that the "SEC, somehow, ought to face those matters squarely, not leave the matters buried in an uncoordinated jumble of regulatory complexity where the sheer mass of rules often makes rethinking of core premises so difficult, but therefore so necessary." \textit{Id.}
\textsuperscript{271} \textit{Id.} supra note 30, at 221-22 (noting that the "SEC's test for integration is imprecise, inconsistently applied and easily manipulated by issuers intending to evade the Act's registration requirements").
\textsuperscript{272} \textit{Id.} at 227.
\textsuperscript{273} \textit{Id.} at 236-41. Wade indicates that "[i]n this Article, I propose a less easily manipulated and better defined integration analysis to replace the SEC's current integration formula. The proposed analysis . . . would establish a two-part inquiry to determine whether offerings warrant integration." \textit{Id.} at 236.
\textsuperscript{274} \textit{Bradford, The New Safe Harbor, supra} note 32, at 255. Bradford writes: Critics have long charged that the Securities Act of 1933 (Act) and the Securities and Exchange Commission (SEC), which administers the Act, are insensitive to the capital formation needs of small businesses. The Act's regulatory regime, it has been argued, is too rigid and expensive and discourages or precludes small businesses from selling securities. In 1992, in reaction to such criticism, the SEC proposed a variety of rule changes designed "to facilitate capital raising by small businesses and reduce the compliance burdens placed on these companies by the federal securities laws." Among these "small business initiatives," adopted in the summer of 1992, was a little-noticed, virtually undiscussed new rule—Rule
response to the fierce criticisms heaped upon the SEC in connection with the integration doctrine, the agency adopted several integration safe harbors, "designed to ease some of the uncertainty inherent in the five factor test." Bradford sternly criticized the SEC for its "silence in adopting the new Rule 251(c) safe harbor" because such silence has "produced uncertainty concerning the basic application of the rule." Bradford implored the SEC to "explain what the Commission is doing and why," concluding that explanation and discussion could resolve many of the ambiguities and uncertainties that have arisen under the integration doctrine and its safe harbors. Bradford concluded that "the SEC's failure to explain or justify provisions like Rule 251(c) produces unnecessary ambiguity and uncertainty.

Bradford returned in 1996 with an exposé on the transaction exemptions of the 1933 Securities Act from an economic perspective. He developed a cost-benefit analysis wherein he analyzes the benefits of registration against the steep costs associated with registration, and further examines the economics of the integration doctrine and determines the effect of multiple offerings on the costs and benefits of registration. Bradford argued that the uncertainty and ambiguity of the five-factor test

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251(c)—protecting Regulation A offerings of securities from integration with other offerings.

Id. at 255 (footnotes omitted).

275. Id. at 266.

276. Id. at 284. In responding to two issues arising under the Regulation A safe harbor, Bradford claims "[t]he rule and SEC commentary hardly provide a clue as to the resolution of this issue. A single, simple comment from the SEC could have easily prevented either of these issues from arising." Id.; see also supra notes 51-54 and accompanying text.

277. Id. at 289. Bradford concludes:

Rule 251(c) appears to be a sensible contraction of the integration doctrine, but it could have been much better. It is, in part, a victim of the SEC's unwillingness to explain what the Commission is doing and why. The SEC has, unfortunately, continued its regrettable practice of substantially revising the integration doctrine in rule revisions and even no-action letters without explanation or discussion.

Id. (emphasis added).

278. Id.

279. See Bradford, An Economic Analysis, supra note 45.

280. Id. at 658. Bradford continued:

The SEC has paid little or no attention to the economics of the integration doctrine. It has instead tried to define the concepts "offering" and "part of an issue" metaphysically. This misdirected focus is unfortunate because the economic model developed in this Article provides several insights into the integration problem. In some instances, the SEC's approach makes sense; in other instances, it does not.

Id.
is costly because it increases risks to issuers,\(^\text{281}\); increases the legal costs of issuers,\(^\text{282}\) increases the possibility of mistakes by the SEC in particular scenarios\(^\text{283}\) and increases the cost of administration.\(^\text{284}\) Bradford concluded "although the five factors are relevant to the economic analysis of integration, using them may cost more than they are worth,"\(^\text{285}\) because the "gains associated with more certain rules . . . could outweigh the costs associated with underinclusiveness or overinclusiveness, especially because the application of the five-factor test appears so imprecise and inconsistent."\(^\text{286}\)

Finally, in 2000, Professor Bradford once again addressed the integration dilemma, this time in the context of expanding the non-transactional nature of registration.\(^\text{287}\) Bradford acknowledged many of the previous recommendations for repairing the integration doctrine and addressed the calls for elimination of the doctrine outright.\(^\text{288}\) In concluding that each of the revision suggestions come up short, and in arguing that abolishing integration is short-sighted, Bradford proposed an entirely new approach: a weighted exemption system.\(^\text{289}\) Essentially, Bradford developed a cost-benefit formula that weighed the costs of certain exemptions and, through his weighted exemption system, required that securities be registered only when the benefit of registration (investor protection) outweighed the cost.\(^\text{290}\) Under Bradford's system, which relied heavily on the concept of aggregation,\(^\text{291}\) the 1933 Securities Act would be freed from

\(^\text{281. Id. at 669. Integration potentially chills issuers' attempts to offer securities even when offerings should not be integrated. Id.}\)

\(^\text{282. See id. Legal costs are increased because issuers are more likely to need legal advice prior to initiating offerings. Id. Further, costs are increased because it is inherently difficult for lawyers to predict the SEC's integration position. Id.; see also supra note 65 and accompanying narrative.}\)

\(^\text{283. See Bradford, An Economic Analysis, supra note 45, at 669.}\)

\(^\text{284. Id.}\)

\(^\text{285. Id.}\)

\(^\text{286. Id. at 669-70.}\)

\(^\text{287. See Bradford, Expanding the Non-Transaction Revolution, supra note 30.}\)

\(^\text{288. Id. at 467-73.}\)

\(^\text{289. Id. at 473. Bradford proposes: It is necessary to rethink the transaction exemptions to develop a system that allows issuers to use multiple exemptions where appropriate but retains the registration requirement when it is cost-effective—a system, in other words, that is efficient, but not subject to manipulation. The answer lies in a weighted exemption system. Id.}\)

\(^\text{290. Id. at 474-80.}\)

\(^\text{291. Id. at 462-63 (noting that "closely related to the integration doctrine is the concept}\)
its transactional underpinnings and a sole focus on exemptions and aggregated offering prices would replace it.2⁹² The integration doctrine and its complex system of metaphysics, safe harbors, and informal interpretations that keep the system (barely) alive should be abolished and replaced with the weighted exemption system proposed in this Article.2⁹³ This creative weighted exemption proposal has found no acceptance at the SEC.

B. Support for the Integration Doctrine

Again, as noted above, the integration doctrine is a useful regulatory instrument, albeit, one that is riddled with ambiguities and confusion and, as such, is justly criticized. Nevertheless, calls for the doctrine's abolition go too far, as aggressive revision of the doctrine by the SEC will allow integration to continue and serve its purpose of protecting investors from unscrupulous issuers seeking to avoid valid, required registration.

Acknowledgment of the genuine usefulness of the integration doctrine has been voiced by a number of leading securities scholars.²⁹⁴ Some of aggregation, which is used to calculate the maximum offering amount in some of the exemptions") (footnote omitted).

²⁹². Id. at 476-77. Bradford introduces the idea that "[a]n issuer could use multiple exemptions for a single offering, subject to an overall dollar amount limit. In calculating whether an issuer's total sales fall within that limit, sales pursuant to each exemption would be weighted based on the amount of investor protection the particular exemption provides." Id. at 473-74.

²⁹³. Id. at 485. Critical analysis of Bradford's weighted exemption proposal is beyond the scope of this Article.

²⁹⁴. Wade, supra note 30, at 208-09 ("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 principle to avoid abuse of the exemptions from registration."); see also Johnson & Patterson, supra note 1, at 542-43 ("This remains true even as heightened attention has been given in recent years to yet another policy objective of the Securities Act—fostering capital formation. In this altered regulatory environment the doctrine of integration still is needed, but the doctrine is subjected to an additional strain because it must continue to serve the original goal of investor protection while not unduly stifling capital formation, particularly for smaller businesses.") (footnote omitted)(emphasis added)); Task Force, supra note 44, at 623-24 (describing that "new integration rules should be devised to accomplish three objectives: to provide objective standards that minimize confusion about their application and, correspondingly, minimize the interpretive burden on the Staff; to eliminate doubt regarding the effect of satisfying or not satisfying a particular test; and to require integration in a particular situation only if it would enhance investor protection and not merely impose a greater burden to capital formation"); Morrissey, supra note 32, at 77 ("However much issuers resent it, registration is not unduly onerous or a serious impediment to capital formation when viewed in light of the recently liberalized
commentators base their general support for integration upon the stated goal of promoting investor protection through full and fair disclosure, and argue that this goal is facilitated by integration. Most commentators writing in support of integration do not question the authenticity of the doctrine, nor the FTC's authority in creating it, but do acknowledge the severe shortcomings inherent in its principles.

One commentator, when comparing the economic cost and benefit of integrating two small offerings, approvingly finds that:

[s]urprisingly, the much-maligned five-factor integration test developed by the SEC helps to determine when the additive view is likely to be correct and when, because of differences between the two offerings, integration makes less sense. All five factors have at least some relevance to the costs and benefits of registering the combined offering.

It is therefore evident that a number of scholars have found integration to be useful from an economic perspective in some cases. Still, the greatest support for the doctrine is found in the writings of those who believe it protects investors by requiring that two offerings, that likely should have been offered as a single issuance in the first place, be integrated. Notwithstanding this support expressed for integration, the most recent and persistent voices have called for the abolishment of the

exemptions and the SEC's steady attempt to expedite the process. Perhaps the true aversion many issuers have to registration is based on fear that the SEC or state authorities might deem their offering materials to contain inadequate disclosure or to present unfair investment opportunities.

295. Wallace, supra note 61, at 989 (arguing that "[t]he SEC should give serious consideration to the ABA proposals as modified by the recommendations outlined in this Article. The result of such consideration could well be the beginning of a truly useful and workable doctrine of integration of securities offerings" (emphasis added)); Morrissey, supra note 32, at 46 (noting that "[t]he Article will then conclude by urging rejection of the subcommittee's new test and continued use of the integration criteria articulated in recent judicial opinions. These steps are necessary to safeguard the prime tool of investor protection, the registration process").

296. See supra notes 294-95 and accompanying text. But see supra Part IV.A.1 (characterizing recent calls for elimination of the integration doctrine).

297. Bradford, An Economic Analysis, supra note 45, at 666. Bradford concludes "[t]hus, the five factors considered by the SEC in deciding whether to integrate offerings have some justification in economic theory." Id. at 668.

298. See supra notes 295-97.

299. See supra notes 294-95.
V. THE INTEGRATION DOCTRINE AS AN ONGOING CONCERN

Despite a passionate call for eradication of the integration doctrine and a creative call for a completely new exemption-based approach, I add my voice to the integration doctrine mix and argue here that securities integration should continue as a viable securities law doctrine, although it must be reformed to truly function effectively. The exasperation described vividly by integration critics is not lost on me, as I have suffered and struggled on many occasions through the quagmire that is integration. Nevertheless, for a number of reasons, some policy, some practical, the integration doctrine should be repaired, revised and reformed.

A. Policy Reasons Why the Integration Doctrine Should Remain

In 1933, when the 1933 Securities Act became law and when the integration doctrine was announced, the primary focus of lawmakers, and later the SEC, was to protect investors through full and fair disclosure of important material information thought necessary for making sound investment decisions. The integration doctrine arose over a concern that registration requirements would be improperly avoided by unscrupulous securities issuers who would splinter single offerings of securities into separate smaller offerings that would then be forced into discrete exemptions from registration, thereby depriving investors of that full and fair disclosure mandated by the 1933 Securities Act.

For twenty years following the initiation of the integration doctrine, investor protection was the most important consideration in securities issuances. Slowly, there arose concerns that the opportunity to raise capital by various businesses and corporations was being constrained by the registration requirements of the 1933 Securities Act, particularly by the integration doctrine. Eventually, small issuers were identified as the

300. See supra Part IV.A.1.
301. Wade, supra note 30, at 227 (describing that “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.”); see also supra notes 75-86 and accompanying text (describing the early focus on protecting the investor).
302. See supra notes 82-92 and accompanying text.
303. See id.
304. Wallace, supra note 61, at 941 (reporting that “because of the inadequacies in
parties that were most restricted by the registration requirements of the 1933 Securities Act, and the integration doctrine was identified as being particularly offensive to the capital-raising ability of said small issuers. In response to these criticisms, the SEC created various safe harbors that enabled small businesses and other issuers easier access to the capital markets by exempting certain offerings from registration. In spite of the safe harbors, recently much has been written about the continued plight of the small issuer, and the SEC has again been called upon to ease the registration requirements for smaller issuers. Very little has been written or voiced recently in connection with investor protection and the goals associated therewith. Until now.

Investor protection is the key ingredient in the 1933 Securities Act, as it imposes the requirements of registration “in order ‘to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails’ in the interest of investor protection.” Today, in a market ruled by volatility and violent swings, and in this current environment of corporate wrongdoing and company management criminality, perhaps at no time in history, apart from the early 1930s and the Great Depression, has there been a greater fundamental need for investor protection.

Investors need to be protected now more than ever. Just like in the market collapse of the late 1920s and early 1930s, the current crisis is being fueled largely by the fraudulent actions and criminal behavior of the issuers of securities. The comparison between corporate and issuer wrongdoing the present approaches to the integration doctrine, capital formation has suffered. For small businesses in particular, the spectre of regulatory reproach and private litigation can easily dash capital formation plans”).

305. Id. at 941-42; see also Campbell, The Plight of Small Issuers, supra note 32.
306. See supra Part II.C.
307. See Wallace, supra note 61; Campbell, The Plight of Small Issuers, supra note 32; Glover, supra note 55.
309. See supra notes 4, 8, 56; see also infra notes 314, 320, 323.
310. See supra notes 6, 10, 15, 17.
311. See supra notes 7, 8; see also infra notes 314, 324.
312. With billions upon billions of dollars being invested in the stock market today and with millions of people basing their retirement plans almost solely upon the U.S. markets, protections must be put into place to safeguard the futures of investors. See Greg Burns, Scandals Shake Faith in Big Business, Chi. Trib., July 28, 2002, at A-1. Particularly, steps must be taken to protect investors from corporate wrongdoers.
313. See supra notes 71-78 and accompanying text (describing the historical market collapse leading to the Great Depression); see also supra notes 6-8, 10, 15, 17 and
by perpetrators of securities fraud in the 1930s and those corporate criminals today, particularly in the cases of Enron, Tyco, and WorldCom, is startling. The mandate of the 1933 Securities Act is to protect investors accompanying text (describing the corporate malfeasance that plagues the capital markets today).

314. Congress reported in 1933 that over half of the securities sold in the decade following World War I were worthless because the securities issuers inflated earnings figures, deceived investors and lied about the worth of their respective companies. JOHNSON & MCLAUGHLIN, supra note 47, at 1-5. By hiding expenses in various complex accounting maneuvers, inflating earnings projections, deceiving investors and lying about the worth of their respective companies, WorldCom, Enron and Tyco executives were promoting securities that are now worthless. See supra notes 6, 8, 10, 15; see also infra note 324.

Based on their fraudulent representations and flagrant violations of securities laws, two former WorldCom executives were arrested and charged with fraud and conspiracy. Former WorldCom Executives Face Federal Fraud Charges, N.Y. TIMES, Aug. 2, 2002, available at http://www.nytimes.com/aponline/business/AP-WorldCom.html (url no longer available) (on file with author). The New York Times reports that:

Two former WorldCom executives [former Chief Financial Officer Scott Sullivan and former Director of General Accounting Buford Yates] surrendered Thursday [August 1, 2002] to face fraud and conspiracy charges accusing them of hiding $3.8 billion in company expenses from investors in the now bankrupt telecommunications giant.

The arrests were the second in two weeks of executives of large corporations that have filed for protection from creditors in bankruptcy court. Federal agents led the pair out of New York’s FBI headquarters in handcuffs at midmorning, enroute to court. The men, both wearing dark suits, did not speak to ... reporters. Id. A seven-count complaint, unsealed in federal court Thursday, charges them with securities fraud, conspiracy, and false statements to the Securities and Exchange Commission. Id. The securities fraud and false statement charges carry a maximum prison sentence of ten years. If convicted of conspiracy, they face up to five years in prison. Id.


[The plea arrangement with Myers] may help prosecutors go after Scott Sullivan, the ex-WorldCom CFO whose plea of not guilty last month paved the way for a
based on "full and fair disclosure of the character of securities." The SEC was given full authority to implement and police the 1933 Securities Act and the 1934 Securities Exchange Act.

The SEC has failed, in an unprecedented way, to protect the investors

Myers pleaded guilty in New York to one count each of conspiracy to commit securities fraud, securities fraud, and making false filings with the Securities and Exchange Commission. ... Myers told U.S. District Judge Richard Casey that, on the instruction of senior management, he falsified WorldCom's financial statements between October, 2000, and June, 2002, by hiding costs to make the company appear more healthy.

One former Enron official in November 2002 pleaded "not-guilty" to a seventy-eight-count indictment "charging him with masterminding complex financial schemes that enriched him and helped doom the energy-trading powerhouse. If convicted [Andrew Fastow] technically could face a maximum sentence of 860 years in prison." Enron's Fastow Pleads Not Guilty, USA TODAY, Nov. 7, 2002, at B1.

In September 2002, three top executives at Tyco, former CEO Dennis Kozlowski, former CFO Mark Swartz, and former general counsel Mark Belnick were indicted on charges that they reaped $600 million through a racketeering scheme involving stock fraud, unauthorized bonuses and falsified expense accounts. Andrew Ross Sorkin, Two Top Executives Charged with $600 Million Fraud Scheme, N.Y. TIMES, Sept. 13, 2002, at A1.

The New York Times reports that:

The authorities accuse Mr. Kozlowski and Mr. Swartz of stealing $170 million from the company itself and reaping $430 million more by covertly selling Tyco stock while "artificially inflating" the value of that stock. Tyco stock has fallen 70 percent in value this year. ... The New York grand jury indictments ... also accuse Mr. Kozlowski and Mr. Swartz of bribing a Tyco board member and several Tyco employees apparently to try to keep the scheme secret. The indictment accuses Mr. Kozlowski and Mr. Swartz of "enterprise corruption," a charge often used in Mafia prosecutions.

In announcing the indictment, an SEC representative claimed:

Kozlowski, Swartz and Belnick treated Tyco as their private bank, taking out hundreds of millions of dollars of loans and compensation without ever telling investors. ... Defendants put their own interests above those of Tyco's shareholders. Those shareholders deserved better than to be betrayed by the management of the company they owned.

Id. (emphasis added).


316. JOHNSON & MCLAUGHLIN, supra note 47, at 5.
it was created to protect.

The integration doctrine was created to protect investors.\(^{317}\) Initially, it was supposed to discourage unscrupulous securities issuers from purposely fragmenting offerings rather than registering them, as required by the 1933 Securities Act, thereby deceiving investors.\(^{318}\) In a meaningful, yet infuriating way, the integration doctrine has stood for investor protection from unscrupulous issuers for nearly seventy years.

**B. Practical Reasons Why the Integration Doctrine Should Remain**

Aside from policy reasons and the importance of investor protection and the economic justifications for integration, a number of important practical considerations are evident when considering whether to abolish or repair the integration doctrine.

One factor, overlooked consistently by commentators, is the constructive chilling effect the integration doctrine has on prospective securities issuers. Before initiating new securities sales, a prospective issuer must approach its issuance cautiously, vigilantly planning, seeking advice from legal counsel before carefully joining pooled transactions or initiating its own issuance. While most commentators squash the idea that it is productive for the issuer to incur extra costs, such as legal fees, in an attempt to form capital, I argue that, particularly in this current environment of corporate malfeasance, a doctrine that forces caution in corporate executives and company management is crucial.

Another factor ignored wholesale by those who call for the integration doctrine's demise are the scandalous intentions and criminal minds of corporate executives and issuers of securities. Critics of the integration doctrine get so occupied with removing obstacles to capital formation, particularly for small issuers, that the entire eradication argument seems to be based on a presumption that no issuer, particularly a small issuer, would intentionally circumvent the registration rules to defraud investors.\(^{319}\) Certainly, circumstances exist where a fraudulent issuer would improperly splinter a large offering into separate, distinct issuances in order to avoid registration, and simultaneously target investors, based on its choice of exemption, who would be susceptible to erroneous purchase of fraudulent


\(^{318}\) See supra Part II.A.

\(^{319}\) See generally Campbell, *The Overwhelming Case*, supra note 31; Bradford, *Expanding the Non-Transaction Revolution*, supra note 30.
securities undetected by the SEC because of its non-registration status. In this explosive capital market environment, such a scenario is not difficult to imagine.

Further, as the economy lurches ahead in fits and starts and the capital markets battle to avoid a significant stock market crash, and in an environment where the U.S. Congress has passed legislation to regulate the accounting profession and crack down on corporate wrongdoers, and at

320. See Bulls Charge Back: Dow Soars Nearly 500 Points in Second-Biggest Point Gain Ever, Chi. Sun-Times, July 25, 2002, at 1. "Stocks rode a euphoric high Wednesday [July 24, 2002], turning in their best session in nearly 15 years, as the Dow Jones industrial average levitated by nearly 500 points." David Roeder, Light at the End of the Tunnel . . . or Was Wednesday’s Near 500 Point Gain Just a Glimmer of False Hope?, Chi. Sun-Times, July 25, 2002, at 47. After months of gloom and precipitous drops in the capital markets, the near 500-point rally caused much speculation as to whether the markets were rebounding or bouncing. See id. at 52 ("Not all analysts are convinced the rally will hold. ‘Every time we’ve had one of these violent rallies, it’s been a classic bear market bounce with no follow through,’ said Todd Clark, head of listed equity trading at Wells Fargo Securities."); see also Matt Krantz, Markets Extend Winning Streak: ‘Turn in Psychology’ Might Signal Rebound, USA Today, July 30, 2002, at 1A (“In what is shaping up to be the stock market’s most impressive showing this year, an explosive rally Monday [July 29, 2002] sent the Dow Jones industrial average to its second gain of 400 points or more in a week, fanning hopes that the worst might finally have passed.”). But see Alexandra Twin, Bears Rage on Wall Street, CNN Money, Aug. 2, 2002, available at http://money.cnn.com (accessed from homepage by entering title into CNN/Money search engine) (last visited Feb. 6, 2003) ("U.S. stocks closed out a highly volatile week sharply lower Friday [August 2, 2002], although off their worst levels, on a weak employment report, a profit warning from Walt Disney, and a Goldman Sachs prediction that the Federal Reserve will be forced to cut interest rates by the end of the year."). But see Barbara Hagenbaugh, Uncertainty Slows March to Recovery, USA Today, Nov. 7, 2002, at 1B (“Recent data have shown the economy slowed dramatically in September and October [2002]. The number of jobs in the nation shrank; consumers cut spending, especially on cars; and wary CEOs scrapped plans to buy equipment. Early signs suggest things won’t pick up in November or December [2002]."). See supra notes 4, 8, 56.

321. See supra notes 312-13; see also supra notes 4, 8, 56.

322. See also Elizabeth Bumiller, Bush Signs Bill Aimed at Fraud in Corporations, N.Y. Times, July 16, 2002, at C1. Bumiller reports:

[i]n a sign of how profoundly the nation’s business scandals and volatile stock market have rocked his administration, President Bush signed a sweeping corporate-fraud bill today [Sarbanes-Oxley Act] with central provisions that he opposed just three weeks ago. Even though he had objected to the provisions earlier and had promoted his team’s corporate experience in his presidential campaign, Mr. Bush cast himself today as the protector of the small investor and the rank-and-file worker. Vowing stiff punishment for corporate wrongdoers, Mr. Bush bluntly threatened, “No more easy money for corporate criminals, just hard time.” He called the legislation “the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt.”
a time when investor confidence has been battered, it would be a most inopportune time to, in essence, deregulate the securities integration area.

323. See Burns, supra note 312 ("A wave of corporate scandals and the sinking stock market have shaken Illinois residents' faith in big business, and only a handful think now is a good time to invest."). Commentators are beginning to compare the market crash of the Great Depression era to the 2002 stock market tumble and are stating that greater numbers of people will suffer now than in the 1930s. See Janet Kidd Stewart, Anger Rises as Markets Fall, Chi. TRIB., July 28, 2002, at 5-1. Stewart compares the two eras, writing:

And although their [1990s investors] pain hasn't reached the breadlines and joblessness of the Depression era, in some respects it has cut deeper into society than the 1929 stock market crash. Then, just 1.2 percent of the population invested in stocks. ... Today, after the historic bull market run-up of the 1990s, more than half of American households own stocks, and nearly a third of their total net worth is tied to the market.

324. Already, commentators are pointing out that the major corporate scandals being played out currently are in industries that were deregulated by Congress in recent years, such as telecommunications (WorldCom) and energy (Enron). See Jeanne Cummings et al., Bush Crackdown On Business Fraud Signals New Era, WALL ST. J., July 10, 2002, at A1. In giving a "tongue-lashing" to big business executives, President Bush marked a distinctive swing from his election campaign of two years ago where he wooed many of those same business executives by promising an administration that would scale back Washington's interference in their affairs. Id.

But that effort has been hurt by the continuing stream of corporate scandals—and the fact that the most notorious have exploded in sectors deregulated in the 1990s:

- Enron Corp. and its competitors in electricity and energy trading and WorldCom Inc., Global Crossing Ltd, and Qwest Communications International Inc. in telecommunications.

Id. (emphasis added). The depth of the scandals in companies whose industries were deregulated in the 1990s continues to amaze. Additional fraud charges were filed against WorldCom in November 2002. Kurt Eichenwald & Seth Schiesel, S.E.C. Files New Charges on WorldCom, N.Y. TIMES, Nov. 6, 2002, at C1 ("The Securities and Exchange Commission filed additional fraud charges against WorldCom yesterday, saying that the company inflated earnings by almost $2 billion more than it had previously disclosed in accounting manipulations that begin in 1999, earlier than was originally charged." (emphasis added)).


Another example of corporate scandal in the deregulated energy industry is that of El Paso Corp., a natural gas supplier that "illegally tightened natural gas supplies needed by California during the state's energy crisis, contributing to a rise in power prices" as the company "withheld extremely large amounts of capacity that could have flowed to its California delivery points." El Paso Hurt Calif.: Judge CNN MONEY, Sept. 23, 2002,
Under intense political and public scrutiny, the SEC can ill afford to dissolve a doctrine that removes certain investor protections, despite the dubious effectiveness of the application of the doctrine.

VI. A NEW INTEGRATION ANALYSIS

A. Proposed Reforms to the Integration Doctrine

In arguing that the integration doctrine is still a useful and important regulatory tool, one must acknowledge that the doctrine’s current formulation and history are problematic and grueling. Nevertheless, a simplified integration analysis could prove to be valuable and comprehensible, if the proper protections inherent in the doctrine remain intact. To that end, I propose the following integration doctrine test.

1. A New Safe Harbor

Because an integration safe harbor protects offerings from integration, the current five-factor test does not apply to offerings protected by a safe harbor.\(^\text{325}\) I propose that the SEC adopt a new rule where, similar to the Rule 147 and Regulation D safe harbors, all multiple offerings of securities that occur outside a six-month period be protected from integration. Currently, only Rule 147, Regulation D and to an extent Regulation A offerings are protected from integration if they occur either six months before or six months after the Rule 147, Regulation D or Regulation A sale. This new rule would create a safe harbor that would protect all offerings of all securities classes from integration if they occur more than six months before or after each other.

Under this new safe harbor, only offerings of securities that occur within six months of each other would ever be confronted with integration analysis. Any two or more offerings made within six months of each other would automatically be analyzed under the integration standard, unless the offerings fell within a separate safe harbor. Adopting a permanent six-

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\(^{325}\) Bradford, An Economic Analysis, supra note 45, at 652.
month safe harbor would introduce the first bright line rule to the integration dilemma. A new starting point would be available to issuers and issuers’ counsel for specific integration analysis.

Under the current system, if two offerings are not protected by a discrete safe harbor, proper integration analysis is confounding because no bright lines exist and there is no starting point from which to begin analysis. Only an ambiguous five-factor test is available, without guidelines or specific directions on how to properly apply it. Under the new six-month safe harbor, a definitive starting point is established: if the multiple offerings are made more than six months apart, no integration analysis must be conducted as the offerings are protected—if the multiple offerings are made within six months of each other, integration analysis must be conducted.

Admittedly, the six-month standard established by the SEC with regard to several other safe harbors has been criticized as arbitrary. Nevertheless, the agency established the six-month window presumably because it felt that it represented a sufficient amount of time to safely assume that a single offering had not been splintered inappropriately in connection with Regulation D and Rule 147 offerings. My new safe harbor proposal would perpetuate that accepted time period and assume that if six months pass between offerings, then it is likely that the offerings were not a single offering fragmented by an unscrupulous issuer seeking to avoid registration.

Establishing a new six-month safe harbor would also effectively neutralize one of the factors in the five-factor test, the “at or about the same time” factor. Essentially, adopting the six-month safe harbor for all securities would by definition force the “at or about the same time” factor to be defined as “within six months.” All securities offerings by the same issuer, occurring within six months of the last offering will be analyzed under the integration doctrine, unless protected by a separate safe harbor. Establishing a definite time standard will greatly facilitate clarification of the needlessly complex integration doctrine.

Further, the SEC will promote goodwill with securities practitioners, scholars and lawyers by removing one of the ambiguous rules that has hung

326. See supra Part III.A.
327. Deaktor, supra note 32, at 517 (“Whatever the merits to a policy promoting compliance with rules 146 and 147, a case can be made for shortening the present six-month measure of freedom from integration. In the first place, the length of time chosen is largely arbitrary.”) (emphasis added).
328. See supra Part III.A.3.
over the capital markets for too long: the refusal to explain or define the meaning of "at or about the same time," forcing issuers to speculate constantly about timing. By adopting this new safe harbor the SEC can adopt a starting point that makes sense and with its adoption the integration doctrine becomes far less murky.

2. A New Three-Factor Test

The new six-month safe harbor protects from integration all offerings made more than six months before or six months after a second offering. Therefore, only simultaneous offerings originating within six months of each other need be analyzed for integration purposes under a specific SEC test. With the time element factor now eliminated from the five-factor test by virtue of the new six-month inclusive safe harbor, the five-factor test must be reconfigured if it is still to be used for integration analysis.

The least important, and by far the most ineffective factor is the "same type of consideration" element. Almost every offering receives cash as consideration in exchange for the security. This factor is rarely analyzed and in very few instances has the SEC examined multiple securities offerings where different types of consideration were used. Because it is an outdated and unnecessary element, I recommend that the "same type of consideration" factor be completely eliminated from the integration analysis.

Therefore, I propose a new three-factor test for all integration questions regarding offerings that are not protected by the new six-month safe harbor. The new three-factor test will be comprised of: (1) whether the same class of securities is being offered in simultaneous (i.e., within six months) offerings, (2) whether the simultaneous offerings are being made for the same general purpose, and (3) whether the simultaneous offerings are part of a single plan of financing.

Clearly, the new three-factor test adopts the remaining elements from the original five-factor test after the "time" and "consideration" factors are removed from the analysis. However, I will later propose how the test is to be conducted in order to allow for maximum simplicity and clarity.

329. Wade, supra note 30, at 221-23.
330. See supra Part VI.A.1.
331. See supra Part III.A.4.
332. Loss & Seligman, supra note 163, at 1242.
333. Id.
334. See supra Part III.A.
a. Same Class of Securities

The first element to be considered in all future integration analyses under the new three-factor test will be whether the multiple securities offerings are of the same class of securities. The SEC must first clearly define the "same class of security." For integration purposes, that definition will include four categories: common, preferred, unsecured debt and secured debt. If the two offerings are the same class, then a strong presumption is created that the offerings should be integrated. For example, two offerings of common stock, initiated within six months of each other, will be presumed to be splintered and in need of integration.

Conversely, if the two offerings are not the same class of security, then a strong presumption will be created that the offerings should not be integrated. Two offerings, initiated within six months of each other, where one transaction involves common stock and the second transaction involves secured debt, will be presumed to be two distinct offerings not in need of integration.

Therefore, the most dynamic feature for integration consideration under the new three-factor test is whether the securities being offered are of the same class. This is so because what would otherwise be a single offering that has been splintered into multiple offerings to avoid registration would in most cases involve offerings of similar classes of securities. Thus, only when multiple offerings involve securities of the same class will there be a strong likelihood that the offerings will be integrated. Nevertheless, the remaining two elements play an important role in rebutting the presumption in favor of or against integration.

b. Same General Purpose

The second factor to be considered in all future integration analyses under the new three-factor test will be whether the multiple simultaneous securities offerings are intended to accomplish the same general purpose. This question is answered by determining how the issuer intends to use the proceeds of the offering. To accomplish a simple examination of this factor, the SEC must first adopt a clear definition of the term "same general purpose," which for purposes of the new three-factor test will be whether the issuer intends to use the proceeds to accomplish the same goals or ends.

335. See supra Part III.A.2.
336. See generally JOHNSON & MCLAUGHLIN, supra note 47, at 414-16.
337. See supra Part III.A.5.
In order to show that the proceeds are not being used for the same general purpose, an issuer must use the proceeds for very divergent objectives. A strong showing of divergent purposes will consist of specific plans for proceed usage and a showing that such proceeds will be used for entirely different objectives. If, for example, proceeds from one offering are to be used for financial purposes (i.e., raising capital, paying down high interest debt) and the proceeds from the second offering are to be used for non-financial purposes (i.e., construction costs, expansion), sufficiently divergent purposes will be demonstrated.

Because of the natural overlap between the same general purpose factor and the single plan of financing factor, these second and third factors in the new three-factor test will be considered together. They will be analyzed most intensely when the multiple offerings in question consists of the same class of security. When simultaneous offerings do in fact involve the same type of security, a presumption exists that the offerings will be integrated. The only way to rebut this presumption is to show clearly and decisively that the proceeds from the offerings are not to be used for the same general purpose and that the simultaneous offerings are not based on a singular plan of financing.

Clearly articulating the purposes for which the proceeds from the offerings will be used, and demonstrating that the goals and objectives of such usage are very different, will rebut the presumption that offerings of the same class of securities will be integrated.

c. Single Plan of Financing

The third factor to be analyzed in all future integration analyses under the new three-factor test will be whether the simultaneous securities offerings are part of a single plan of financing. The SEC must first clearly define a “single plan of financing.” For purposes of the new three-factor test a single plan of financing will be analyzed against the following three factors: (1) the method through which an issuer offers the securities, (2) the timing of the multiple offerings, and (3) whether the offerings are financially interdependent.

In order to show that the offerings are not made pursuant to a single plan of financing, an issuer must show that the methods of offering are different, the timing for when the capital is needed with respect to each

338. Wade, supra note 30, at 213.
340. See LOSS & SELIGMAN, supra note 163, at 1235.
offering is dissimilar and the offerings are not financially interdependent. If an issuer is using different offering methods to initiate the securities offerings and if the timing for when the capital is needed is sufficiently dissimilar, this will constitute a satisfactory demonstration of contrasting plans of financing.

Again, due to the natural overlap between the same general purpose factor and this single plan of financing factor, the second and third factors in the new three-factor test will be considered concurrently. When multiple offerings do in fact contain the same type of security, a presumption exists that the offerings will be integrated. This presumption can be defeated only upon a solid showing that the multiple offerings are not part of a single plan of financing and that the proceeds from the offerings will not to be used for the same general purpose.

Plainly showing that the offerings are not part of a single plan of financing will have the effect of rebutting the presumption that offerings of the same class of securities will be integrated.

3. Properly Conducting the Three-Factor Test

The new test, to be efficient and effective, must be conducted as follows:

First: The Six-Month Safe Harbor. The multiple offerings will be examined and a determination made as to whether they fit within the new six-month safe-harbor. If the multiple offerings are outside the six-month window, they are protected from integration. If the offerings are within the six-month window, they are not protected by the safe harbor and must be examined for purposes of integration.

Second: The First Factor of the Three-Factor Test—Same Class of Security. After determining that the multiple offerings are not protected by the six-month safe harbor, they must be analyzed under the three-factor test for integration. The first factor to be considered is whether the multiple securities offerings are of the same class (i.e., common, preferred, unsecured debt or secured debt). If the offerings do involve the same class of securities, a strong presumption is created that the offerings will be integrated. If the multiple offerings do not involve the same class of security, a strong presumption is created that they will not be integrated.

If the simultaneous offerings do involve the same class of security, the presumption that the offerings will be integrated can only be defeated through a robust showing that the offerings are not being made for the same general purpose and that the offerings are not part of a single plan of
financing. If the multiple offerings involve different security classes, a presumption exists that the offerings will not be integrated, and only upon a weak showing that the offerings are not for the same general purpose, or are not part of a single plan of financing, will the offerings be integrated.

Third: The Second and Third Factors of the Three-Factor Test—Same General Purpose and Single Plan of Financing. If the multiple offerings of securities involve the same class, an issuer must first show that they were not made for the same general purpose. In order to show that the proceeds are not being used for the same general purpose, an issuer must use the proceeds for very divergent purposes. A strong proof of divergent purposes will consist of specific plans for proceed usage and a strong showing that such proceeds from the two offerings will be used for entirely different objectives.

Further, to avoid integration and overcome the strong presumption in favor of integration, the issuer must show that, interrelated with the same general purpose factor, the offerings were not part of a single plan of financing. In order to show that the offerings are not made pursuant to a single plan of financing, an issuer must demonstrate that the methods of offering are different, the timing for when the capital is needed is different and the offerings are not financially interdependent.

Only upon a strong showing that the offerings are not for the same general purpose and are not part of a single plan of financing will the presumption in favor of integration be rebutted and the offerings will not be integrated. Otherwise, if the proceeds are to be used for the same or similar purposes and the offerings are not from significantly different plans of financing, the offerings will be integrated.

On the other hand, if the multiple simultaneous offerings are not of the same class of security, a strong presumption exists that they will not be integrated. Only upon a feeble showing that they are not being made for the same general purpose and are not part of a single plan of financing will the offerings be integrated. If an issuer fails to establish divergent use of proceeds and if the issuer cannot exhibit varying delivery methods or deviating time for capital need, then the offering, albeit of different security classes, will be integrated.

Therefore, if the offerings are not of the same class, but if the issuer plans to use the proceeds for the same general purpose, and if the offerings appear to be from the same plan of financing in that the same method of delivery is used and the timing for raising the capital is the same, then even though the securities are not of the same class, the offerings will be integrated because they were being made for the same general purpose and
from a single plan of financing. The presumption of non-integration will be defeated.

Accordingly, this proposed three-factor integration test simplifies and clarifies what has been a troubled sea of uncertainty for many years. The most important factors are left intact: timing (within six months), class of security, and the dual same general purpose/single plan of financing factors. As recommended above, the SEC should, through a release, adopt the three-factor test and clearly define each of the factors and terms as suggested above. With a new safe harbor and a well-defined three-factor test, the integration conundrum can once and for all be resolved, thereby keeping the goal of investor protection intact while creating no new obstacles for capital formation.

B. The SEC Can Take a Major Step Toward Boosting Consumer Confidence

It is a fact that in this troubled and volatile economic time, with capital markets deteriorating under the weight of accounting fraud, financial restatement and executive management corruption, the

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341. See supra Part III.B.
342. See supra Part III.A.1-5.
343. See supra notes 4, 56, 309, 312.
344. See supra notes 6, 8, 10, 15, 17, 312, 320, 323; see also Former Adelphia Executives Arrested for Fraud, N.Y. TIMES, July 24, 2002, available at http://www.nytimes.com/reuters/business/business-crime-adelphia.html (url no longer available). In yet another example of corporate fraud and criminal activity by the management of a major U.S. corporation, former executives of Adelphia Communications Corp. were arrested July 10, 2002:

Three members of the founding family of troubled cable operator Adelphia Communications Corp. and two former executives were arrested on Wednesday on federal securities and bank fraud charges.

The complaint, unsealed in Manhattan federal court, names as defendants former Chief Executive John Rigas; former Chief Financial Officer Timothy Rigas; Michael Rigas, former executive vice president, operations; James R. Brown, former vice president, finance; and Michael Mulcahey. . . .

The lengthy complaint alleges the defendants conspired to commit securities, wire, and bank fraud. "The investigation has revealed probable cause to believe that John J. Rigas . . . together with members of his family has looted Adelphia on a massive scale, using the company as the Rigas family's personal piggy bank at the expense of public investors and creditors," the complaint alleges.

The Rigas family members had resigned from Adelphia following the disclosure of billions of dollars of off-balance-sheet loans guaranteed by the company to the Rigas family, overstated earnings, and other accounting issues. Id. (emphasis added). James R. Brown, Adelphia’s former executive vice president, plead
SEC and the U.S. capital markets have lost investor confidence. Further, the SEC is losing its reputation as a competent protector of the financial markets, as it is harshly criticized and attacked by both elected legislators and the general public. The agency can no longer exist in a world of self-guilty to bank fraud and other charges in November 2002 "as part of a [plea] deal to testify against Rigs family members accused of plundering the now-bankrupt cable company." Ex-Adelphia Exec Pleads Guilty, CNN MONEY, Nov. 14, 2002, available at http://money.cnn.com/2002/11/14/news/companies/adelphia/index.htm (accessed from the homepage by entering title into CNN/Money search engine) (last visited Mar. 13, 2003) ("The former vice president of finance at Adelphia Communications Corp. was the first person to plead guilty in the scandal that authorities say cost investors more than $60 billion."). As it now seeks bankruptcy protection due to Adelphia management malfeasance, the bankrupt cable operator announced the appointment of a new chairman whom the company hopes will lead it back to solvency and respectability as a viable corporate concern. Adelphia Names New Chiefs, CNN MONEY, Jan. 17, 2003, available at http://money.cnn.com (accessed from homepage by entering title into the CNN/Money search engine) (last visited Feb. 7, 2003) ("[B]ankrupt cable operator Adelphia Communications Corp. . . . named former AT&T executive William Schleyer as its chairman and chief executive. . . . In addition, the company said Ron Cooper, AT&T Broadband's chief operating officer, would be appointed with the same title at Adelphia.").

On the heels of the Adelphia debacle, Merck & Co. announced that it too had committed accounting fraud. Merck Accounting Murky, CNN MONEY, July 8, 2002, available at http://money.cnn.com (accessed from homepage by entering title into the CNN/Money search engine) (last visited Feb. 7, 2003) ("Merck & Co. shares tumbled Monday [July 8, 2002] after a Securities and Exchange Commission filing by the company revealed that more than $14 billion, or 10 percent, of revenue reported since 1999 was never actually collected by the company.").

Further startling corruption came to light when the former chief executive of the Sunbeam Corporation, Albert J. Dunlap, agreed to settle S.E.C. fraud claims against him for $500,000 and acceptance of a condition that he be banned from ever serving as an officer or director of a public company. Floyd Norris, Former Sunbeam Chief Agrees to Ban and a Fine of $500,000, N.Y. TIMES, Sept. 5, 2002, at C-1 (late ed.). When Dunlap was initially hired at Sunbeam in 1996:

the company’s share price leaped nearly 50 percent on the announcement, and it rose further after the company reported a turnaround in 1997. Sunbeam’s board responded by agreeing to double Mr. Dunlap’s base salary to $2 million a year.

But the S.E.C. later said that the turnaround was largely because of fraud. The company restated profits and later filed for bankruptcy.

"This was a primer in the techniques of financial fraud in that they employed such a wide variety of techniques to manage earnings," Thomas C. Newkirk, an S.E.C. associate director of enforcement, said yesterday.

Id.

345. See supra note 323.

346. See supra notes 3, 9, 18; see also Labaton, S.E.C. Is Facing Deeper Trouble, supra note 11. Labaton quoted Alan Bromberg, a law professor at Southern Methodist University, for the suggestion that many of the recent problems facing the SEC have been self-inflicted:
imposed ambiguities. The time has come for the SEC to overhaul itself. This era of reform should include, as a key priority, the reformation of the integration doctrine. Now is the time for the SEC to update its antiquated systems and mend the areas of the law that are in need of significant repair. In an environment ripe for securities law reform, the priority should be to end the legacy of ambiguity, confusion and exasperation that is the securities integration doctrine.

Significantly repairing and reforming the securities reporting system would be an important and historic step in winning back the confidence of U.S. investors in the capital markets and in the disclosure system upon which those markets are based. Further, once and for all resolving the integration conundrum as recommended above would show that the SEC is responsive to the concerns of securities practitioners and scholars and is not deaf to the calls for reform from those who thoughtfully criticize specific doctrines and actions by the SEC. Conducting such reforms now would preserve the two important non-competing interests of restoring consumer and investor confidence through investor protections and simplifying the issuance process for issuers of securities.

Adopting the suggested reforms above will help to ameliorate the criticisms lodged against the SEC as an unresponsive and arrogant agency. Further, adopting these changes will accomplish the goal of moving the general public into a position of regaining confidence in the U.S. capital markets. Finally, by adopting the reforms outlined above, the SEC can end the legacy of confusion, ambiguity and dissatisfaction that has tainted the integration doctrine for over seventy years.

An example might appropriately illustrate:

[T]he commission has lost its leadership in a whole bunch of vital areas.

It’s partly because of Harvey Pitt, who came in promising to be friendlier to the accountants ... It’s partly because of this administration [under President George W. Bush], which has been friendlier to big business. And it’s partly because the agency has been starved for money and resources.


347. See generally supra note 59.

348. See generally supra Part III.B.
While working as a young associate at a major international law firm in Chicago, Illinois, I was approached by a senior partner in the corporate department who was also the securities law subgroup leader and was assigned a project that dealt with what was termed an "integration issue." A client of the firm had recently decided to issue an offering of its common stock and we had begun to prepare the appropriate form for purposes of filing it with the SEC prior to offering and selling the proposed underwritten offering. The client was intending to raise capital with the common stock transaction in order to effectuate particular corporate improvements within the company. While in the midst of preparing the required forms, an opportunity arose for the company to become involved in a distinct pooled transaction organized by a major underwriter, wherein certain warrants would be purchased by a number of participating banks.

The senior partner, confessing that she knew the "basics" when it came to integration, needed me to dig into the details and instructed me to hit the books and return in a day or two with a definite answer as to whether the two proposed offerings would be integrated for purposes of registration. I was told that the client would be expecting a concrete answer from us as to whether it could participate in the pooled vehicle without worrying that its issuance of common stock would be tainted by the subsequent issuance of warrants in the pooled transaction. Essentially, I needed to determine whether the issuance of warrants would be integrated into the offering of common stock.

I went directly to the books and identified a new safe harbor and three-factor integration analysis. I was able to quickly and easily determine that our client did not come within the six-month safe harbor based on the fact that it was registering its offering of common stock and was hoping to participate in the pooled vehicle within the same month.

In recognizing that no safe harbors protected the offering from integration, I learned that a three-factor test must be used to analyze simultaneous securities offerings. First, I needed to determine whether the classes of securities being offered were the same. If yes, then a presumption of integration would be present. If no, then a presumption of non-integration would exist. Because one of the securities was common stock and the warrants were for secured debt, the classes of securities were not the same and our
client was rewarded with a presumption against integration.

Next, I analyzed whether the offerings were being made for the same general purpose and with a single plan of financing. I needed only to make a credible showing that they were not for the same general purpose and were not through a single plan of financing, based on the classes of securities being different, and was able to easily meet that burden by quickly determining that the proceeds were to be used for different purposes (to make corporate improvements in one and to repay higher interest debt with the other). Because the classes of securities were different and because, upon cursory examination, the use of proceeds were going to be different, I was able to seamlessly determine that the client could participate in the pooled vehicle with no fear whatsoever of integration.

I delivered this news to the senior partner and was able to tell the client confidently, in a conference call, that they had nothing to fear on the integration front. The senior partner and I had greater confidence in the SEC and its rulemaking authority based on the new test and the helpful explanations and definitions that accompanied it. The client had greater confidence in its ability to raise needed capital.349

VII. CONCLUSION

Recent corporate malfeasance has led to intense scrutiny of the Securities and Exchange Commission and the securities laws. As the U.S. capital markets falter under the weight of accounting scandal, executive misdeeds and outright management fraud, investors in the U.S. markets stand by in stunned disbelief as retirement funds, college education accounts and life savings fade away. Recent events have presented a challenge to the SEC never before encountered, and all eyes are on the agency charged with regulating the U.S. markets and protecting the investors that invest in those markets. The environment is ripe for corporate reform and the SEC must act correctly and quickly to spare its reputation by finding and punishing corporate wrongdoers.

One area in which the SEC could provide positive, timely and vitally needed corporate reform is the integration doctrine. This long-criticized doctrine, challenged consistently as being ambiguous, inconsistent,

349. See supra note 65 and accompanying narrative.
confusing and even useless, can be resurrected with ease and distinction. Abolishing the doctrine is not politically sound, nor will it replace the investor protection element badly needed at this time. Repairing the integration doctrine would address long held concerns regarding its usefulness. Simplifying the doctrine would show that the SEC is responsive to scholarly criticism and is open to explaining the reasons why it acts as it does. Rescuing the doctrine from its haze of confusion and misapplication would be politically savvy as a reform move meant to strengthen investor protections.

The SEC, in an official release, should adopt the new six-month safe harbor and new three-factor test as enunciated above. The safe harbor is simple and the test is easily conducted and interpreted. Adoption of the safe harbor and new three-factor test would accomplish the objectives of the 1933 Securities Act by providing protection to investors through requiring full and fair disclosure of certain securities that do not fall within discrete exemptions. Issuers would be delighted to have a coherent, easily applied test by which to measure its multiple offerings of securities. Securities lawyers would be eager to answer integration questions raised by issuers because a logical examination would be in place to analyze the offerings. The general public would receive some sense of satisfaction from knowing that the SEC is becoming more expressive and accessible to market difficulties. Finally, the SEC would be perceived as a greater investor protector and as a responsive and critical governmental agency.