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Comments

SEC REGULATION OF CALIFORNIA REAL ESTATE SYNDICATES

During the past few years the number of real estate syndicates has grown rapidly.\(^1\) By no means a new phenomenon, syndication of real estate, with the accompanying federal income tax advantages, is especially attractive to high income taxpayers.\(^2\) Limited partnership interests, the most common form of interest in real estate syndicates, are securities\(^3\) and are subject to the securities laws of the state where the limited partnership is established. However, while some large syndicates have registered their securities under the Federal Securities Act of 1933,\(^4\) by far the greater number of syndicates have not done so, in reliance upon one or more of the exemptions provided in that Act.\(^5\)

The Securities and Exchange Commission (SEC) has recently evinced a heightened interest in the activities of certain real estate syndicates.\(^6\) Suspicious that some syndicates have abused the exemptions of the Act in order to avoid registration, the SEC has intimated that it may require registration by invoking the integration doctrine. This doctrine allows the SEC, upon a finding that one of a series of successive syndications does not qualify for exempt status, to integrate

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1. See, e.g., Shelter for Whom, BARRON'S, Dec. 27, 1971, at 5, col. 1. Although the term "syndicate" may be applied to ventures in forms other than the statutory limited partnership, in this Comment it is used exclusively to denote a real estate venture using the limited partnership form of doing business. See text accompanying notes 11-15 infra.

2. See text accompanying notes 11-12 infra. While the Tax Reform Act of 1969 significantly restricted the availability of these advantages, residential rental property was specifically exempted from the narrowing provisions. INT. REV. CODE OF 1954, § 167(j). Although the intent of Congress was to provide a tax incentive for construction of new housing for low and middle income families (see note 128 infra), all residential rental property qualifies for the benefits.


5. See text accompanying notes 65-103 infra.

6. See notes 120-24 infra.
the syndicates of the series, thus denying the exemption to each of them.7

If a syndicate fails to register as required by the Act, every pur-
chaser of its securities has the right to rescind his purchase and recover
the price paid plus interest, less any income received.8 While this risk
poses a threat primarily to syndicates not meeting investors' expecta-
tions, it also poses a practical problem of more general concern. After
finding a suitable property, the syndicator usually attempts to obtain an
option or purchase contract to ensure the availability of the property
later, when financing is obtained from the subscriptions of limited part-
ners. However, it is difficult to tie up property in this fashion for more
than a few months. The additional time necessary for a federal regis-
tration statement to become effective causes some syndicators to fear
that if the SEC requires registration of syndicate securities, only the
larger and better-financed syndicators who are able to bear the in-
creased presyndication expenses will be able to continue in business.9

California has responded to its substantial real estate syndicate
activity with a comprehensive regulatory scheme.10 Registration un-
der the Federal Securities Act would affect the scope and impact of this
scheme upon California real estate syndicates. It is the purpose of this
Comment to examine the appropriateness of federal regulation of such
syndicate securities in light of the interaction between the federal and
California laws. Part I of this Comment outlines the mechanics of lim-
ited partnership syndicates. Part II examines the regulation of syndi-
cate securities in California. Part III discusses the applicability of the
Securities Act of 1933 to syndicate securities, and Part IV suggests cri-
teria for determining the appropriateness of SEC regulation of syndi-
cate securities through application of the integration doctrine.

I

FORMATION AND OPERATION OF CALIFORNIA LIMITED
PARTNERSHIP SYNDICATES

A. The Limited Partnership

The major reason that investors prefer the limited partnership over
other forms for real estate syndicates is that the profits and losses of a

7. Integration involves a factual finding that two or more purportedly separate
exempt issues of securities are part of a single, non-exempt issue. The factual criteria
for such a finding are set forth in SEC Securities Act Release No. 4552 (Nov. 6, 1962).
See notes 104-24 infra and accompanying text.
9. Letter from Harris E. Lawless to the author, December 2, 1971, on file
with the author. See text accompanying notes 132-35 infra.
10. See notes 27-62 infra and accompanying text. California has been a fore-
limited partnership, rather than being taxed to the partnership, are passed through directly to the partners in proportion to their interests.\textsuperscript{11} If the corporate form were used, the pass-through advantage would be lost since the corporation would be taxed directly on its profits.\textsuperscript{12} While a general partnership form offers the same tax advantages as a limited partnership, all its partners are exposed to unlimited personal liability.\textsuperscript{13} The personal liability of limited partners, however, is restricted to the amount of their investment.\textsuperscript{14} Thus, if the general partner is a corporation, all parties holding interests in the syndicate are insulated from unlimited personal liability.\textsuperscript{15}

Most real estate syndicates are designed to take maximum advantage of the tax pass-through feature of the limited partnership. Actual cash investment is kept at a minimum, as large a mortgage as possible is obtained, interest is prepaid,\textsuperscript{16} and the syndicate takes the maximum allowable depreciation.\textsuperscript{17} Thus, although the project may generate a positive net cash flow, it may show “paper losses” for tax purposes during the first few years. These losses are passed through

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11. INT. REV. CODE OF 1954, § 704. The partners may agree among themselves to share profits and losses disproportionately to their respective interests. INT. REV. CODE OF 1954, § 704.

12. INT. REV. CODE OF 1954, § 11. Of course the corporation would receive the tax benefit of its losses, but in many cases, it would be unable to take full advantage of such losses unless it had income from other sources.


15. Some courts have been hesitant to recognize the ability of a corporation to act as the general partner of a limited partnership, usually on the theory that the mutual agency relationship between partners is inconsistent with the principle that the business of a corporation shall be managed by its board of directors. While this theory may pose a genuine problem where a corporation purports to enter a general partnership, it is inapposite to the limited partnership situation, at least where the corporation is the sole general partner, since the limited partners cannot exercise any affirmative control of the business without incurring liability as general partners. See Armstrong, Can Corporations be Partners?, 20 BUS. LAW. 899 (1965); Comment, Public Limited Partnerships in Northwest Real Estate Syndication, 7 WILLAMETTE L.J. 74, 75-76 (1971). See also Bates v. Coronado Beach Co., 109 Cal. 160, 41 P. 855 (1895) (corporation may enter general partnership where entire management of partnership business is entrusted to corporation).

16. Prepayment of interest for a period extending more than 12 months beyond the end of the current taxable year may be challenged by the IRS as a material distortion of income. Freshman & Forst, Tax and Economic Analysis of Soft Dollar Syndications, 46 L.A. BAR BULL. 281, 286-87 (1971).

17. The Tax Reform Act of 1969 limited depreciation of depreciable real property to the 150 percent declining balance method, with the exception that “residential rental property” still qualifies for the double declining balance method. INT. REV. CODE OF 1954, § 167(j)(2).
to the limited partners and shelter cash distributions from the syndicate, other income, or both.

Some syndicates are formed for the purpose of buying and operating a specific property, for example, a new multi-unit apartment building. The original decision to syndicate the property may come from the builder, a real estate broker, or a promoter, and these parties may or may not be affiliated with each other. The syndicate may be formed before the building is completed, or the syndicate may purchase it from the developer on completion. In any event, the promoters of the syndicate carefully calculate both the anticipated revenues and expenses of the building in order to keep the limited partners' initial investment as small as possible. They also attempt to maximize deductible interest payments by obtaining a large mortgage. The accelerated depreciation available to the syndicate is included in these calculations, so that the tax shelter to be generated for each of the first few years can be measured against anticipated revenues. Within limits, a syndicate may be tailored to offer either maximum tax shelter (and no cash distributions) or maximum cash distributions (with little tax shelter for other income).

In another common form of real estate syndicate no specific property is involved in the decision to syndicate. Instead, the limited partnership is formed for the purpose of investing in the type of property that will generate the desired tax shelter or cash distribution, and the contributions of the limited partners are used to make the down payment when suitable property is located. Such syndicates have been called "blind pools" because the investor does not know beforehand

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18. See note 21 infra.
19. An apartment building is a frequent choice of syndicators because it affords the maximum depreciation. However, the same principles apply to syndications of other kinds of depreciable property, the only difference being that less depreciation may be taken. See note 17 supra.
20. Use of the "wrap-around" or all-inclusive deed of trust is a popular form of financing syndicates because it maximizes and consolidates deductible interest payments. See S. Freshman, California Real Estate Association Syndication Glossary, in CALIFORNIA REAL ESTATE SYNDICATION PRACTICES: EIGHTEEN MONTHS LATER 3 (California Continuing Education of the Bar Oct. 1971); cf. note 16 supra.
21. The precision of these calculations often determines the success of the investment. Where the syndicate's own cash distributions to investors are to be sheltered, for example, the syndicate may expect to make annual cash distributions of 10 percent which, after computing the shelter, will result in a much larger real return. The exact amount of the return will depend on the individual investor's marginal tax rate. If the syndicate generates only a two percent cash distribution, the investor may have more shelter than he can use, and thus receive a small real return on his investment. See generally Freshman & Forst, Tax and Economic Analysis of Soft Dollar Syndications, 46 L.A. BAR. BULL. 281 (1971).
22. Blind pool syndicates may contemplate the purchase of several properties. See, e.g., OFFERING CIRCULAR OF CENTURY PROPERTIES FUND 71-3, 8 (Sept. 20, 1971).
how his money will be invested. It is therefore impossible to calculate in more than a general way the rate of return from cash distributions or the potential tax advantages; for this reason, offerings of blind pool securities have sometimes been regarded as "inherently misleading."23

B. Potential for Abuse

While some commentators question the use of syndicates as tax shelters from a policy standpoint,24 arguments favoring stricter regulation of syndicate securities usually focus on the susceptibility of syndicates to hidden and excessive compensation to promoters.25 The formation of a syndicate often involves a number of entities. It is not uncommon, for example, for a syndicate to include at some point the participation of a builder and developer, a real estate agent, a person or corporation acting as promoter, and a management company to operate the completed building. In addition, a broker and underwriter may be involved in the sale of the syndicate interests. Each of these participants may receive a fee or commission for services, or a profit on property sold by it to the syndicate. Where these multiple entities are controlled by one or a few persons, the total compensation received by the controlling persons may be quite large in comparison to the total investment of the limited partners, even though the compensation for any one of the entities involved, viewed alone, may be reasonable according to prevailing rates.26 Similarly, where the interrelationship of these multiple entities is not disclosed, the investor may be unaware of the extent to which his total investment constitutes compensation to the syndicators. Registration of syndicate securities would at least compel disclosure of the compensation of syndicators and thus curtail this abuse. California's regulation of syndicate securities extends beyond bare disclosure to detailed regulation of substantive fairness. The growing nationwide popularity of real estate syndications as


26. See text accompanying notes 44-49 infra.
an investment medium now demands that the SEC assess its role in the regulation of purportedly exempt syndicate securities.

II

REGULATION OF SYNDICATE SECURITIES IN CALIFORNIA

Real estate syndicates in California are created under the Uniform Limited Partnership Act. The increasing use of the form and the need to give investors a measure of control over their investments prompted an amendment to the Act in 1963 that conferred upon limited partners a right to vote upon matters affecting the "basic structure of the partnership." Most of the substantive regulation of real estate syndicates, however, is carried out under California's Corporate Securities Law of 1968 and the Real Estate Syndicate Act of 1970. Although the definition of "security" in the Corporate Securities Law does not specifically include limited partnership interests in real estate syndicates, the treatment of such interests as securities subject to the Corporate Securities Law has never been questioned. Unless a syndicate can avail itself of an exemption, it must qualify its securities with the Commissioner of Corporations before they may be sold in California. The California Securities Law and the Federal Securities Act of 1933 coincide in this respect, for the requirement that securities

28. CAL. CORP. CODE § 15507. The amendments were adopted particularly with reference to real estate syndicates. N. LATTIN, R. JENNINGS & R. BUXBAUM, CORPORATIONS, CASES AND MATERIALS 45 n.2 (4th ed. 1968). Matters upon which limited partners may vote include (but are not limited to) election or removal of general partners, termination of the partnership, amendment of the partnership agreement, and sale of all or substantially all partnership assets. Such rights must, however, be specified in the certificate of limited partnership, and the regulations of both the Corporations and Real Estate Commissioners require their inclusion in the limited partnership agreement. See note 37 infra.
32. See MARSH & VOLK, supra note 3, at 161; JENNINGS & MARSH, supra note 3, at 308-09.
33. An offer (but not a sale) of securities is exempt from qualification if it does not involve any public offering. CAL. CORP. CODE § 25102(a) (West Supp. 1972). In addition, the Commissioner of Corporations may by rule exempt any transaction if he finds that it is not comprehended within the purposes of the law and qualification is not necessary or appropriate in the public interest or for the protection of investors. Id. § 25105.

In contrast, the Real Estate Syndicate Act of 1970 provides an exemption from its qualification provisions for both offers and sales "not involving a public offering." CAL. BUS. & PROF. CODE § 10261 (West Supp. 1972). The regulations of the Real Estate Commissioner define "non-public offering and sale" for the purpose of § 10261 as being an offer to no more than 25 persons, and sales to no more than 10 of such offerees. 10 CAL. ADMIN. CODE § 2990(d)(1) (1971).
be registered or qualified before sale is central to both. The California law differs, however, from the federal act in one important respect: while the latter is satisfied if the registrant has made full disclosure of all required information, the California law goes further by authorizing the Commissioner of Corporations to refuse to qualify, or to suspend the qualification of, any security if he finds that the issuer's present or proposed course of business is not "fair, just and equitable."

Pursuant to this authority the Commissioner has established standards of presumptive fairness to serve as guidelines to syndicators. These standards create only a presumption of fairness on the part of the syndicate, but where the requirements are met, the syndicate offering will usually be deemed to be fair, just and equitable. One set of standards relates to investor control and protection against assessments and forfeitures. Included in this group is a requirement that the limited partnership agreement provide for a measure of investor control by granting the limited partners the right to vote on specified matters. The agreement must provide that a majority in interest of the investors may remove the general partners. It must also include a detailed provision for any future assessments on limited partners that may be required, but it may not provide for forfeiture of a limited partner's interest in the event of his default. Also required are annual reports to the investors, a legend condition on the limited partnership certificates stating that they may not be transferred without the Commissioner's consent, and restrictions on the transferability of interests in order to support the tax advantages.

35. See 1 Loss, supra note 3, at 184-86.
36. CAL. CORP. CODE § 25140 (West Supp. 1972). The Commissioner may refuse, suspend, or revoke a qualification if (1) he finds that it is in the public interest to do so and (2) the proposed plan of business is not fair, just and equitable, or the securities or the method of issuance thereof will work a fraud upon the purchaser. Id.
37. 10 CAL. ADMIN. CODE § 260.140.110(b) (1971). The regulation requires the inclusion in the agreement of the limited partners' right to vote upon those matters for which the Uniform Limited Partnership Act permits such a right. See note 28 supra.
38. 10 CAL. ADMIN. CODE § 260.140.110(a). Nor may the general partner insert a provision establishing a method for the valuation of its interest that would be unfair to the limited partners in the event of the removal of the general partner.
39. 10 CAL. ADMIN. CODE § 260.140.112(a).
40. 10 CAL. ADMIN. CODE § 260.140.112(b).
41. 10 CAL. ADMIN. CODE § 260.140.112(e).
43. 10 CAL. ADMIN. CODE § 260.140.112(c).
Another group of standards, designed to guarantee substantive fairness, restricts the amount of the promoters' compensation. The total compensation to promoters, for example, "should be reasonable in the light of the nature of the syndication and the identity of the investors."\textsuperscript{44} Some compensation, however, is presumptively reasonable. Where promoters receive a commission on the sale of limited partnership interests, a promotional interest equal to a 10 percent subordinated interest in the profits of the syndicate is presumptively reasonable;\textsuperscript{45} where no such commissions are received, a 25 percent subordinated interest in the profits is presumptively reasonable.\textsuperscript{46} In addition, the rules provide that investors should receive a minimum return of six percent on invested capital, calculated without regard to accelerated depreciation, before the promoters may receive their subordinated share of profits.\textsuperscript{47} Similarly, the investors must receive a return of 100 percent of invested capital before a general partner may receive any distribution of capital on the sale of partnership assets or termination of the partnership.\textsuperscript{48} Selling expenses are limited to 15 percent of initial invested capital.\textsuperscript{49}

A third set of provisions relates to conflicts of interest on the part of promoters. Although the promoters may receive a standard real estate commission in addition to the 25 percent compensation described above,\textsuperscript{50} they may not take an exclusive listing of the property to be bought or sold at the time the syndicate is formed.\textsuperscript{51} Nor may the promoter profit by selling to the syndicate property in which he has an interest "except in exceptional circumstances."\textsuperscript{52} Sales from one syndicate to another in which the promoter also is involved are similarly forbidden "unless the price is clearly substantiated as being the fair market value of the property."\textsuperscript{53}

\textsuperscript{44} 10 CAL. ADMIN. CODE § 260.140.111(a).
\textsuperscript{45} 10 CAL. ADMIN. CODE § 260.140.111(b).
\textsuperscript{46} 10 CAL. ADMIN. CODE § 260.140.111(b).
\textsuperscript{47} 10 CAL. ADMIN. CODE § 260.140.111(b).
\textsuperscript{48} 10 CAL. ADMIN. CODE § 260.140.111(b).
\textsuperscript{49} 10 CAL. ADMIN. CODE § 260.140.111(c). Thus up to 25 percent of the limited partners' investment may be compensation to the promoters.
\textsuperscript{50} 10 CAL. ADMIN. CODE § 260.140.111(d).
\textsuperscript{51} 10 CAL. ADMIN. CODE § 260.140.111(d). While the Rules of the Commissioner of Corporations prohibit giving a promoter an exclusive sales listing to sell at the time the syndicate is formed, the Real Estate Commissioner's rules provide that "the reasonableness (fairness) of the granting to a syndicator of an exclusive sales listing or exclusive employment to purchase or sell, at the time of the formation of the syndicate, will be examined by the Commissioner on the basis of the length of that listing, its terms, and the appropriateness of such a listing to the type of syndicate being formed." 10 CAL. ADMIN. CODE § 2994(b) (1971).
\textsuperscript{52} 10 CAL. ADMIN. CODE § 260.140.111(e).
\textsuperscript{53} 10 CAL. ADMIN. CODE § 260.140.111(e).
Finally, a rule promulgated by the Commissioner seeks to limit sales of interests to investors with financial responsibility "suitable to the proposed investment." Suitability is determined by reference to annual income and liquid net worth, but the rule does not set out specific guidelines. Since the rule itself uses a two-factor formula, and considers both the investors' "financial responsibility" and the "proposed investment," the formulation of such guidelines would be quite difficult.

In 1969 California transferred jurisdiction over syndicates with fewer than 100 owners from the Commissioner of Corporations to the Commissioner of Real Estate. The latter promulgated rules governing the sale of syndicate securities under his jurisdiction. These rules contain provisions for procedural and substantive protection of investors that are substantially identical to those of the Commissioner of Corporations. Additionally, the Real Estate Commissioner's rules establish $1000 as the minimum initial capital investment that will be considered fair in most circumstances, and they provide for a "non-public offering" exemption similar to that in the Federal Securities Act.

III

THE SECURITIES ACT OF 1933: APPLICABILITY TO REAL ESTATE SYNDICATE INTERESTS

Since real estate syndicate interests fall within the definition of "security" under the Securities Act of 1933, they must be registered

54. 10 CAL. ADMIN. CODE § 260.140.114.
55. 10 CAL. ADMIN. CODE § 260.140.114. The concept of investor suitability as measured by income and net worth, pioneered by California, is becoming widely accepted as a tool for regulating tax shelter investments. See Mosburg, supra note 10, at 230-31.
56. It is the policy of the Commissioners of Corporations and Real Estate to establish standards of suitability for investors according to the particular characteristics of the syndicate sought to be qualified. Practically, however, the usual minimum standard is $20,000 liquid net worth and $20,000 annual income. Real Estate Syndications: Common Problems 1, in CALIFORNIA REAL ESTATE SYNDICATION PRACTICE: EIGHTEEN MONTHS LATER (California Continuing Education of the Bar Oct. 1970).
57. For purposes of calculating this figure, husband and wife are counted as one person. CAL. BUS. & PROF. CODE § 10251 (West Supp. 1972).
58. CAL. BUS. & PROF. CODE § 10340.
59. 10 CAL. ADMIN. CODE §§ 2990-99.6 (1971).
60. But see note 51 supra.
61. 10 CAL. ADMIN. CODE § 2995 (1971).
62. 10 CAL. ADMIN. CODE § 2990(d). See note 33 supra.
unless they qualify for one of the Act's exemptions. While some syndicates are registered, most seek to avail themselves of one of these exemptions, primarily because of the cost and the time delay involved, with the consequent effect on financing the syndicate's purchase of property. 64

A. The "Private Offering" Exemption

Section 4(2) of the Act exempts from registration "transactions by an issuer not involving any public offering." 66 While the Act does not define what constitutes a public offering, the SEC ordinarily considers: (1) The number of offerees and their relationship to each other and to the issuer; (2) the number of units offered; (3) the size of the offering; and (4) the manner of offering. 66 The SEC has assigned no relative weight to these criteria, regarding them rather as "the principle factors to be considered." 67

In 1953, however, the Supreme Court in SEC v. Ralston Purina Co. 68 indicated that the primary consideration in determining the availability of the exemption is whether the offerees need the protection of the Act. The case involved a distribution of unregistered stock by a corporation to its employees. The Court reasoned that the purpose of the Act was protection of investors through full disclosure of material information, and therefore the rationale for an exemption from the Act's requirements must be that the offerees had no need of such protection. This situation might arise where all of the offerees have a relationship with the issuer such that the information will be available to them without compelled disclosure through registration, and they possess investment sophistication sufficient to protect their own interests. 69

C M. Joiner Leasing Co., 320 U.S. 344 (1943). Whether or not syndicate interests are securities because they are "commonly known" as such, they have "always been held to be within the scope of the Federal Securities Act of 1933." MARSH & VOLK, supra note 3, at 161.

64. See note 9 supra and accompanying text.
67. Id. But see note 69 infra.
68. 346 U.S. 119 (1953).
69. Id. at 125-26. See generally SEC v. Continental Tobacco Co., 463 F.2d 137, 158 (5th Cir. 1972); Hill York Corp. v. American International Franchises, Inc., 448 F.2d 680, 689 (5th Cir. 1971); Lively v. Hirshfeld, 440 F.2d 631, 632-33 (10th Cir. 1971). For a discussion of offeree sophistication and access to information about the issuer as affecting the availability of the private offering exemption, see Patton, The Private Offering: A Simplified Analysis of the Initial Placement, 27 BUS. LAW. 1089 (1972). This Comment's discussion of the private offering exemption and its usefulness in real estate syndication may require reevaluation in light of the SEC's proposed Rule 146, CCH FED. SEC. L. REP. ¶ 79, 108 (Nov. 28, 1972) announced after this Comment was prepared.
The Court rejected the idea that the character of an offering can be determined by looking mechanically at the number of offerees involved. The SEC indicated soon after passage of the Act that an offering to not more than “approximately twenty-five” offerees was presumptively not a public offering. The SEC quickly revised that position, however, as issuers began to fragment their issues into successive “private” offerings in order to avoid registration. But while the Court in Ralston Purina rejected a numbers test for the exemption, it did suggest that the SEC might adopt a fixed number of offerees as a rule of thumb for deciding whether or not to investigate a particular exemption claim. The SEC, however, declined this invitation and took the position that the number of offerees is relevant “only to the question whether they have the requisite association with and knowledge of the issuer . . . .”

The lack of clear guidelines limits the utility of the private offering exemption to many syndicators. Even if the offering is confined to only a few offerees, and even if the SEC indicates that registration is not required, a finding in a subsequent judicial proceeding that one or more of the offerees lacked the requisite sophistication or access to information could mean that the entire issue will lose the exemption. In that event each purchaser would be entitled to rescind the transaction. Of additional concern to the syndicator is the prospect that such an offering might be integrated with one or more of his other offerings, thereby destroying their exemptions as well.

B. The Intrastate Exemption

Section 3(a)(11) of the Act exempts securities from registration when the issuer, the offerees, and the purchasers of the securities are all residents of, and the issuer is doing business within, the same state. If a limited partnership is considered to be the issuer, it

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70. 346 U.S. at 125.
72. Id.
75. [T]he terms of an exemption are to be strictly construed against the claimant, who also has the burden of proving its availability. Moreover, persons receiving advice from the staff of the Commission that no action will be recommended if they proceed without registration in reliance upon the [private offering] exemption should do so only with full realization that the tests so applied may not be proof against claims by purchasers that registration should have been effected.
76. See also SEC v. Continental Tobacco Co., 463 F.2d 137, 156 (5th Cir. 1972).
78. See text accompanying note 105 infra.
should, by analogy to a corporation, be considered a resident of the state under whose laws it exists. On the other hand, assuming the promoter or prospective general partner is the issuer, the availability of the exemption would be determined by his residence. In either case, the issuer must also be doing business in the state of residence. Few syndicates would have difficulty meeting this requirement, since most of them purchase property in the state where the certificate of limited partnership is filed.79

Availability of the exemption also depends upon the residence of the purchasers, all of whom must be "persons resident within" the same state as the issuer.80 The Act does not, however, define the phrase "persons resident within." While some cases have treated this phrase as if it meant "residents,"81 the SEC has stated that "residence means something more than mere presence in the state—it requires something resembling domicile."82 This view is harmonious with the statement in the committee reports accompanying the 1954 amendments to the Act that the exemption is only available when the entire issue of securities is offered and sold "exclusively to persons domiciled in one state."83

In view of the absence of a definitive construction of the term "persons resident within" by the SEC or the courts, syndicators live

79. In view of the relative ease with which a limited partnership may be formed, most problems of residence and place of doing business of the issuer can be avoided by the creation of a limited partnership in the state where the property is located that will do business solely in that state. Nevertheless, problems occasionally arise. In American Plan Investment Corp., CCH Fed. Sec. L. Rep. ¶ 78,044 (Feb. 9, 1971), a California corporation proposed to sell limited partnership interests in property located in Illinois solely to residents of Illinois, after which it would file a certificate of limited partnership in Illinois. The SEC refused to conclude that no action should be taken on these facts, on the basis that the California corporation would be the issuer, and as such was not incorporated by and doing business within Illinois. As to what constitutes doing business within the meaning of this section, it appears to be the location of the property to which the security pertains that is decisive. In Chapman v. Dunn, 414 F.2d 153 (6th Cir. 1969), a Michigan issuer sold oil and gas leases to Michigan residents for property in Ohio. The exemption was denied, even though the issuer maintained a sales office in Michigan, the court saying that "[w]hile this can be viewed as 'doing business' in Michigan for some purposes ... we conclude that it is not 'doing business' within the meaning contemplated by ... the Act. We are convinced that Congress meant the 'doing business' requirement of § 3(a)(11) to be something substantially more than has been held sufficient to subject one to service of process in civil suits." Id. at 157. See also SEC v. Truckee Showboat, Inc., 157 F. Supp. 824 (S.D. Cal. 1957).


with a degree of uncertainty about this question. This uncertainty could be eliminated if the SEC were to adopt a test based on the good faith efforts of the issuer to restrict his offers and sales to bona fide residents or domiciliaries as defined by the law of the state where the issue takes place. Thus, if the issuer stated conspicuously that the securities were available only to residents, required offerees and purchasers affirmatively to represent that they are residents, and in addition undertook to verify this representation by some objective means such as consulting voter registration lists, then the exemption should not be denied simply because of the misrepresentation of an individual purchaser.

In addition to the residence and doing business requirements, a security qualifying for the intrastate exemption must also be "part of an issue offered and sold . . . within a single state . . . ." The Act is silent as to the definition of the crucial word "issue," however. In some cases there may be little doubt about what constitutes an issue of securities. For example, a distinct and separate issue clearly exists when a closely held corporation with only one class of stock sells all of its authorized stock to a few purchasers within a period of a few days. If, however, the same corporation were to sell half the authorized stock in one offering, and the remainder six months or a year later, it is far from clear on these facts alone whether these offerings would constitute one issue or two. Where different kinds of securities are issued in combinations at various times by the same issuer, the question may become even more difficult. To these uncertainties must be added the problem of timing. When, if ever, may an original purchaser of exempt intrastate securities resell to a nonresident without destroying the exemption for the entire issue?

The courts have provided little guidance. In Shaw v. United States, the only case to construe "issue" as used in § 3(a)(11), the Ninth Circuit defined "issue" as "all the shares of common character

84. Cf. SEC, Securities Act Release No. 4434 (Dec. 6, 1961): "The mere obtaining of formal representations of residence . . . should not be relied upon without more as establishing the availability of the exemption . . . ." (emphasis added). While obtaining mere pro forma representations of residence should not be sufficient to establish the issuer's good faith (except perhaps as against a rescission claim by the purchaser making such a representation), where the issuer has done "more" this policy should be inapplicable. California real estate syndicators often require that the subscriber furnish, at the time of subscription, information that will enable them to independently verify the subscriber's domicile, such as driver's license number and the county where the subscriber is registered to vote. See Jennings & Marsh, supra note 3, at 547-48.

85. See note 98 infra.
88. 131 F.2d 476 (9th Cir. 1942).
Commentators have criticized this definition as overbroad and as making “issue” synonymous with “class.” In the latter case, an issuer could not use the intrastate exemption for an offering if any units of the same class of security had ever been sold to nonresidents. While the qualifying word “originally” may negate this position, its meaning is perhaps even less clear than that of “issue.” If “originally” means that all of the originally authorized shares of a class of stock, even though issued in several blocks over a period of time, would be exempt so long as sold only to residents of the issuer's state of incorporation, the word seems to add nothing. The same result would be achieved by considering each successive intrastate offering as an “issue.” On the other hand, on this view, if any of the shares in one block had been sold to nonresidents, the entire class of stock would be nonexempt, even though other offerings of the shares had been properly restricted to residents. While such a result may be theoretically unobjectionable, it could create obstacles to financing without any demonstrable benefit in terms of either protection of investors or the public interest, since each separate block of shares may be associated with a different investment situation despite the fact that they are all of the same class.

The SEC's approach to the issue concept has been quite different. It has stated that deciding whether an offering is part of an issue is a question of fact, and the primary consideration is “whether the offerings are a related part of a plan or program.” In view of the great number of factual situations in which the issue concept may be involved, such a factual, case-by-case approach may be the only practical manner of dealing with the problem. Determining what constitutes an issue requires not only consideration of the kind and amount of securities involved, but also of the timing of the offerings. In the corporate example above, the length of time by which the offerings are separated is one aspect of the factual question whether the offerings are part of a “related plan or program.” Although this kind of timing may be important to a consideration of whether securities of a real estate syndicate are all “a part of an issue” qualifying under the intrastate exemption, most syndicates have only one kind of security and contemplate issuing all such securities in one continuous offering. Especially in specific property syndicates, where there is but one offering
for the single purpose of acquiring the property, the securities are part of a single issue.93

Resale of an interest can also create stumbling blocks for the syndicator. Suppose a resident investor purchases a number of limited partnership interests early in the offering, and then, before the offering is completed, sells some or all of his securities to a nonresident. Are the syndicate’s securities exempt under § 3(a)(11)?

This question has arisen primarily in the context of sales to nonresidents by subunderwriters and dealers,94 but an individual purchaser may also be a statutory underwriter.95 The SEC has stated that, in order to quality for the intrastate exemption, the entire issue must have “come to rest” in the hands of resident investors before any resales to nonresidents may take place.96 The SEC has defined “resident investors” as “persons purchasing without a view to further distribution or resale to nonresidents.”97 Thus, the exemption may be denied if an investor purchases for further distribution; it may also be denied if he purchases for resale to a nonresident, and the wording suggests that this may be so even if such resale were a result of the original purchaser’s own initiative rather than being a part of a “distribution” planned by the issuer.

Whether the exemption will in fact be denied, however, depends on whether the purchaser had “a view” to resale at the time of purchase. Unless the facts indicate that the issuer had reason to know otherwise at the time of purchase, representations by the purchaser that he purchased for investment and not for resale or further distribution should be conclusive of this issue.98 Even if the syndicator does not obtain such a representation he could argue that the legend condition imposed on syndicate securities in California serves the same purpose.99 This argument is weakened, however, by the fact that the legend only notifies the purchaser that he must have the Commissioner’s consent

93. Occasionally the general partners may want to reserve a right to sell a specified number of additional interests in the future. See, e.g., OFFERING CIRCULAR OF CENTURY PROPERTIES FUND 71-3, 2 (Sept. 20, 1971). Even so, where the additional interests are offered for the same purpose as the interests originally sold, they should be considered a single issue. See text accompanying notes 114-16 infra.


97. Id.

98. Professor Loss has suggested that Congress cannot have intended “to make the issuer an absolute insurer of every offeree’s residence . . . and of every salesman’s integrity,” and that the standard should be one of due care, including “reasonable supervision of all selling agents and . . . something more than automatic acceptance of the buyer’s representations . . . .” 1 Loss, supra note 3, at 604-05.

99. See note 42 supra and accompanying text.
to transfer the legended securities "except as permitted in the Commissioner's rules." Since these rules permit transfers to nonresident relatives and nonresident institutions by way of hypothecation, they do not explicitly prohibit resales that might destroy the exemption. In any case, this problem may be of little practical significance since most syndicates reserve a right of first refusal when a limited partner sells his interest. Both the Commissioners of Corporations and Real Estate expressly approve of this practice.

If a syndicate loses its private offering or intrastate exemption for any of the reasons discussed above, the Securities Act provides each purchaser with a right to rescission plus interest. The promoter's difficulties may be compounded if the offering in question is "integrated" with the offerings of other syndicates of the same issuer.

C. The Integration Doctrine

The doctrine of integration of offerings is a corollary of the issue concept. In the case of the intrastate exemption, for example, to say that the "entire issue" must be offered and sold intrastate is to say that the issue may not be fragmented and sold partly intrastate and partly interstate. If the SEC finds that ostensibly separate offerings are really part of a single "issue" and integrates them, then all must be exempt, or none are. For example, if a syndicator makes a qualified intrastate offering of syndicate securities, and later makes a registered interstate offering of securities of another syndicate, and these two offerings are subsequently integrated, the earlier offering loses the intrastate exemption.

The integration doctrine is equally applicable to the private offer-

100. 10 CAL. ADMIN. CODE § 2997 (1971).
101. Transfers may be made without the Commissioner's prior consent (1) to the issuer, (2) pursuant to court order, (3) by way of pledge to financial institutions, (4) to the transferor's ancestors, descendants or spouse, or (5) to investors in the same syndicate. Id. Cf. Whitehall Corp., 38 S.E.C. 259 (1958), where the exemption was held to be unavailable, despite the restriction of the offer in the subscription agreement to residents of Arkansas, because interim certificates issued to the subscribers were freely assignable to nonresidents.
102. 10 CAL. ADMIN. CODE §§ 260.140.112(e), 2995.5(g) (1971). The syndicator may find it advisable to establish a reserve account for the purpose of ensuring that the syndicate will be able to exercise its right of first refusal. See, e.g., OFFERING CIRCULAR OF CENTURY PROPERTIES FUND 71-3, 17 (Sept. 20, 1971).
104. Application of the integration doctrine is not limited to the private offering and intrastate exemptions. The issue may also arise with regard to Regulation A offerings, where the question is whether the aggregate offering ceiling has been exceeded. See Shapiro & Sachs, supra note 91, at 22-23.
105. The word "lose" is perhaps inaccurate, since theoretically the offering never "had" the exemption, but it is descriptive of the practical consequence of integration.
ing and intrastate exemptions, and the SEC's approach to both has been factual. As to private offerings, the SEC has stated that the determination whether an offering is public or private requires consideration of whether it is part of a larger offering. Factors relevant to integration of purportedly private offerings are whether the different offerings:

- are part of a single plan of financing;
- involve issuance of the same class of security;
- are made at or about the same time;
- are made for the same type of consideration; or
- are made for the same general purpose.

Earlier, in speaking of the integration of intrastate offerings, the SEC had enumerated identical criteria, but it also stated that "[a]ny one or more of [these] factors may be determinative of the question of integration." In *Value Line Fund, Inc. v. Marcus,* the only case expressly to apply these criteria to determine whether several allegedly exempt private offerings should be integrated into a single issue, the court rejected integration on all five criteria and added a sixth test of its own under which it also rejected integration: whether the offerings were made by the same person. The offerings were by a corporation of notes convertible into its unregistered common stock, and by the corporation's president of his own unregistered common stock in the corporation. Since none of the SEC's criteria was met in *Value Line,* it is difficult to assess the weight to be given to the criterion added by the court. That two offerings were made by the "same person" would seem clearly relevant under the SEC's formulation. But it seems to go too far to say that this factor, like the others, might be "determinative," for in such case any two offerings by the same person could be integrated. Thus, although *Value Line* listed this criterion ahead of those of the SEC in stating its reasons for refusing to integrate the offerings, the most reasonable interpretation of that holding is that the added criterion is one more factor to be considered along with the other five in deciding whether the offerings constitute a single issue. Indeed, the SEC's first statement of the integration doctrine established that not all offerings of the same class of securities by the same person would be integrated:

> If the offerings may be segregated into separate blocks, as evidenced by material differences in the use of the proceeds, in the manner and terms of distribution, and in similar related details, each offering will be a separate issue.

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109. See text accompanying note 107 supra.
110. See text accompanying note 108 supra.
Most real estate syndicate offerings involve the same class of security, are made at about the same time, and are for the same type of consideration. Therefore, the remaining criteria relevant to integration of syndicate securities are (1) issuance by the same person, (2) a single plan of financing, and (3) the same general purpose.

1. The Issuer

Simply because the issuer of two offerings is the same person should not necessarily always lead to integration. On the other hand, the interposition of a separate entity such as a corporation between the promoter and the purchasers of the second offering should not preclude integration. For example, if a syndicator forms two separate, wholly owned corporations to act as general partners of two syndicates, the corporate entities should not be barriers to integration if other facts dictate such action.

Each syndicate must be examined separately to determine who is actually the issuer of the limited partnership interests. If the same corporate general partner participates in two syndicates, the “same person” requirement is clearly fulfilled, but if the two syndicates have different corporate general partners, it is necessary to determine who controls the corporations. When the same person or group controls both corporate general partners, the “same person” test should also be met, even though the corporations may have outside minority interests that are not identical.

2. A Single Plan of Financing

Three general interpretations of this second test for integration may be made. First, since the business of real estate syndicators is purchasing and operating real property, one might argue that all sales of partnership interests are a part of the same plan of financing these purchases. This approach assumes that it is the issuer's plan of financing that is relevant, and that the issuer is the promoter. In contrast to this broad approach, it could be reasoned that a single plan of financing requires, in addition to financing the same kind of business, a “common enterprise” or an intermingling of the business of the purportedly different issuers whose offerings are sought to be integrated. Support for this interpretation is found in Los Angeles Trust and Deed and

113. Cf. note 79 supra. In some cases the limited partnership could be considered the issuer, for example, if formation of the limited partnership took place before the offering was completed.
Mortgage Exchange v. SEC,\textsuperscript{114} where ostensibly separate offerings were integrated upon a finding that the two issuers involved had pooled their assets and were in effect operating as a single business.\textsuperscript{115}

A third approach is to argue that a single plan of financing may be found where the offerings are for interrelated businesses, although they need not actually commingle assets or operations. Suppose, for example, a syndicator owns two pieces of contiguous property. He forms one syndicate to take one piece, upon which an apartment complex is built. A second syndicate is formed to take the other piece, upon which a shopping center is to be built. Each property is syndicated upon the supposition that the other will be also; the shopping center is to attract tenants to the apartment, while the apartment is to furnish customers for the shopping center. Even if the two syndicates are formed and operated entirely separately by different promoters, their relationship both physically and in planning suggests that a single plan of financing exists that is sufficient to satisfy this test.

3. \textit{The Same General Purpose}

This test for integration is, like the "single plan of financing" test, susceptible to both broad and narrow interpretations.\textsuperscript{116} The word "general" lends itself to a broad rather than a narrow interpretation, however. Both the terminology of this test and its position as last on the SEC's list suggest that it was added as a catchall provision for cases in which integration is warranted but establishing the existence of the other criteria would prove difficult. This view is supported by the fact

\textsuperscript{114} 264 F.2d 199 (9th Cir. 1959), remanded, 186 F. Supp. 830 (S.D. Cal. 1960), mod. and aff'd, 285 F.2d 162 (9th Cir. 1960), cert. denied, 366 U.S. 919 (1961).

\textsuperscript{115} This argument may be carried a step further to say that in order to integrate two or more offerings there must be a finding that investors in the offerings were led to believe they were investing in a common enterprise. The Los Angeles Trust Deed case does not go so far. The court remanded for a factual finding on common enterprise in order to decide the threshold question whether the plan involved securities subject to the Securities Act, and not for the purpose of deciding whether, if securities were involved, the offerings should be integrated. Such representations to investors would of course be relevant to the single plan of financing test insofar as they might estop the issuer from denying that there is such a plan, but they should not be a \textit{sine qua non}. To make them so overlooks the fact that the SEC has an interest in preventing circumvention of the Securities Act for purposes other than the protection of investors in a specific security. \textit{See} notes 148-49 \textit{infra} and accompanying text.

\textsuperscript{116} One argument for a narrow interpretation of this test would look to the disposition of funds raised by the offering, rather than to the purpose for which the offering itself is made. If the latter is taken as controlling, any two syndicate offerings would be potentially subject to integration, while if the former is used, integration would be appropriate only where funds raised in a later, ostensibly separate offering were devoted to the same specific purpose as funds raised in an earlier offering. The difficulty with such an attempted narrow approach is that it is hardly distinguishable from the single plan of financing test.
that no case or ruling has ever found integration appropriate on this ground alone.

IV

WHEN IS INTEGRATION APPROPRIATE?

A. Current SEC Attitudes

The doctrine of integration is a flexible tool with which the SEC may assert authority to regulate offerings of real estate syndicate securities that have for some reason failed to qualify for an exemption from the registration requirement of the Act. The doctrine is applicable where even one of the offerings to be integrated does not qualify for one of the exemptions. Although the intrastate exemption offers the syndicator more certainty than does the private offering exemption, either exemption may be lost in ways that are beyond the control of the syndicator.117

Assuming that one of the offerings is found not to be exempt, the SEC will then apply its factual tests to determine whether the offering can be integrated with other offerings of the same issuer. As already indicated, however, these tests may be interpreted broadly or narrowly. Taking the broadest possible view, the SEC could integrate offerings “made for the same general purpose” regardless of whether the other tests are fulfilled.119 Although the SEC has not gone this far, no coherent position on real estate syndicates and integration of their offerings has yet emerged from the SEC’s rulings. In *Presidential Realty Corporation*,120 for example, the SEC indicated there would be a “serious question” of the availability of the intrastate exemption where a corporation sold property to one corporation, which financed the purchase with an unregistered intrastate offering, and then, while shares in the intrastate offering were still being distributed, proposed to sell contiguous property to a third corporation which would finance the purchase through a registered interstate offering. On the other hand, in *Boetel & Co.*,121 the SEC indicated that syndicates formed pursuant to the intrastate exemption would not be integrated with proposed interstate offerings that would be registered under Regulation A.122 And in *DeMatteis Development Corporation*,123 the SEC indicated that

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118. *See* text accompanying notes 76-85 supra.
119. *See* text accompanying note 107 supra.
122. *See* note 130 infra and accompanying text.
it would not require DeMatteis (DDC) to register as a broker dealer, where the proposed general partners were DDC, an affiliated builder, and a limited profit housing company, whose only function would be to receive loans from the State of New York under its Private Housing Finance Law. DDC proposed that several limited partnerships be formed, the securities of some of which would be registered, and others of which would be placed privately by DDC. The SEC carefully pointed out, however, that its action did not mean that the proposed activity "would be in accord with applicable statutory or regulatory provisions."\textsuperscript{124}

The Presidential Realty and Boetel rulings appear inconsistent since in both cases syndicates were initially formed in reliance on the intrastate exemption and later registered interstate offerings were proposed.\textsuperscript{125} The contiguity of the subject properties in Presidential Realty may be a significant distinction because it tends to meet the SEC's factual test for integration, whereas in Boetel some of the property to be syndicated in registered interstate offerings was located in other states.

Yet if Presidential Realty and Boetel suggest that the basic criterion for integration is a factual finding of a single plan of financing or the same general purpose, DeMatteis indicates that a single overall plan may not be determinative of integration, or at least that even when such a plan or purpose is found it may be outweighed by other factors.

That the SEC in many cases can integrate the offerings of real estate syndicates does not answer the question whether it should do so. While the result in each of the above examples may have been optimal in light of the particular facts of each case, this is little consolation to the syndicator who desires to structure his enterprise in order to qualify for exemption from registration. A coherent policy regarding integration of syndicate securities is therefore needed.

\section*{B. The SEC's Function—Appropriateness of Integration}

Whether the SEC will apply the integration doctrine to real estate syndicate offerings depends upon whether the factual criteria warranting integration are present, and whether integration is appropriate under the circumstances given the presence of these facts. The integration doctrine gives the SEC considerable latitude in reaching a deci-

\textsuperscript{124} \textit{Id.} This caveat may be understandable if viewed as tacitly acknowledging that the quasi-public nature of the enterprise furnished a countervailing factor outweighing other factors which might have dictated integration absent such a quasi-public aspect.

\textsuperscript{125} \textit{But see} text accompanying note 131 \textit{infra.}
sion about the factual criteria. In view of this latitude, it is all the more important that the decision whether integration is appropriate be based upon a consideration of all the potential effects of integration. Criteria for determining the appropriateness of integration of syndicate offerings should, therefore, take account not only of the policies underlying the federal securities laws, but other countervailing federal policies, and the effect of integration upon state regulation of syndicate securities as well.

1. Countervailing Federal Policies

The SEC intimated in *DeMatteis Development Corporation*[^126] that it may be willing to consider policy arguments that offerings of some syndicates should not be integrated even if there are facts justifying integration.[^127]

One such argument might be based on the favored treatment accorded to residential rental property in the Internal Revenue Code. The purpose of this treatment is to encourage construction of new residential housing[^128] and one might argue that this national policy should take precedence over the Securities Act's policy of requiring registration to the extent that requiring registration would inhibit real estate syndication.

A similar argument may be made on behalf of syndicates formed to construct new housing or to renovate old housing under the National Housing Act[^129], the purpose of which is to alleviate the national shortage of low and moderate income housing. Arguably, because such syndicates are under FHA scrutiny, there is less need for SEC protection of investors.

Finally, one of the SEC's own rules furnishes a basis for a countervailing policy argument against integration of syndicate securities. In order to provide a simplified procedure for raising capital by small businesses, Regulation A[^130] grants an exemption from the registration provisions of the Act for offerings up to $500,000 upon appropriate notice by the issuer to the SEC. Although Rule 254[^131] provides that securities of affiliates of the issuer issued within two years of such an offering will be included in computing the aggregate ceiling on the amount of securities that may be issued under Regulation A, an exception is provided where the issuer is a syndicate formed to operate

[^126]: See note 124 *supra*.
[^127]: See note 125 *supra*.
specific real property. In such a case, interests in any affiliated syndicate organized to operate other specific real property will not be aggregated with those of the issuer in calculating the $500,000 ceiling. Presumably, the securities of such affiliated syndicates are often sold under either the intrastate or private offering exemptions. It may therefore be argued that granting such affiliated syndicate immunity from integration with the Regulation A offering while applying the doctrine to syndicates not affiliated with a Regulation A offering is inconsistent. The Rule 254 exception, however, may be viewed as expressing the presumption that the offerings of the affiliates are separate issues; since Regulation A requires notifications and some disclosure of material facts by the issuer, the SEC can forestall abuses by monitoring offerings claiming the Rule 254 exemption. The lack of opportunity for such monitoring in the cases of the intrastate and private offering exemptions weakens the argument against integration in those cases based on Rule 254.

2. Impact on State Regulation

If the SEC were to adopt a policy of integrating syndicate offerings in every case where the factual tests for integration were met, one immediate effect would be that registration would be required for many more syndicates than are currently registering. A result of such a policy might be that small syndicators unable to undertake Federal registration would be squeezed out, leaving real estate syndication to large, well-financed syndicators. These larger syndicators, under time pressures that result from the nature of the syndication process, might turn increasingly toward blind pool syndication in preference to syndication of specific properties. Although California has allowed blind pool syndicates in recent years, regulatory authorities and commentators still believe that blind pools may require stricter scrutiny than specific property syndicates because they present risks to the investor that are not precisely calculable. Ironically, an aggressive SEC policy of integration of syndicate offerings might thus channel those who desire to invest in real estate syndicates into the riskier blind pools.

An aggressive SEC integration policy and the resulting increase

133. Id. See also text accompanying note 9 supra.
134. See note 23 supra.
135. The California Commissioner of Corporations, for example, has suggested that blind pool syndicators be required to have a minimum of three years' experience, and that participation should require a minimum investment of $5,000. San Francisco Examiner, June 26, 1972, at 54, col. 5. See also Marsh & Volk, supra note 3, at 318.
in Federal registration of real estate syndicates would also affect the regulation of syndicate securities by the California Commissioner of Corporations. Syndicate securities registered under the Securities Act of 1933 must still qualify under the California Corporate Securities Law of 1968 before being sold in California, and they are subject to evaluation under the same "fair, just and equitable" standard as securities not registered under the Securities Act; the application of this standard to federally registered securities, however, may be somewhat less stringent than it is for nonregistered securities. In the case of an application for qualification by permit (the only method of qualification available for securities not registered under any federal law, and hence the method used by most syndicates), the Commissioner of Corporations may refuse to issue a permit unless he finds that the proposed plan of business and issuance of securities is fair, just and equitable. The burden of establishing this falls upon the applicant. Securities registered under the Securities Act of 1933, however, may be qualified by coordination, and the Commissioner may only deny the effectiveness of the qualification by making an affirmative finding that the proposed plan of business and issuance of securities is not fair, just and equitable. The Commissioner's discretion is further circumscribed by section 25140(d) of the corporate securities law, which provides that in the case of securities qualified by coordination that are the subject of a firm commitment underwriting by underwriters registered under the Securities Exchange Act of 1934, the Commissioner may not issue a stop order on the basis that the price at which the securities are being offered is unfair, unjust, or inequitable.

Although syndicate securities qualified by coordination may in theory still be subject to the same substantive standards of what is fair, just, and equitable as syndicate securities qualified by permit, the shifting of the burden to the Commissioner may make the application

137. CAL. CORP. CODE § 25110.
138. CAL. CORP. CODE § 25140.
139. CAL. CORP. CODE § 25113. For a description of the process of qualification by permit, see MARSH & VOLK, supra note 3, at 193-97.
140. CAL. CORP. CODE § 25140(b) (West Supp. 1972).
141. MARSH & VOLK, supra note 3, at 244-45.
142. CAL. CORP. CODE § 25111 (West Supp. 1972). Qualification by coordination allows the issuer to file with the Commissioner of Corporations essentially the same documentation submitted for registration under the Securities Act of 1933, thus avoiding duplication of documentation and making the qualification effective simultaneously with the federal registration statement. MARSH & VOLK, supra note 3, at 186.
143. CAL. CORP. CODE § 25140(a) (West Supp. 1972); MARSH & VOLK, supra note 3, at 244-45.
144. CAL. CORP. CODE § 25140(d) (West Supp. 1972).
of such standards more difficult in practice. If blind pool securities registered under the Securities Act are qualified by coordination, this problem may be compounded by the difficulty of evaluating the issuer's plan of business absent a specific piece of property, the characteristics of which can be measured with some degree of accuracy.\textsuperscript{145}

\section*{C. Proposed Criteria}

In view of the interaction of federal policies affecting real estate syndicates and their impact on state regulation of syndicate securities, an aggressive policy of integrating such offerings wherever possible is unwarranted. The SEC should take advantage of the flexibility of the integration doctrine to examine offerings on a case-by-case basis, determining the appropriateness of integration under the circumstances, in light of the objectives of protecting both the public interest and investors.

Where the interests of syndicate investors are adequately protected by state law, the determining factor should be whether integration would further some public interest distinct from the protection of individual investors. If, for example, the SEC found that one of a series of syndicates purportedly falling within the intrastate exemption was in fact not exempt because one of the investors was a nonresident, and further found that the syndicators had made diligent, good-faith efforts to limit offers and sales to bona fide residents, integration would not appear to serve any public interest.\textsuperscript{146} On the other hand, if the SEC found that a syndicator had divided a closely interrelated series of projects into two syndicates, one intrastate and the other purportedly an exempt interstate private offering, and further found that the latter was not in fact a private offering, integration might well serve the public interest. It would promote fair and orderly operation of the securities markets when the circumstances indicate that the syndicator was attempting to use the exemptions provided by the Securities Act to avoid registration of an offering that should have been registered.\textsuperscript{147} Finally, where investors in the syndicates that may be integrated are not adequately protected by state law, integration may be appropriate whether or not some distinct public interest would be served.

\section*{Conclusion}

A syndicator's desire to avoid registration of his securities under the Federal Securities Act is not always indicative of bad faith or an

\begin{footnotesize}
\begin{itemize}
\item[145.] See note 21 \textit{supra}, and accompanying text.
\item[146.] Cf. note 98 \textit{supra}, and accompanying text.
\item[147.] Cf. text accompanying note 115 \textit{supra}.
\end{itemize}
\end{footnotesize}
intention to circumvent the Act. Where these are his motives, the integration doctrine offers a means of denying the claimed exemption and requiring compliance. Similarly, where a syndicator's activities, while not fraudulent as to investors, are contrary to the public interest in maintaining a fair and orderly securities market, integration is an available means of protecting that public interest. Where integration of syndicate offerings would produce neither greater compliance with the public interest nor greater protection for investors, however, the doctrine not only produces no discernible benefit, but it might well be an obstacle to investors desiring the broadest possible range of investment choices.

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