THE REVIEW OF
SECURITIES & COMMODITIES REGULATION
AN ANALYSIS OF CURRENT LAWS AND REGULATIONS AFFECTING THE SECURITIES AND FUTURES INDUSTRIES

Vol. 46 No. 3 February 6, 2013

SEC RULE 412: WHAT IS SAID NOW TRUMPS WHAT WAS SAID BEFORE

Application of rarely used SEC Rule 412 leads to the dismissal of Securities Act claims against GE, GE's directors, and underwriters in the putative class action alleging misrepresentations concerning GE's ability to sell commercial paper. The authors trace the regulatory history of the rule, the pre-GE cases, and then turn to the current decision.

By Richard D. Bernstein and Zheyao Li *

In April 2012, the United States District Court for the Southern District of New York, in *In re General Electric Co. Securities Litigation* ("*GE*"),[1] relied on the rarely cited SEC Rule 412 to dismiss certain claims brought under the Securities Act of 1933, thereby eliminating all 26 underwriter defendants and 16 director defendants from the case.[2] The decision was the third in history to mention the 30-year old Rule 412. *GE* relied on a plain reading of the text to apply Rule 412 to hold that under the 1933 Act, statements in prior incorporated filings are inactionable when they were modified or superseded in substance by different statements in the offering documents themselves. As elucidated by *GE*, Rule 412 does not require a "blue pencil" approach where issuers would have to specify which of the incorporated statements were no longer operable. This article explores the *GE* decision and potential applications of Rule 412 in other 1933 Act cases.

The Provisions of Rule 412

The key provisions of Rule 412 are that (a) *any statement* contained in a document incorporated by reference shall be deemed to be modified or superseded to the extent that a statement in the prospectus modifies or replaces such statement, (b) the modifying or superseding statement need not state that it has modified or superseded a prior statement, and (c) any statement so modified or superseded shall not be deemed to constitute a part of the registration statement or prospectus. The text of the rule is set out in the margin.[3]

[1] 856 F. Supp. 2d 645 (S.D.N.Y. 2012).

[2] The authors represented the underwriter defendants in the *GE* litigation. The views expressed in this article are those solely of the authors, not of any company or entity.

[3] Rule 412's three parts state:

(a) Any statement contained in a document incorporated or deemed to be incorporated by reference or deemed to be part of a registration statement or the prospectus that is part of the registration statement shall be deemed to be modified or

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The Regulatory History

Form S-1, in General Instruction VII, allows but does not require registrants that are already public companies to incorporate Exchange Act filings by reference.[4] The SEC first published for comment what would eventually become Rule 412 in 1978, as part of an ongoing effort to merge the disclosure requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934 into one coherent and more efficient system.[5]

The SEC articulated particular concerns with two potential bases for Section 11 liability for material misstatements or omissions resulting from incorporation by reference of other documents: "first, because the incorporated document, when filed contained false or misleading statements or omissions; or second, because subsequent material events occurred but were not disclosed, causing incorporated disclosures to be misleading."[6] The solution to this dual threat was the genesis of Rule 412, which effectively would result in "the removal of statements made in documents incorporated by reference from the application of the Securities Act" when those statements have subsequently been "superseded or modified by disclosure" in a prospectus or other document filed later with the SEC, even if the modifying or superseding statement does not explicitly state it has done so.[7] To further encourage more meaningful and timely disclosure, the Commission proposed "that the making of a modifying or superseding statement shall not be deemed an admission that the modified or superseded statement, when made, constituted a violation of the" federal securities laws.[8]

Having received a "mixed reaction at that time," the Commission took no action in 1978, but again proposed what became Rule 412 in 1981 as part of its "comprehensive program to integrate the disclosure requirements of the Securities Act and the [Exchange Act]."[9] In so doing, the SEC decided to act on the recommendations of the 1977 report of the Advisory Committee on Corporate Disclosure, which advocated "the complete integration of the Federal Securities Acts, primarily by incorporating by reference Exchange Act reports into Securities Act registration statements."[10]

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superseded for purposes of the registration statement or the prospectus that is part of the registration statement to the extent that a statement contained in the prospectus that is part of the registration statement or in any other subsequently filed document which also is or is deemed to be incorporated by reference or deemed to be part of the registration statement or prospectus that is part of the registration statement modifies or replaces such statement. Any statement contained in a document that is deemed to be incorporated by reference or deemed to be part of a registration statement or the prospectus that is part of the registration statement after the most recent effective date or after the date of the most recent prospectus that is part of the registration statement may modify or replace existing statements contained in the registration statement or the prospectus that is part of the registration statement.

(b) The modifying or superseding statement may, but need not, state that it has modified or superseded a prior statement or include any other information set forth in the document which is not so modified or superseded. The making of a modifying or superseding statement shall not be deemed an admission that the modified or superseded statement, when made, constituted an untrue statement of a material fact, an omission to state a material fact necessary to make a statement not misleading, or the employment of a manipulative, deceptive, or fraudulent device, contrivance, scheme, transaction, act, practice, course of business, or artifice to defraud, as those terms are used in the Act, the Securities Exchange Act of 1934, the Investment Company Act of 1940, or the rules and regulations thereunder.(c) Any statement so modified shall not be deemed in its unmodified form to constitute part of the registration statement or prospectus for purpose of the Act. Any statement so superseded shall not be deemed to constitute a part of the registration statement or the prospectus for purposes of the Act.

[4] If a registrant that is already public elects to incorporate information by reference, Item 12 of Form S-1 requires that the latest Form 10-K annual report and any subsequent Exchange Act filings pursuant to Sections 13(a), 14, and 15(d) be included. Similarly, seasoned issuers electing to use Form S-3 are required to incorporate by reference the latest Form 10-K and any subsequent reports filed pursuant to Sections 13(a) or 15(d), and any documents filed between the prospectus and the termination of the offering pursuant to Sections 13(a), 13(c), 14, or 15(d) are deemed to be incorporated.

[5] *In re Short Form for Registration of Securities*, SEC Rel. No. 33-5998, 1978 WL 196203 (1978).

[6] *Id.* at *6.

[7] *Id.*

[8] *Id.*

[9] *Circumstances Affecting the Determination of What Constitutes Reasonable Investigation and Reasonable Grounds for Belief Under Section 11 of the Securities Act*, SEC Rel. No. 33-6335, 1981 WL 31062, at *1, *8 (1981); *see also Reproposal of Comprehensive Revision to System for Registration of Securities Offerings*, SEC Rel. No. 33-6331, 1981 WL 30765 (1981). Numbered Rule 418 at the time, it was subsequently renumbered when a different proposed Rule 412 was not adopted.

[10] SEC Rel. No. 33-6335, *supra* note 9, 1981 WL 31062, at *3.

This decision was the culmination of a process that had begun after 1964 of "better coordination" of the two disclosure systems: "the transaction-based disclosure system of the Securities Act and the continuous disclosure system of the Exchange Act," which previously had "operated independently of each other."[11] Under that dual regime, information that had been disclosed previously in an Exchange Act periodic report had to be included separately in a Securities Act registration statement, resulting in "needless duplication and overlap."[12]

The rules proposed in 1981 were thus designed to further "the Commission's efforts to achieve a simplified and integrated disclosure system under the Securities Act and the Exchange Act," [13] the goal of which was to furnish investors with "meaningful, non-duplicative information both periodically and when securities distributions are made to the public," while decreasing "costs of compliance for public companies."[14] In particular, the SEC expanded the use of incorporation by reference of Exchange Act filings in Securities Act registration statements. In so doing, however, the Commission was cognizant of "concerns expressed by some members of the financial community regarding the ability of underwriters and others to undertake a reasonable investigation with respect to the adequacy of the information incorporated by reference from periodic reports filed under the Exchange Act into the short form registration statements utilized in an integrated disclosure system."[15] The Commission further recognized that underwriters can change and long periods of time may pass between the effective date of the registration statements and the documents incorporated by reference, particularly in shelf offerings, which can occur "over a substantial period" of time.[16] As a result, the Commission followed the advice of the Advisory Committee that "this expanded utilization of incorporation by reference of 1934 Act filings necessitates a corresponding limiting interpretation of the liability provisions" of the securities laws.[17]

In 1981, the SEC noted market participants' renewed appreciation of the fact "that liability could be asserted based on information in a previously filed document which was accurate when filed but which had become outdated, and subsequently was incorporated by reference into a registration statement."[18] The Commission intended Rule 412 to eliminate this possibility, so that "inaccurate or outdated information in a prior filing should not be deemed to make the prospectus false or misleading if updating or correcting information is included in a later filing or in the registration statement."[19] The Commission finally adopted Rule 412 in March 1982, and at that time it clarified that the rule would also apply in the case of financial statements, including ones restated due to an accounting change or pooling.[20]

Pre-GE *Cases*

Before *GE*, only two cases had made any mention of Rule 412, and only one of those discussed the rule in any detail.[21] In *Wielgos v. Commonwealth Edison Company*, the court mentioned Rule 412 in passing as it granted summary judgment for the defendants. The plaintiffs in *Wielgos* had brought claims under Section 11 of the Securities Act alleging false and misleading statements in Commonwealth Edison's September 22, 1983 registration statement, in connection with a December 5, 1983 stock offering. The plaintiffs alleged that the September 22 registration statement underestimated the completion dates and total costs of the company's nuclear construction projects.[22] The court noted, however, that the company's November 9, 1983 Form 8-K, an after-incorporated filing, stated that the in-service date of one power plant would "likely" be moved back, and that other changes might occur. The court cited Rule 412 in holding that the 8-K "modified the earlier disclosures as to the cost and scheduling of the nuclear construction program" and thus "the disclosures in that document [the 8-K] control."[23]

In the second case, *In re AirGate PCS, Inc. Securities Litigation*, the court discussed Rule 412 in some detail

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] SEC Rel. No. 33-6331, *supra* note 9, 1981 WL 30765, at *2.

[15] SEC Rel. No. 33-6335, *supra* note 9, 1981 WL 31062, at *1.

[16] *Id.* at *6.

[17] *Id.*

[18] *Id.*

[19] *Id.* at *15.

[20] *Adoption of Integrated Disclosure System*, SEC Rel. No. 33-6383, 1982 WL 90370, at *9 n.25 (1982).

[21] *Wielgos v. Commonwealth Edison Co.*, 688 F. Supp. 331, 340 (N.D. Ill. 1988); *In re AirGate PCS, Inc. Sec. Litig.*, 389 F. Supp. 2d 1360, 1369-70 & n.5 (N.D. Ga. 2005).

[22] *Wielgos*, *supra* note 21, 688 F. Supp. at 337.

[23] *Id.* at 340.

while dismissing certain Securities Act claims.[24] In *Airgate*, the plaintiffs attempted to base liability on two Form 10-Q filings and three Form 8-K filings that had been incorporated by reference into the company's initial registration statement. But in Amendment No. 1 to that registration statement, those filings "were no longer specifically incorporated by reference into the Registration Statement."[25] While the court expressed some skepticism as to whether Rule 412 applied in the situation of an "amendment of a registration statement itself," if it did apply, the change to the list of incorporated documents reflected in Amendment No. 1 rendered the unincorporated documents inactionable, even though they had been expressly incorporated by reference into the initial registration statement.[26]

Another case, *Tracinda Corporation v. DaimlerChrysler AG*, is analogous, but did not cite Rule 412.[27] In *Tracinda*, the plaintiff alleged that "the Proxy/Prospectus falsely represented that the two non-automotive members of the DaimlerChrysler Board of Management were non-voting members, when in fact these members were voting members."[28] The source of this alleged misrepresentation was an 8-K statement incorporated by reference into the Proxy/Prospectus that listed the two board members in question as "Non-Voting." The Proxy/Prospectus itself, however, contained "no designation or reference that these members would not be voting."[29] "Because the Proxy/Prospectus controls as to any statement incorporated by reference and the Proxy/Prospectus contains no reference that any members of the Board of Management would be non-voting," the court held that the plaintiff could not establish a misrepresentation based on the incorporated Form 8-K.[30]

The GE *Case*

In 2009, the State Universities Retirement System of Illinois, the lead plaintiff, brought a putative class action against General Electric Company ("GE") and the underwriters of an October 2008 $12 billion GE common stock offering. The plaintiff asserted 1933 Act claims alleging that the offering documents were false and misleading as to, among other things, GE's ability to sell commercial paper. The defendants moved for judgment on the pleadings.

District Judge Denise Cote held that the complaint "improperly relied on . . . statements that were modified and superseded by later statements."[31] In particular, the plaintiff relied on statements in GE's prior Form 10-K filings for 2004 to 2007, which were incorporated by reference into the offering documents. Those prior 10-Ks had characterized commercial paper markets as "reliable," and impaired access to those markets as "unlikely." But the October 2008 prospectus supplement stated things quite differently: among other things, it described "current levels of market disruption and volatility," the prospect of "further deterioration in the commercial paper and other credit markets," and how "there can be no assurance that such markets will continue to be a reliable source of short-term financing for GE Capital."

None of these new descriptions appeared anywhere in the prior 10-Ks that had been incorporated by reference. Instead, the new October prospectus statements described a "recent" and "unprecedented" level of market disruption and volatility that did not exist when the earlier 10-Ks were issued. In fact, the "Risk Factors" section in the October 2008 prospectus supplement began with a current disclosure on the course of the Troubled Asset Relief Program ("TARP") legislation and then discussed the unprecedented volatility and disruption then found in the capital and credit markets. The defendants thus argued that, at a minimum, the 2008 prospectus supplement modified and superseded the earlier 2004-07 Form 10-Ks by replacing the statement that "impaired access" to the commercial paper markets was an "unlikely event" with new statements, including that the October offering "will give us additional flexibility in the event of further deterioration in the commercial paper . . . markets" and that "there can be no assurance that such markets will continue to be a reliable source of short-term financing for GE Capital."

The court agreed, discussing the plain text of Rule 412 at length. Applying Rule 412, the court held that GE's description of "ongoing events in the financial crisis" in the prospectus "modifies GE's earlier statements on the likelihood of impaired access to commercial paper markets and reliability of commercial

[24] *In re AirGate*, *supra* note 21, 389 F. Supp. 2d at 1370 n.5.

[25] *Id.* at 1369.

[26] *Id.* at 1370 n.5.

[27] *Tracinda Corp. v. DaimlerChrysler AG*, 364 F. Supp. 2d 362 (D. Del. 2005), *aff'd*, 502 F.3d 212 (3d Cir. 2007).

[28] *Id.* at 414.

[29] *Id.*

[30] *Id.*

[31] *GE*, *supra* note 1, 856 F. Supp. 2d at 655.

paper."[32] As the court further explained, Rule 412 provides that when the substance of a statement in the prospectus "modifies or replaces" a prior statement in an incorporated filing, the prior statement "shall not be deemed to constitute part of the registration statement," regardless of whether the prospectus expressly states that it has modified or superseded that prior statement.[33] The superseded statements from the incorporated 10-Ks, therefore, "are not deemed to constitute part of the Offering Documents."[34] Thus, pursuant to Rule 412, even though the earlier 10-Ks were incorporated, because their commercial paper statements were modified and superseded by different commercial paper statements in the prospectus supplement, no 1933 Act claim could be based on the commercial paper statements in the earlier 10-Ks.

Moving Forward

GE applied the plain meaning of SEC Rule 412 to dismiss claims based on statements in earlier incorporated filings that, in substance, were later effectively superseded by the offering documents.[35] Perhaps most importantly, the decision recognizes that offering documents need not expressly state that they are superseding a particular outdated earlier statement in an incorporated document.

In many respects, *GE* was an easy case for the application of Rule 412. There was no dispute – nor could there be – that the older statements and the superseding statements concerned the exact same topic of commercial paper. What occurred in *GE* was akin to a newspaper website forecasting that tomorrow's weather would be rainy, even though the website also contained the text of a week-old edition forecasting sunlight. Moreover, in *GE*, everyone knew that circumstances had changed drastically in the intervening years between the original statements and the new ones, because of the financial crisis. And there was never any allegation that the original statements were somehow false at the times of the prior 10-Ks. Finally, it was clear that the new statements were drastically different in substance from the earlier statements on which the plaintiffs had attempted to base liability.

In future cases, the application of Rule 412 may not be so easy. Because Rule 412 provides that the offering document "need *not*" indicate "that it has modified or superseded a prior statement," it often will not be express when a prior incorporated statement has actually been modified or superseded. As a matter of law, Rule 412 bars a claim whenever, in substance, an offering document "updat[es] *or* correct[s] information" in a previous filing incorporated by reference.[36] At a minimum, Rule 412 applies when there is a plain difference in the substance of statements on a topic. Such a difference indicates that the more recent statement modifies or supersedes the earlier one. Moreover, whether a reasonable investor would still view the prior statement as material after the modifying or superseding statement provides no escape from Rule 412. This is because Rule 412 provides that superseded and modified statements "shall not be deemed to constitute a part of the registration statement or the prospectus for purposes of the [Securities] Act" at all.

Another question that might arise is whether Rule 412 operates any differently on 1933 Act liability if the original statement was false when initially made. Neither Rule 412's text nor its history draws such a distinction. Contrast Rule 412(b) and Rule 412(a). Rule 412(b) states: "The making of a modifying or superseding statement shall not be deemed an admission that the modified or superseded statement, when made, constituted an untrue statement of a material fact, an omission to state a material fact necessary to make a statement not misleading, or the employment of a manipulative, deceptive, or fraudulent device, contrivance, scheme, transaction, act, practice, course of business, or artifice to defraud . . . ." So Rule 412's drafters were aware that the prior statement might have been false or contained a material omission when made. But Rule 412(c) states, without exception, that "[a]ny" modified or superseded statement is not subject to the

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[32] *Id.* at 656.

[33] *Id.* at 655-56.

[34] *Id.* at 656.

[35] Another court recently dismissed 1933 and 1934 Act claims based on alleged false statements in a year-old prospectus that were superseded by a prospectus supplement, but did not mention Rule 412. *Rabbani v. DryShips, Inc.*, 2012 WL 5395787, at *12 (E.D. Mo. Nov. 6, 2012). The original prospectus discussed a one-to-one distribution ratio in connection with a potential transaction, while the shareholders ultimately received only a 0.007266 ratio. The court held that the new prospectus supplement, which disclosed that the company was considering a wide range of possibilities and also that the transaction might not occur at all, superseded the inconsistent earlier statement. Thus, no reasonable investor could rely on the earlier statements.

[36] SEC Rel. No. 33-6335, *supra* note 9, 1981 WL 31062, at *15 (emphasis added); *see also id.* at *6 (Rule 412 applies when "outdated [information] subsequently was incorporated by reference into a registration statement.").

1933 Act. It has long been established that "any" is all-encompassing.[37] Accordingly, Rule 412 should apply to a modified or superseded statement, without any unwritten exception based on whether that statement was accurate or misleading when made. In fact, as early as 1978, the drafters of what became Rule 412 indicated that it would apply both when a modified or superseded statement had been false when made *and* when subsequent events caused earlier statements to become misleading only later.[38] Likewise, in 1981, the SEC stated that what became Rule 412 applied to "inaccurate *or* outdated information in a prior filing."[39]

Finally, the *GE* case involved qualitative descriptions, but Rule 412 should apply equally in cases where numbers, such as earnings and accounting figures, are modified or superseded. Just as with qualitative disclosures, numbers are literally statements, and should fall within the plain meaning of the text of Rule 412, which applies to "any statement." The regulatory history supports this reading as well, as the Commission remarked in 1982 upon adopting the rule that it would also apply to financial statements, including restated financial statements.[40] What if a prospectus had accurate financial statements but incorporated financial statements for a prior period that were false when originally made? The SEC said in its 1981 release that when the prospectus information "up-dat[es]" prior information, Rule 412 bars 1933 Act liability based on incorporated but "inaccurate or outdated" information.[41] A seasoned company could argue that up-to-date, current financial statements in a prospectus render the older financial statements "out-dated," and that Rule 412(b) expressly provides that the company's prospectus "need not state" that the older financial statements have been superseded. Likewise, underwriters and directors could argue that Rule 412 was designed to protect them from having to investigate prior reports that were no longer current.[42]

The *GE* case likely means that Rule 412 will be invoked by defendants in future 1933 Act cases. Ultimately, we may well hear more frequently from the courts about the 30-year old Rule 412. ■

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[37] *See, e.g.*, *Nguyen v. United States*, 556 F.3d 1244, 1252 (11th Cir. 2009) ("We all know that 'any' is all-embracing and means nothing less than all."); *United States v. Maxwell*, 285 F.3d 336, 341 (4th Cir. 2002) ("[T]the word 'any' means 'all.'"); *Fleck v. KDI Sylvan Pools, Inc*., 981 F.2d 107, 115 (3d Cir. 1992) ("The word 'any' is generally used in the sense of 'all' or 'every' and its meaning is most comprehensive."); *Andersen v. Farmers Bank of Clatonia*, 640 F.2d 1347, 1349 (8th Cir. 1981) ("any person" means "each"); *Kalmbach, Inc. v. Insurance Co. of State of Pa., Inc*., 529 F.2d 552, 556 (9th Cir. 1976) ("The common understanding of the word ["any"] is that it means all or every.").

[38] SEC Rel. No. 33-5998, *supra* note 5, 1978 WL 196203, at *6. Whether Rule 10b-5 liability could independently attach to incorporation of superseded statements that were false when originally made is beyond the scope of this article. The authors do note that plaintiffs choosing to pursue such an avenue would have to prove, among other elements, that the incorporation was made with scienter, materiality, reliance at that time, and loss causation.

[39] SEC Rel. No. 33-6335, *supra* note 9, 1981 WL 31062, at *15 (emphasis added).

[40] SEC Rel. No. 33-6383, *supra* note 20, 1982 WL 90370, at *9 n.25.

[41] SEC Rel. No. 33-6335, *supra* note 9, 1981 WL 31062, at *15.

[42] *See supra*, at note 15.