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Truth up to the Date of Use as a Requirement for a Section 10(a) Prospectus: The Implications of SEC v. Manor Nursing Centers, Inc.

The Securities Act of 1933 contains both full disclosure and anti-fraud protection for investors; violations of each type of provision are treated differently in the civil liability sections of the Act. In SEC v. Manor Nursing Centers, Inc., however, the Court of Appeals for the Second Circuit held that untruths in prospectuses subject the seller not only to antifraud liability under section 12(2), but also to section 12(1) liability for violation of the section 5(b)(2) prospectus delivery requirement. The court also determined that the truth requirement it found in section 10(a) exists up to the time the prospectus is used. The author criticizes the court's view, and suggests that the Manor approach would greatly change current practice for disclosure of developments that occur after the registration statement has become effective.

I. INTRODUCTION

Section 5(b)(2) of the Securities Act of 1933 (Securities Act) provides that a prospectus meeting the requirements of section 10(a) must precede or accompany the delivery of any security. Section 10(a)(1) requires only that a prospectus "contain the information contained in the registration statement . . . ." From this language it appears that the prospectus delivery requirement is met if the prospectus delivered mirrors the registration statement (with certain permitted exceptions), or contains at least the information

   It shall be unlawful for any person, directly or indirectly —
   . . .
   (2) to carry or to cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 10.

The term "prospectus," as used in the Securities Act, includes both the section 10 or "statutory" prospectus, see note 2 infra and accompanying text, and the general prospectus, defined in section 2(10), 15 U.S.C. § 77b(10) (1970), as "any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security . . . ."

References to "the Act" and to section numbers refer to the Securities Act of 1933 unless another act is specified.

2 Securities Act § 10(a), 15 U.S.C. § 77j(a)(1) (1970). Continuing, section 10(a)(1) excepts from the prospectus certain documents required in the registration statement. Section 10(a) also contains: paragraph 10(a)(2) — prospectus requirements for securities of foreign governments; paragraph 10(a)(3) — an exception to paragraph (1) for prospectuses used more than 9 months after the effective date of the registration statement; and paragraph 10(a)(4) — authority to omit any information required by the subsection if the SEC so provides by rule or regulation.

3 See note 112 infra.
found in the registration statement. Further, no provision of the Act requires that an effective registration statement be updated to disclose material posteffective events, and the Securities and Exchange Commission (SEC) has consistently held that a registration statement speaks only as of its effective date. In SEC v. Manor Nursing Centers, Inc., however, the Court of Appeals for the Second Circuit held that section 10(a)(1) implicitly requires the prospectus to be truthful and that section 5(b)(2) is violated by use of a would-be section 10(a) prospectus that is materially misleading by virtue of its failure to disclose posteffective events.

Manor Nursing Centers, Inc., offered 450,000 shares of its stock for sale to the public. Several representations made in the prospectus and the registration statement later proved to be false. First, the prospectus stated that the offering was on an “all or nothing” basis: unless all shares were sold within a 60-day period, the offering would end, and all subscription funds would be returned. Second, it stated that all subscribers’ funds would be held in escrow and that arrangements for the escrow had already been made. Third, the registration statement indicated that shares would be sold for cash only. Finally, by not containing statements to the contrary, both the prospectus and the registration statement represented that no special compensation would be given to participants in the distribution. When these representations proved to be false, the SEC sought an injunction pursuant to Securities Act section 20(b) and section 21(e) of the Securities Exchange Act of 1934 (Exchange Act). In affirming the district court, the court of appeals held that the defendants had violated antifraud provisions of the Securi-

4 The structure of section 5 of the Act divides the registration process into three periods: the period before the registration statement is filed (the prefiling period), the waiting period, and the period after the registration statement becomes effective (posteffective period). Posteffective events are those that occur after the effective date.

5 E.g., Funeral Directors Mfg. & Supply Co., 39 S.E.C. 33, 35 (1959); Charles A. Howard, 1 S.E.C. 6, 10 (1934). In certain circumstances the SEC does require the registrant to undertake to file posteffective amendments to disclose later events. 1 L. Loss, SECURITIES REGULATION 300-02 (3d ed. 1961) [hereinafter cited as Loss].

6 458 F.2d 1082 (2d Cir. 1972).

7 The 450,000 shares included 100,000 shares then held by stockholders.

8 458 F.2d at 1088-94. Securities Act schedule A, 15 U.S.C. § 77aa (1970), requires that the registration statement set forth any variations in offering price (item 16) and all commissions or discounts paid to underwriters directly or indirectly (item 17). Through section 10(a)(1) the prospectus must contain this information as well.


12 458 F.2d at 1094-95.
ties Act (section 17(a)),\textsuperscript{13} the Exchange Act (section 10(b)),\textsuperscript{14} and Exchange Act Rules 10b-5 and 10b-9.\textsuperscript{15} Although the court needed no other basis than findings of fraud to affirm the injunction, it went on to hold that the section 5(b)(2) prospectus delivery requirement had also been violated.\textsuperscript{16} In so doing, the court created in section 10(a) the implicit requirements (1) that a prospectus be truthful and (2) that it be truthful as of the date it is used.\textsuperscript{17}

The court’s holding — that an untrue prospectus, though consistent with the registration statement, violates the section 5(b)(2) prospectus delivery provision — will become most important when it is taken up by purchasers in private actions. An untrue prospectus might now give rise to liability under section 12(1) of the Securities Act, which provides relief for any section 5 violation.\textsuperscript{18} In addition, the purchaser will still retain the traditional antifraud remedies.\textsuperscript{19}

\textsuperscript{15} 17 C.F.R. §§ 240.10b-5, -9 (1973).
\textsuperscript{17} 458 F.2d at 1098-1100. While the court of appeals described Manor as a section 5(b) (2) violation, the district court held it to be a violation of section 5(b) (1). 340 F. Supp. at 934. Securities Act § 5(b)(1), 15 U.S.C. § 77e(b)(1) (1970), provides that:

\textbf{It shall be unlawful for any person, directly or indirectly —}

(1) to make use of any means or instruments for transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this Act, unless such prospectus meets the requirements of section 10 . . . .

Sections 5(b)(1) and 5(b)(2) differ in that section 5(b)(1) requires generally that written offers take the form of a section 10 prospectus (either a section 10(a) or 10(b) prospectus, 15 U.S.C. §§ 77j(a), (b) (1970)), unless — and this applies only in the posteffective period — the written offer is accompanied or preceded by a section 10(a) prospectus. \textit{See} note 2 \textit{supra} and text accompanying notes 39-41 \textit{infra}. Section 5(b)(2) requires the use of a section 10(a) prospectus. Both sections are equally applicable in Manor. Use of the non-section 10 prospectus (not accompanied or preceded by a valid section 10(a) prospectus) constituted a section 5(b)(1) violation; delivery of the security prior to delivery of a valid section 10(a) prospectus violated section 5(b)(2).

\textsuperscript{18} It could equally be said that these requirements are implicit under section 5(b)(2); sections 5(b)(2) and 10(a) together comprise the prospectus delivery requirements.

\textsuperscript{19} Securities Act § 12(1), 15 U.S.C. § 77l(1) (1970), imposes liability for rescission or the equivalent in damages upon "any person who offers or sells a security in violation of section 5," provided that the plaintiff purchased from the defendant. \textit{See} notes 27, 36 \textit{infra}.

\textsuperscript{20} The antifraud remedies include Securities Act §§ 11, 12(2), 17(a), 15 U.S.C. §§ 77k, 77l(2), 77q(a) (1970); Exchange Act § 10(b), 15 U.S.C. § 78j(b) (1970);
This added protection to investors causes an overlap of antifraud and prospectus delivery provisions in the Act, with an attendant reduction of the plaintiffs' burdens and defendants' defenses which the Act explicitly provides under its private antifraud remedies.20 Further, Manor may force the amendment of a registration statement whenever a material event occurs in the posteffective period.21

II. TRUTHFULNESS AS A REQUIREMENT FOR A 10(a) PROSPECTUS

The Manor court's decision to interject a truth requirement into section 10(a)(1) has no real foundation in the language of that section.22 More importantly, this approach appears to conflict with the scheme of the Securities Act. The Act is composed of two separate branches of substantive requirements: (1) the registration and prospectus control provisions (referred to as the full disclosure provisions); and (2) the antifraud provisions.23 The Act is struc-


20 See notes 24-26 infra and accompanying text.
21 See notes 110-21 infra and accompanying text.
22 Section 10(a) contains no explicit requirement of truthfulness. Nor do SEC rules, Securities Act schedule A, 15 U.S.C. § 77aa (1970), the general or special instructions to SEC Form S-1, or the signature verification of form S-1 contain any requirement of truth. Compare notes 60-65 infra and accompanying text.
23 The only requirement clearly within section 10(a) is the matching requirement, that is, that the prospectus "contain the information contained in the registration statement." The original section 10(a)(1) required the prospectus to contain the "same statements" as the registration statement. Securities Act of 1933, ch. 38, § 10(a)(1), 48 Stat. 81, as amended, 15 U.S.C. § 77j(a)(1) (1970). This provision was amended in 1954 to avoid any implication that the language in the prospectus and the registration statement had to be identical. No suggestion was made at that time or in 1933 that a truth requirement be included. H.R. REP. NO. 1542, 83d Cong., 2d Sess. (1954).
24 The full title of the Act sets forth its two purposes: "An Act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes." Securities Act of 1933, ch. 38, 48 Stat. 74.
25 The full disclosure provisions are contained in sections 5, 7, and 10, 15 U.S.C. §§ 77e, 77g, 77j (1970). Section 7 prescribes the content of the registration statement; section 10 is the analogous section for the prospectus. Section 5, the core of the Act, dictates requirements of the offer-and-sale process in terms of these two documents. The prohibition against fraudulent offers or sales, section 17(a), 15 U.S.C. § 77q(a) (1970), functions independently of section 5. Section 17 and the civil antifraud rem-
tured so that each set of provisions functions independently of the other. In Manor, however, the court in effect intertwines these two sets of provisions; in so doing it produces a result that appears unsupportable in view of the overall statutory scheme.

The impact of the court's melding of the full disclosure-anti-fraud dichotomy is best illustrated by section 12, which gives a remedy to buyers of securities for violations of the full disclosure provisions (section 12(1)) and the private antifraud provision (section 12(2)).\(^{24}\) Though the remedy is identical in either case — rescission or the equivalent in damages if the security has been resold\(^{25}\) — the basis for section 12(1) liability differs from that for section 12(2) liability. In addition, a section 12(2) action in fraud is subject to the defense of due diligence,\(^{26}\) while liability under section 12(1) for violating the full disclosure provisions is virtually absolute.\(^{27}\) Thus the structure of section 12 indicates that the full provisions, sections 11 and 12(2), 15 U.S.C. §§ 77k, 77l(2) (1970), comprise the anti-fraud provisions. See note 19 supra.


Any person who —

1. offers or sells a security in violation of section 5, or
2. offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

\(^{25}\) Id.

\(^{26}\) Id. The other antifraud provisions, section 17(a) of the Securities Act and section 10(b) of the Exchange Act, contain no explicit due diligence defenses, but most decisions have required the plaintiff to show at least some lack of care on the part of the defendant. See, e.g., Shemtob v. Shearson, Hammill & Co., 448 F.2d 442, 445 (2d Cir. 1971), in which the court held that something more than negligence is necessary in an action for a monetary award.

\(^{27}\) Professor Loss states:

The liability under § 12(1) is virtually absolute. The plaintiff need only allege and prove (1) that the defendant was a seller or, under § 15, a person in control of a seller; (2) that the mails or some means of transportation or communication in interstate commerce was used . . . in the offer or sale to the particular plaintiff; (3) that the defendant failed to comply with either the registration or the prospectus requirements; (4) that the action is not barred by the statute of limitations; and (5) that adequate tender was made when the plaintiff is seeking rescission.
closure and antifraud provisions should not be merged.28

The legislative history of the Act also demonstrates that section 12(1) was not intended to reach misrepresentations in prospectuses. The House Report specifically sets out the level of care expected and the type of liability imposed for false or misleading statements used in selling literature:

The committee emphasizes that these [civil] liabilities attach only when there has been an untrue statement of material fact or an omission to state a material fact in the registration statement or the prospectus. . . . All who sell securities with such a flaw, who cannot prove that they did not know — or who in the exercise of due care could not have known — of such misstatement or omission, are liable under [section 11 and subsection 12(2)].

. . . The responsibility imposed is no more nor less than that of a trust. It is a responsibility that no honest banker and no honest business man should seek to avoid or fear. To impose a lesser responsibility would nullify the purposes of this legislation. To impose a greater responsibility . . . would unnecessarily restrain the conscientious administration of honest business with no compensating advantage to the public.29

Since section 12(1) by its terms imposes virtually absolute liability, it is clear that Congress did not intend sales made through false or misleading statements to be addressed by this subsection. Indeed,

3 LOSS 1693 (footnotes omitted).

28 There are other distinctions between section 12(1) actions and actions based on the two civil antifraud provisions of the Securities Act: section 11 and section 12(2). (Securities Act § 11, 15 U.S.C. § 77k (1970), imposes civil liability for a false registration statement on the issuer, those persons intimately involved with the issuer, the underwriters, and those persons who participated in the preparation of or who signed the registration statement.) The group of people who can be defendants under section 12(1) is likely to include people who may not be defendants in actions based upon sections 11 or 12(2). The section 11 defendant group is limited to the issuer (and its directors), underwriters, and those who participated in the preparation of or who signed the registration statement. Section 12(2) is limited by its "by means of" language to those people who participated in both the sale and the misrepresentations. Section 12(1), however, would appear to require only that the defendants have participated in the sale. But cf. note 36 infra. Also, the statute of limitations, Securities Act § 13, 15 U.S.C. § 77m (1970), is one year after the violation of section 12(1), but one year after the discovery of the violation (or one year after discovery should have been made) for section 11 or 12(2). This statute of limitations will usually work to the disadvantage of plaintiffs under section 12(1), but if the fraud should have been discovered before delivery of the section 10 prospectus, the statute begins to run sooner for section 12(2).

29 H.R. REP. NO. 85, 73d Cong., 1st Sess. 9-10 (1933). In place of the bracketed language contained in the first paragraph of the quotation, the House Report uses the phrase "sections 11 and 12." But the context makes it clear that the reference is not to section 12 in its entirety, but only subsection 12(2).
if an untruth in a prospectus gives rise to a section 5 violation and
the absolute liability of section 12(1), then the committee's express
intent, to permit due diligence defenses and to require lack of plain-
tiff's knowledge in cases of misstatements or half-truths, is negated.

Commentary on the Act has recognized the disclosure-antifraud
dichotomy. Professor Schulman stated in a 1933 article:

The first part of Section 12 does not deal with the truth or falsity
of the representations in the registration statement or prospectus.
It puts upon the seller only the burden of ascertaining the existence
of a registration statement and the conformity of the prospectus
with that statement.30

Later, Professor Loss noted:

[P]resumably, the presence of a misleading statement in a pro-
spectus does not prevent it from being one which "meets the re-
quirements of section 10" within the meaning of § 5(b). Other-
wise every violation of § 17(a) as a result of a misleading
prospectus with respect to a registered security would automatically
involve a violation of § 5(b) as well, and any buyer who had a
civil action in such a case under § 11 or § 12(2) would also have
one under § 12(1) on account of the violation of § 5. This does
not seem consistent with the statutory framework.31

Despite the scheme of the Act, supported by its legislative his-
tory and commentary, the Manor court held truth to be a section
10(a) requirement. Under Manor therefore, use of a section 10(a)

30 Shulman, Civil Liabilities and the Securities Act, 43 YALE L.J. 227, 243 (1933).
See also Shumen v. Sherman, 356 F. Supp. 911, 917 (D. Md. 1973), where the court
makes a similar point concerning section 12: "It is also to be noted that the very nature
of the underlying purposes of Sections 12(1) and 12(2) are dissimilar. Section 12(1)
exists for the prophylactic purposes of insuring registration; Section 12(2) exists to
provide a remedy to a wronged purchaser . . . ."

For early general discussions of the civil liabilities provisions of the Securities Act,
see Douglas & Bates, The Federal Securities Act of 1933, 43 YALE L.J. 171 (1933);

31 1 LOSS 628. Professor Loss makes this statement in the course of discussing
whether an order suspending an exemption under regulation A, 17 C.F.R. §§ 230.251-
.263 (1973), because of misleading or fraudulent statements in the sale of a security,
destroys the exemption ab initio or only as of the date of the order. If the exemption
is lost retroactively, the analogy to Manor is clear; if the exemption is lost only after the
suspension, however, previous buyers will have only antifraud remedies. The SEC has
used the former approach and found violations of both sections 5 and 17 as a result of
fraudulent sales literature. The section 5 violation in Manor follows logically from
¶ 79,170 (SEC 1973). See also Cooperative Oil Investments, Inc., [1973 Transfer
B, 17 C.F.R. §§ 230.500-346 (1973)). It is arguable, however, that the Commission's
power to condition exemptions pursuant to section 3(b), 15 U.S.C. ¶ 77(c) (b)
(1970), upon full compliance with its own rules is greater than that with respect to
section 5. See notes 73-76 infra and accompanying text.
prospectus that contains an untruth is the equivalent of a failure to deliver a section 10(a) prospectus at all. Thus, any sale actionable under section 12(2) because of an untruth in a section 10(a) prospectus will also result in a section 5 violation upon delivery of the security and be actionable under section 12(1) as well. Since section 12(1), unlike section 12(2), does not require the plaintiff to prove his lack of knowledge of the fraud and does not permit any due diligence defense, plaintiffs can be expected to sue under section 12(1). Section 12(2) will be effectively read out of the statute with respect to section 10(a) prospectuses.

To the extent that Manor would permit section 12(1) actions for untruths in prospectuses, it indirectly imposes absolute liability on all sellers for the truth of the prospectuses they use. Yet in other situations where the Act seeks to impose absolute liability in section 11 (for issuers) and for violations of section 5 — it does so explicitly. Further, even though the fiduciary standard intended

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32 Half-truths — omissions of material facts necessary to make other statements not misleading — are presumably covered under Manor, since this type of misrepresentation is generally actionable to the same extent as an affirmative misrepresentation. See, e.g., Securities Act §§ 11(a), 12(2), 15 U.S.C. §§ 77k(a), 77l(2) (1970). Pure omissions, however, would probably not be actionable, except for those items that are specifically required to be included in the prospectus. See Securities Act schedule A, 15 U.S.C. § 77aa (1970), SEC Form S-1, and the general and special instructions to SEC Form S-1. Omissions of those items, however, would not satisfy the matching requirement of section 10(a) (1) and would constitute a section 5 violation apart from Manor.

33 In cases in which the prospectus is delivered after sale and payment, but before delivery of the security, section 12(1) liability may now exist where section 12(2) liability would not. The language of section 12(2), “offers or sells . . . by means of,” suggests some relationship between the untruth and the fraud. It could be asserted that a buyer who receives a faulty section 10(a) prospectus only upon delivery after an oral sale and payment could not have relied on the prospectus; therefore, it was not sold “by means of” the prospectus. However, courts have generally not required any reliance under section 12(2); so long as the buyer did not know of the untruth, he is conclusively presumed to have relied on the prospectus. See Gilbert v. Nixon, 429 F.2d 348, 356 (10th Cir. 1970); Demarco v. Edens, 390 F.2d 836, 841 (2d Cir. 1968). If the Manor decision is followed, no vestige of reliance — even buyer’s knowledge — will remain.

34 Although the court in Manor discusses the defendants’ lack of good faith, knowledge of some violations, and negligence with respect to others, 458 F.2d at 1094-97, it does so only in connection with the section 17(a) and Exchange Act section 10(b) violations. In its discussion of the prospectus delivery violations, the court neither holds nor implies that liability is contingent upon some degree of neglect or knowledge by the defendants. Nor does the language of section 5 or 12(1) suggest such a reading. Accordingly, Manor cannot be read as implying that some degree of guilty knowledge is a requirement for liability under section 12(1).

35 Securities Act § 11(b), 15 U.S.C. § 77k(b) (1970), provides: “[N]o person, other than the issuer, shall be liable . . . who shall sustain the burden of proof [of enumerated defenses].” Violations of Securities Act § 5, 15 U.S.C. § 77e (1970), are not subject to defenses, as evidenced by the absolute language of section 12(1). This
by the drafters may be quite strict, it is harsh to place upon all sellers\textsuperscript{36} absolute liability for all misstatements, particularly those they neither made nor could have discovered.\textsuperscript{37} This liability is especially burdensome since after Manor a seller, at the risk of absolute liability, not only must make an initial preeffective date investigation, but must continue to investigate during the entire period of the distribution to insure that no posteffective developments impair the validity of the prospectus.\textsuperscript{38}

The Manor rationale could also affect a number of other prospectuses now permitted by SEC rules. During the waiting period SEC Rule 433\textsuperscript{39} permits a preliminary (priceless) prospectus to qualify as a section 10 prospectus for the purpose of section 5(b)(1). An untruth in such a prospectus would, after Manor, disqualify it as a section 10 prospectus and its use would then violate section 5(b)(1).

Although Manor involved a section 10(a) prospectus, the court's contrast with section 12(2), which expressly provides for a due diligence defense and a purchaser's knowledge element. See note 24 supra.

\textsuperscript{36} The group of "persons who sell" under section 12 can encompass persons who participate in the selling process on behalf of the person who actually transfers title. See Lewis v. Walston & Co., 487 F.2d 617 (5th Cir. 1973); Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 692-93 (5th Cir. 1971); Lennenth v. Mendenhall, 234 F. Supp. 59 (N.D. Ohio 1964); 3 Loss 1712-20; 6 Loss 3834-42 (Supp. 1969); accord, Neils v. Black & Co., 3 CCH BLUE SKY L. REP. § 71,017 (D. Ore. 1972) (interpreting ORE. REV. STAT. § 59.115 (1971)). The concept of "participation," as it applies to section 12(1), identifies persons who have promoted or encouraged a malum prohibitum sale. This is unlike the application of the same "participation" concept to section 12(2), where there is a fault element (negligence) and where the violator, because of the "by means of" language contained therein, must be somehow tied into the misstatements. See 3 Loss 1716. But in the Manor situation, where the prohibited act (violation of section 5) does not involve defective statements or fault, it is arguable that participation should be based only upon substantial facilitation of the illegal sale.


\textsuperscript{38} This duty will extend so long as the seller must comply with section 5. For underwriters, the duty will exist so long as they are acting in an underwriting capacity. Dealers are subject to section 5 only for a period of 40 or 90 days, unless they trade in securities constituting part of an unsold allotment. In that case, the dealer must continue to comply with section 5 until the allotment is disposed of. Securities Act § 4(3), 15 U.S.C. § 77d(3) (1970). See also SEC Rule 174, 17 C.F.R. § 203.174 (1973).

\textsuperscript{39} 17 C.F.R. § 230.433 (1973).

\textsuperscript{40} See 1 Loss 232-33.
holding could be extended to Securities Act section 10(b),\textsuperscript{41} which authorizes the SEC to provide by rule or regulation for the use of summary prospectuses that will qualify as section 10 prospectuses for purposes of section 5(b)(1). If \textit{Manor} were applied, prospectuses currently permitted under SEC Rules 434 and 434A\textsuperscript{42} would not qualify as section 10 prospectuses if incorrect, and their use would violate section 5(b)(1).

In addition, the \textit{Manor} holding could reach other communications, including confirmations, which, because of the section 2(10)(a) definitional exclusion,\textsuperscript{43} are not considered prospectuses under certain conditions. If such a communication follows a prospectus that fails to satisfy section 10(a) because of the \textit{Manor} truth requirement, then the communication itself will be a prospectus and its use violative of section 5(b)(1). Similarly, a rule 134 "tombstone,"\textsuperscript{44} excluded from status as a prospectus by section 2(10)(b), could lose its exclusion under the \textit{Manor} approach. Both subsections (c)(ii) and (d) of rule 134 condition the allowability of a tombstone upon the prior or simultaneous delivery of a section 10 prospectus.\textsuperscript{45} If the user of a tombstone relies on subsection (c)(ii) or (d), and the section 10(a) prospectus is untrue, the tombstone would not satisfy the rule and it would be a prospectus whose use would violate section 5(b)(1). Further, a possibility exists that a court following \textit{Manor} could conclude that, in addition to the truth requirement applicable to the section 10 prospectus that operates in the section 2(10)(a) exception and the rule 134(c)(ii) and (d) situations, a truth requirement exists for the selling information itself. In that event, a false or misleading statement could constitute a failure to comply with the provisions for exception, despite existence of a valid section 10(a) prospectus. The tombstone or supplemental selling literature would then be a section 2(10) prospectus, and its use would violate section 5(b)(1).

\textsuperscript{42} 17 C.F.R. §§ 230.434, 434a (1973).
\textsuperscript{43} Securities Act § 2(10)(a), 15 U.S.C. § 77b(10)(a) (1970), provides in part that:

\textbf{[A]} communication sent or given after the effective date of the registration statement . . . shall not be deemed a prospectus if it is proved that prior to or at the same time with such communication a written prospectus meeting the requirements of subsection (a) of section 10 at the time of such communication was sent or given to the person to whom the communication was made . . . .

\textsuperscript{44} SEC Rule 134, 17 C.F.R. § 230.134 (1973).
\textsuperscript{45} SEC Rules 134(c)(ii), (d), 17 C.F.R. §§ 230.134(c)(ii), (d) (1973).
Another possible Manor application exists if truth is read into the section 7 requirements for a registration statement. By analogy to Manor, the inaccurate registration statement would not be an effective section 7 statement; any offers would then violate section 5(c) and any sales would violate section 5(a)(1). However, Manor should be inapposite in the case of a registration statement because of the language of section 5. Sections 5(c) and 5(a)(1) require only that a registration statement be filed with and declared effective by the SEC. Once the SEC has allowed the statement to become effective, it seems anomalous and unfair for it to argue that there had not been compliance. In contrast, sections 5(b)(1) and 5(b)(2) contain specific qualitative requirements for a prospectus—that it meet the requirements of section 10 and 10(a) respectively. Compliance with these requirements is not determined by the SEC; it is therefore less inequitable to make an after the fact determination that the prospectus was invalid for purposes of section 5.

Furthermore, the application of Manor to a registration statement serves to merge section 11 with section 12(1) and to read the section 11 defenses out of the statute. Analogously to section 12(2), section 11 requires that the plaintiff not know of the untruth or omission in the registration statement. But even this weak “reliance” requirement would be negated by the Manor approach; in all cases in which the registration statement and prospectus were untrue as of the effective date, plaintiffs would have a choice of suing under section 12(1) or section 11, as well as section 12(2).

Manor cites two cases for the proposition that “implicit in the statutory provision that the prospectus contain certain information

46 Sections 11 and 12(2) differ in that under section 11 the burden is on the defendant to prove that the plaintiff knew of the untruth or omission, so that lack of reliance is a defense. By contrast, an element of the plaintiff’s case under section 12(2) is an allegation that he did not know of the untruth or omission. The difference in reliance is apparent even more where the issuer has activated a further “reliance” requirement by making a 12-month earning statement generally available to its security holders. Section 11(a) concludes:

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.


47 The lack of any privity element in section 11 will continue to make it more attractive than section 12(1) where the defendant cannot be shown to have “sold,” even in the broad sense of that term. See note 36 supra.
is the requirement that such information be true and correct." Both cases may be criticized for contributing to the same confusion of the section 12(1) and 12(2) remedies that Manor perpetuates. SEC v. North American Finance Co. and Eugene Rosenson arose from the same set of facts. The defendants Rosenson and Baumann organized the North American Finance Company to engage in the small loan and consumer finance business. They became the principal officers, directors, and owners of all voting stock of the company. In 1956 they made a public offering of nonvoting stock. In the prospectus filed as part of the registration statement, which became effective in September of 1956, as well as in the prospectuses set forth in several post-effective amendments, the defendants stated falsely that the financial statements included in the registration statement had been examined by an independent accountant. In fact, the certifying accountant was also the principal bookkeeper for the company and clearly not independent.

Since both of these cases, like Manor, were actions instituted by the SEC rather than by private plaintiffs, the District Court of Arizona in North American and the SEC in Rosenson had no occasion to consider the possible effect upon the section 12 dichotomy of reading a truth requirement into section 10(a). North American, like Manor, was an SEC injunctive action; Rosenson was an action for broker-dealer license revocation. The SEC has the power to seek an injunction and to revoke a broker's registration in order to prevent injury. Its power to seek injunctive relief arises "[w]henever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute

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48 458 F.2d at 1098.
53 Rosenson and North American, like Manor, were cases of blatant and willful fraud and would have been decided the same way, whether or not the tribunals had found that section 10 requires that prospectuses be truthful. See note 34 supra.
or will constitute a violation of the provisions of [the Securities or Exchange Acts] or of any rule or regulation” thereunder.\footnote{Securities Act § 20(b), 15 U.S.C. § 77t(b) (1970); Exchange Act § 21(e), 15 U.S.C. § 78u(e) (1970).} Similarly, Exchange Act section 15(b)(5)(D) empowers the SEC to suspend broker-dealer registration for any willful violation of the Securities Act.\footnote{15 U.S.C. § 78o(b)(5)(D) (1970). This section also provides for revocation for violations of the Exchange Act, the Investment Advisors Act of 1940, 15 U.S.C. §§ 80b-1 to -21 (1970), the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to -52 (1970), and any rule or regulation under any of the enumerated statutes.} By reading into the “directive” provisions of the Act\footnote{The “prohibitive” provisions of the Act — sections 5, 17, and 23, 15 U.S.C. §§ 77e, 77q, 77w (1970) — are those which expressly provide that a specified act is unlawful. The other provisions of the Act concerning the registration statement or the prospectus are merely “directive” or mandatory. See 1 Loss 181 n.3.} standards like truthfulness, the SEC can better implement its preventive policing function. Indeed, without such requirements, it may be difficult for the Commission to enjoin the use of the misleading documents until after the harm is done.\footnote{Neither section 17(a) of the Securities Act nor section 10(b) of the Exchange Act are commonly used as a basis for enjoining activity that will only later ripen into violations of the Acts’ mandatory provisions. But see note 58 infra. Section 15(c)(4) of the Exchange Act, 15 U.S.C. § 78o(c)(4) (1970), also provides the Commission with broad enforcement power, but it too does not provide the preventive relief necessary to implement the SEC’s policing function.} Though this approach is inconsistent with the full disclosure-antifraud dichotomy, it does aid the SEC in attacking potential violations in their incipiency.\footnote{An alternate procedure for providing broad protection would be for the SEC to base each injunctive complaint upon some prohibitive section of the Securities or the Exchange Act or upon a rule or regulation thereunder that specifically declares an act unlawful. Professor Loss, in taking this position, points out that sections 5 and 17 can cover all Securities Act violations, and that “it is difficult to see how one can ‘violate’ a provision . . . that is purely remedial in nature.” 4 Loss 2299 (Supp. 1969).} On the other hand, the Securities Act gives private individuals a remedy only after a violation has occurred. Hence, while Manor and its predecessors reach effective and favorable results in terms of SEC policing of the distribution process, their danger lies in their having confused the scheme of the Act and the inequity to some defendants that could result from the extension of the sweeping holdings of these SEC injunctive cases to private actions.\footnote{One district court in the Second Circuit has applied the Manor rationale to a private cause of action. In Jefferies & Co. v. Arkus-Duntov, 357 F. Supp. 1206 (S.D.N.Y. 1973), a case arising out of the Equity Funding scandal, the defendant director and vice president allegedly sold his securities based on inside knowledge that See 1 Loss 181 n.3.} Accord-
ingly, even if the SEC is permitted to require truthfulness to implement its policing function, such power should not be cross-transferable to private suits since, if section 10 can be "violated," then a section 5 violation and section 12(1) liability must follow.

As a second source of authority Manor cites "analogous situations under the 1934 Act" in which "the SEC has held that the statutory provision that records be kept and that reports be filed . . . embodies the requirement that such records and reports be true and correct." The SEC proceedings cited by the court were based on Exchange Act Rules 17a-3 and 17a-5, which require certain exchange members, brokers, and dealers to maintain records and file reports. Three characteristics differentiate these SEC decisions from the situation in Manor. First, since the Exchange Act rules which were at issue call for specific information to be included in the records and reports, false statements can arguably be said not to comply. In contrast, the simple directive of section 10(a) that one document match another does not so easily lend itself to the imposition of an additional qualitative requirement. Further, rule 17a-5, the only rule involved that actually requires reports kept by broker-dealers to be filed with the Commission, specifically calls for "an oath or affirmation that, to the best knowledge and belief of the person making such oath or affirmation . . . the financial statement and supporting schedules are true and correct . . . ." The fraudulent activity of the company would soon become public. In addition to finding that a cause of action existed under Exchange Act Rule 10b-5, Judge Gurfein noted that even though there was a valid registration in effect for the shares involved, "material omissions and misstatements [in the prospectus] would give rise to a claim under § 12 based on a violation of § 5 of the 1933 Act. S.E.C. v. Manor Nursing Centers, Inc." 357 F. Supp. at 1215. Here, as in Manor, it was unlikely that the defendant would have been able to successfully assert a due diligence defense. 357 F. Supp. at 1216. Thus, relief could have been obtained under section 12(2). See note 53 supra. The real question presented by Manor — whether a defendant with a valid section 12(2) defense can nevertheless be held under section 12(1) — still remains.

60 458 F.2d at 1098 n.22.
63 When tied to schedule A via section 7, the section 10 matching requirement appears to be analogous to the requirements of section 17 of the Exchange Act. But adhering strictly to the analogy, it would seem that a truth requirement would more properly inhere in section 7 than in section 10, because it is section 7, like section 17 of the Exchange Act, that dictates that specific information be included. As noted before, however, imposing a truth requirement upon the registration statement is even more problematic than the imposition of such a requirement upon the prospectus. See text accompanying note 46 supra.
64 17 C.F.R. § 240.17a-5(b) (2) (i) (1973). Unlike section 12(1) of the Se-
Section 10(a) has no similar requirement. Finally, and perhaps most critically, the assertion that the rules under section 17(a) of the Exchange Act contain an implicit truth requirement may be the only means by which the SEC can attack incorrect filings or reports, since these records and reports may not be influencing investors to make purchases and sales of securities. In contrast, an untruthful prospectus will violate one of the antifraud provisions when used.

The statutory framework of the Securities and Exchange Acts, as well as the different purposes of section 10(a) of the Securities Act and section 17(a) of the Exchange Act, make any analogy between the two tenuous.

The court in *Manor* also cited *GAF Corp. v. Milstein* for the proposition that the reporting requirement of section 13(d) of the Exchange Act includes an implicit requirement of truth. The SEC does take the position that filings made pursuant to Exchange Act section 13 are in violation of the filing requirement if they are false or misleading. As with Exchange Act section 17, however, the

65 The only "truth" requirement that could be said to be statutorily based is Securities Act Rule 408, 17 C.F.R. § 230.408 (1973), which states, "In addition to the information expressly required to be included in a registration statement, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading." This rule, however, is promulgated pursuant to section 7 of the Securities Act, not section 10, and therefore does not provide directly for a truthful prospectus. Through the section 10(a) (1) directive that the two documents contain the same information, however, rule 408 may be said to require that a prospectus be truthful.

66 The Exchange Act contains no general prohibition against defective filings. Therefore, even the approach suggested in note 58 *supra*, that the SEC premise each injunction on a prohibitive antifraud provision of the Securities or Exchange Act, would not be possible. No sale is imminent, and therefore no prohibitive section of either act (for example, Securities Act section 17(a) or Exchange Act Rule 10b-5) would be applicable.

67 In addition, as noted in 71 Mich. L. Rev. 591, 594 n.20 (1973), the liability for failure to comply with the Exchange Act section 17(a) requirement that the report be truthful is imposed directly upon the broker-dealer responsible for the misrepresentation. *Manor*, however, may create liability under section 12(1) against those who neither knew nor could have discovered the untruth.

68 453 F.2d 709, 720 (2d Cir. 1971).

analogy to Manor is questionable.\textsuperscript{70} First, section 13 is not self-executing; rather, it gives the Commission full power to condition its observance. Second, there are rules expressly mandating the truth and completeness of filings under section 13.\textsuperscript{71} Finally, until the Commission can show that a report is about to influence sales or purchases, the general antifraud provisions of the two acts are unavailable. The court in Milstein, which used this rule to give the plaintiff corporation standing to sue, noted that this approach provided the only effective means by which the incorrect filing could be attacked.\textsuperscript{72}

Securities Act section 10(b), which allows the SEC to permit use of a summary prospectus, gives the SEC more control than does section 10(a). Accordingly, an analogy of section 10(b) to Exchange Act sections 13 and 17 is sharper. This same comparison, in even more cogent terms, can be made with respect to the regulation A exemption\textsuperscript{73} created pursuant to Securities Act section 3(b).\textsuperscript{74} SEC Rule 252(a), the implementing provision of regulation A, makes available an exemption from registration if the terms and conditions of the regulation are followed.\textsuperscript{75} One of these terms, rule 256(e), requires that the offering circular not be false or misleading.\textsuperscript{76} Therefore, since using a false and misleading circular would constitute noncompliance with the terms of regulation A, the exemption would be lost and section 5 violated.

Although the Manor court did not mention it, Securities Act section 10(a)(3)\textsuperscript{77} provides some support for the court's holding. Section 10(a)(3) provides that when a prospectus is used more than 9 months after the effective date of the registration statement, its contents must be correct as of a date not more than 16 months past. Since section 10(a)(3) specifically calls for information to be added to the prospectus to keep it current and exempts it from

\textsuperscript{70} See notes 61-66 supra and accompanying text.


\textsuperscript{72} 453 F.2d at 720 n.22.

\textsuperscript{73} See note 31 supra.

\textsuperscript{74} 15 U.S.C. § 77c(b) (1970). Section 3(b) is not self-executing; rather, it permits the SEC through its rules or regulations to grant exemptions from registration.

\textsuperscript{75} 17 C.F.R. § 230.252(a) (1973).

\textsuperscript{76} SEC Rule 256(e), 17 C.F.R. § 230.256(e) (1973).

the section 10(a)(1) requirement of compliance with the registration statement, it might be said that the whole of section 10 is directed not only toward a prospectus that mirrors the registration statement, but also toward one that is true. The Manor holding would thus make more sense in the section 10(a)(3) context than it does with respect to section 10(a)(1).78

Because the Manor court determined that the defendants had violated several of the antifraud provisions of the Securities and Exchange Acts,79 its holding that section 10(a) requires the information in a prospectus to be true was not essential to the outcome of the case. It may be, however, that the court has stated a rule that will provide harsh results in a civil suit whenever a seller could otherwise successfully defend against a section 11 or a section 12(2) attack. The antifraud sections of the Act were designed to prevent misrepresentations; the registration and prospectus delivery sections were intended to insure that full disclosure was provided in a structured manner and in the form on file with, and reviewed by, the SEC. By mixing these two functions, the Manor court reads the characteristics of the antifraud remedy out of the statute. And, as will be shown, the harshness of this rule is compounded by the court's holding concerning posteffective events.

III. As of What Date the Prospectus Must Speak

A. Application of the Truthfulness Requirement to Posteffective Developments

The events that caused the Manor prospectus to become untrue — noncash sales, extra compensation paid to participants in the offering, failure to hold funds in escrow, and breach of the all-or-nothing condition of the offering — all occurred after the registration statement became effective.80 The defendants maintained that

78 See 1 Loss 295.
79 See text accompanying notes 8-15 supra.
80 The court might have been able to find that the prospectus was untrue as of the effective date of the registration statement and thus have avoided extending the truth requirement it found in section 10(a)(1) into the posteffective period. The prospectus falsely represented that arrangements for escrow of the proceeds had already been made, 458 F.2d at 1090. Further, the posteffective sales practices might have been evidence that the statements were false when they were made. Cf. note 108 infra and accompanying text. The SEC argued in its brief, "[E]ven if it were assumed that, for purposes of section 5(b)(2), the accuracy of the prospectus is to be determined solely as of the effective date of the registration statement, it is clear that the Manor prospectus was materially false and misleading as of its effective date and thus failed to meet the require-
section 5(b)(2) does not require that a prospectus be amended or supplemented to reflect material events\textsuperscript{81} that occur after the effective date of the registration statement.\textsuperscript{82} They contended that a prospectus that is true as of the effective date of the registration statement complies with section 10(a) and is not in violation of section 5(b)(2). The court held, however, that to comply with section 5(b)(2) the prospectus must be truthful as of the date it is used.\textsuperscript{83}

1. The Preeffective-Posteffective Dichotomy

Prior to the Manor decision, posteffective developments were disclosed in a prospectus only to avoid liability under the antifraud provisions.\textsuperscript{84} Neither the courts nor the SEC had held sellers responsible for posteffective events in order to satisfy the prospectus delivery requirements. However the Manor holding now ties posteffective developments to Securities Act sections 10(a)(1) and 5(b)(2). The court's decision that a prospectus must be truthful during the posteffective period to comply with sections 10(a) and 5(b)(2) is problematic; not only was it unnecessary in this case in view of Manor's antifraud violations, but it also rests on unconvincing authority. More importantly, the court did not decide how the prospectus should be updated, and the possibility exists that the registration

\textsuperscript{81} The requirement of materiality assumed by Manor is not found in sections 10(a), 5(b), or 12(1). \textit{See note 27 supra.} The court appears to be carrying it over from section 12(2). \textit{See note 24 supra.} It has been suggested that courts following Manor may read the elements of actions in fraud into section 12(1). \textit{See 48 Ind. L.J. 464, 471-72 (1973).}

\textsuperscript{82} 458 F.2d at 1099. The court's use of the word “amended” is somewhat confusing. “Amending” refers here to any additions or changes in the prospectus, rather than to a part of the formal amendment procedure of Securities Act § 8(c), 15 U.S.C. § 77h(c) (1970). On the other hand, when the court speaks of a “sticker amendment,” 458 F.2d at 1092, it does mean a formal amendment pursuant to section 8(c) rather than the sticker which is simply affixed to a prospectus. \textit{See text accompanying note 94 infra.}

\textsuperscript{83} 458 F.2d at 1100. Earlier, the court noted:

That these developments occurred after the effective date of the registration statement did not provide a license to appellants to ignore them. Post-effective developments which materially alter the picture presented in the registration statement must be brought to the attention of public investors.

\textit{Id.} at 1095 (footnote omitted).

\textsuperscript{84} \textit{See} notes 94-98 \textit{infra} and accompanying text.
statement itself will now have to be amended whenever a material event occurs in the posteffective period.

Two different types of situations necessitate posteffective changes in a prospectus: (1) the discovery of a material fact that existed but was unknown as of the effective date of the registration statement; and (2) the discovery of a material event that occurred in the posteffective period. Two different procedures had developed for disclosing these changes. Facts that existed before effectiveness were disclosed by amending the registration statement pursuant to section 8(c) of the Securities Act. Posteffective events were disclosed by a sticker which was merely affixed to the prospectus; this stickering process did not affect the registration statement, but did serve to notify prospective purchasers of the changes and thereby avoid antifraud liability.

The existence of a material defect in the registration statement as of its effective date subjects the issuer (and others) to liability under section 11. To avoid this liability, issuers amend the registration statement pursuant to section 8(c). Failure to do so may also result in a stop order, pursuant to section 8(d). Since both section 11 and section 8(d) require that the registration statement be true as of its effective date, a section 8(c) amendment must

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85 This distinction was first discussed by the SEC in Charles A. Howard, 1 S.E.C. 6 (1934). See also 1 Loss 293.
87 See 1 Loss 293. Under SEC Rule 424(c), 17 C.F.R. § 230.424(c) (1973), an issuer need only file 25 copies of the stickered prospectus with the Commission before it is used. See note 119 infra.
In case any part of the registration statement, when such part became effective, contains an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security . . . may . . . sue —
   (1) every person who signed the registration statement;
   (2) every person who was a director of . . . or partner in, the issuer at the time of filing of the part of the registration statement with respect to which his liability is asserted;
   (3) every person who, with his consent, is named in the registration statement as being or about to become a director . . . or partner;
   (4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him . . . ;
   (5) every underwriter with respect to such security.
89 Typically, issuers and sellers will also offer rescission to those who have already bought, since the section 11 liability will always exist as to these buyers.
90 Securities Act § 8(d), 15 U.S.C. § 77h(d) (1970). The impact of a stop order is that the registration statement is no longer effective, and no offers or sales can be made.
91 Though section 11 clearly requires that the registration statement be true only as of its effective date, there is some dispute about the date as of which the registration
be used to remedy the defective registration statement.\textsuperscript{92} As a part of this procedure the issuer also corrects the prospectus, so that it contains the same information as the registration statement in accordance with section 10(a)(1). This correction of the prospectus will also make it truthful, and thereby avert liability under the antifraud provisions. Failure to deliver such a corrected prospectus by the time the security is delivered will cause a violation of section 5(b)(2), since the prospectus no longer satisfies the matching requirements of section 10(a), and in a private suit make the seller liable under section 12(1).\textsuperscript{93} Thus, although there is no explicit statutory requirement for a formal amendment to the prospectus, an issuer in this situation ends up correcting the prospectus so that it contains the information found in the registration statement.

Events that occur after the effective date of the registration statement traditionally have been treated differently from those that existed as of the effective date. Typically, additions have been made by stickering the prospectus, and the registration statement has not been amended. This process protects sellers from liability for fraud\textsuperscript{94} unless the sticker is itself false or misleading.\textsuperscript{95} Since section

\textsuperscript{92} A posteffective amendment will also be required for disclosure of an event that occurred during the waiting period. Kinner Airplane & Motor Corp., 2 S.E.C. 943, 951 (1937); Charles A. Howard, 1 S.E.C. 9, 9 (1934).

\textsuperscript{93} Use of an incorrect prospectus in this situation will also violate section 5(b)(1), since the prospectus will not be a section 10 prospectus. See note 16 supra.

\textsuperscript{94} The relevant federal antifraud provisions are Securities Act §§ 12(2), 17(a), and SEC Exchange Act Rule 10b-5. See Danser v. United States, 281 F.2d 492, 496-97 (1st Cir. 1960); SEC v. Bangor Punta Corp., 331 F. Supp. 1154, 1160 n.10 (S.D.N.Y. 1971); Charles A. Howard, 1 S.E.C. 6 (1934). See also 1 LOSS 293. The Manor
11 requires that the registration statement speak only as of its effective date,\textsuperscript{96} and, since stop orders have not been used by the SEC to respond to posteffective events,\textsuperscript{97} no change to the registration statement has been deemed necessary. A 1933 release of the Federal Trade Commission, predecessor to the SEC in the administration of the Securities Act, took the position that a registration statement need not be amended to disclose posteffective events;\textsuperscript{98} until \textit{Manor}, the SEC maintained that position. But, as will be discussed,\textsuperscript{99} the \textit{Manor} court’s holding that the defendants had a duty under the full disclosure provisions of the Act to update the prospectus\textsuperscript{100} may result in creating a duty to amend the registration statement as well.

In summary, a posteffective discovery of a preeffective fact not in the registration statement must be disclosed by an amendment to the registration statement; a sticker traditionally sufficed to disclose posteffective events. Though it could have required amendment to the registration statement for posteffective events,\textsuperscript{101} the court seems to recognize that the antifraud provisions require the prospectus to disclose posteffective developments:

> The effect of the antifraud provisions of the Securities Act (§ 17(a)) and of the Exchange Act (§ 10(b) and Rule 10b-5) is to require the prospectus to reflect any post-effective changes necessary to keep the prospectus from being misleading in any material respect .... 458 F.2d at 1096. Nevertheless, the court holds that the same disclosure of posteffective developments is demanded by the prospectus delivery requirements. \textit{Id.} at 1098.

\textsuperscript{96} See 1 Loss 293.
\textsuperscript{97} See note 81 supra.
\textsuperscript{98} See note 91 supra. But see note 109 infra.
\textsuperscript{99} FTC Securities Act Release No. 97 (Dec. 28, 1933):
Under section 11 the accuracy of the registration statement is to be judged by the date upon which it becomes effective. It is, therefore, unnecessary, and probably impossible, to amend it to include facts which occur after its effective date. It may, of course, be necessary to supplement the information contained in the prospectus in order that it may not be misleading within the meaning of sections 12(2) and 17.

The use of supplementary information, however, does not require an amendment of the prospectus, and no further papers need, therefore, be filed with the Commission. On the other hand, if it is proposed to substitute new information for that contained in the prospectus, since under the rules of the Commission the prospectus must not omit certain items contained in the registration statement, such changes can be effected only by a regular amendment filed with the Commission ....

\textit{See also} 1 Loss 291.
\textsuperscript{100} Text accompanying note 119 infra.
\textsuperscript{101} The SEC could have accomplished this (1) by reading section 10(a)(1) to
SEC preferred to test the prospectus content only as of the effective date for purposes of sections 5 and 8.\textsuperscript{102} The sticker served to avoid the inconvenience and expense of the formal amendment procedure; it raised no problems under section 10(a)(1), 8(d), or 11, and by disclosing new developments it avoided fraud. Before the \textit{Manor} decision then, it was necessary to reflect posteffective developments only to avoid antifraud liability and not to meet the prospectus delivery requirements.

2. \textit{The Manor Court's Approach}

The \textit{Manor} court had no case law squarely supporting its holding that sections 5(b)(2) and 10(a) require that the prospectus be amended as events occur after the effective date. The court used \textit{Charles A. Howard}, an early SEC decision that held that a stop order would not issue because of posteffective events.\textsuperscript{103} The court pointed to language in \textit{Howard} to the effect that even though the registration statement need not be amended to disclose posteffective events, the seller is under a duty to disclose such changes in the prospectus.\textsuperscript{104} In \textit{Howard}, however, the SEC stated that posteffective events must be disclosed only to escape liability under sections 12(2) and 17(a).\textsuperscript{105} \textit{Howard} provides no authority, therefore, for the proposition that a prospectus delivery violation will occur because of posteffective events that make the prospectus materially misleading.

\textit{Manor} also quoted from \textit{Franchard Corp.},\textsuperscript{106} a 1964 SEC release, in which the SEC said that supplementing the prospectus "is inadequate and misleading when numerous changes in the issuer's affairs . . . have clearly outdated the prospectus."\textsuperscript{107} This release does not help the \textit{Manor} court's position, however. In \textit{Franchard} require that the prospectus plus any sticker include \textit{only} the information contained in the registration statement, see discussion at text accompanying notes 112-13 \textit{infra} and at text accompanying notes 118-19 \textit{infra}, or (2) by rule, pursuant to its power under Securities Act § 19(a), 15 U.S.C. § 77s(a) (1970), to make, amend, and rescind any rules necessary to carry out the provisions of the Act. Alternatively, the Commission could have forced amendments by interpreting section 8(d) so that "at any time" modifies "includes" rather than "appears." See note 91 \textit{supra}. Then, posteffective events could have formed the basis for stop order proceedings; the threat of a stop order in turn would force amendment of the registration statement.

\begin{footnotes}
\item[102] See 1 \textit{LOSS} 294.
\item[103] 1 S.E.C. 6 (1934).
\item[104] 458 F.2d at 1099.
\item[105] 1 S.E.C. at 10.
\item[107] 458 F.2d at 1099 n.23.
\end{footnotes}
an issuer sought to file a posteffective amendment to correct statements that were untrue as of the effective date of the registration statement. Therefore mere changes in the prospectus would not have been sufficient; an amendment to the registration statement was mandatory. The issue in *Franchard* concerned only the format of a posteffective amendment; the SEC held that the prospectus portion of each amendment was unclear when it contained merely the old prospectus and a supplement. *Franchard* did not discuss the inadequacy of supplementing the prospectus as opposed to amending the registration statement in terms of reflecting posteffective events, or even the need to reveal posteffective developments at all. *Franchard* held only that once there had been established a need to amend to correct preeffective error, the posteffective amendment may not be effected merely by supplementing an earlier prospectus. *Franchard* offers little support for the proposition that posteffective developments must appear in the prospectus for purposes of section 10(a)(1) or that posteffective developments ever need be disclosed in the registration statement.

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108 The Commission noted:

> We reject registrant’s contention that this finding cannot be made because there is no direct evidence with respect to Glickman’s [registrant’s president] state of mind on the effective date of the 1960 filing. In view of the brevity of the time interval — two days — and the absence of countervailing evidence, we consider it reasonable to infer that Glickman intended to divert proceeds from registrant’s offering on that date.

SEC Securities Act Release No. 4710, n.15 (July 31, 1964). This argument is further buttressed by the Commission’s discussion of section 11 liability; reference to this section indicates a material defect as of the effective date.

109 The *Manor* court appears to have confused the “supplementation of the outmoded prospectus” that the defendant in *Franchard* attempted to use as a posteffective amendment, and the “supplement versus substitute” distinction applicable to prospectuses. See 1 Loss 294. A prospectus is usually stickered by adding to (supplementing) the earlier prospectus. When this procedure creates a misleading prospectus, a section 12(2) violation may ensue. Therefore, if the sticker is inadequate to disclose facts clearly, an issuer, to present a clearer document, will substitute rather than supplement. This substitution creates a mismatch between the prospectus and the registration statement; accordingly, the issuer must formally amend the registration statement in order to comply with section 10(a)(1), even if section 10(a)(1) means only that the prospectus must contain at least the information found in the registration statement. (The alternative interpretations of section 10(a)(1) are discussed at notes 112-14 infra and accompanying text.) The need to amend here is a product of the decision to substitute rather than supplement, a different situation from one like *Franchard*, in which the need to modify or substitute rather than supplement was necessary to avoid “an obscure and uncoordinated presentation” of a posteffective amendment.

The reliance upon *Franchard* may also be attributable to the Commission’s position regarding the requirements for filing posteffective amendments. The SEC argued that “where an issuer willfully changes the basic terms of an offering, a supplement or sticker simply will not suffice.” Brief for Appellee at 48, SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082 (2d Cir. 1972). According to the Commission, it does not matter that the changes took place in the posteffective period; nor, presumably, would it matter
B. Effects of Manor Upon the Updating Procedure

The court in Manor stated that it “[d]id not reach the question whether merely supplementing the prospectus would have been adequate in the instant case.” Yet the major impact of the Manor decision lies in the answer to this question, for under the Manor rationale, it may well be that stickering will never be a sufficient response to posteffective developments, and that the registration statement will have to be amended in every case.

A reasonable reading of the Manor decision indicates that section 10(a)(1) now requires that the prospectus contain the information in the registration statement, that such information be correct, and that it be correct up to the time it is used. Given such a reading, all posteffective developments would have to be disclosed in the prospectus to satisfy the truth requirement of action 10(a)(1).

One interpretation of Manor and section 10(a)(1) combined is that section 10(a)(1) should be read as requiring that the prospectus contain the information contained in the registration statement, plus any supplemental information necessary to make the prospectus true and not misleading up to the time of sale. Any disclosure of a posteffective event could be regarded as merely supplemental. This reading of Manor would allow compliance through the same stickering process an issuer would normally employ to avoid liability for fraud as material posteffective events occur. The validity of such a reading, however, depends upon the determination of two subsidiary questions: (1) whether a prospectus must satisfy not only

whether the changes could be clearly effected by a sticker. It appears, therefore, that the Commission is attempting to implement a new policy whereby the importance of the changes or the willfulness with which they were effected rather than the manner and clarity with which they can be presented will determine whether a sticker is adequate or an amendment is required. No statutory authority supports either factor as a basis for requiring an amendment; the SEC brief states, however, “Under such circumstances it is clear that no unnecessary burden is imposed in requiring an amendment of the registration statement and prospectus...” Id. at 49. The Commission, in attempting to reconcile its position with previous SEC policy, tries to carve out an exception for voluntary and substantial changes in the posteffective period. In arguing that no “unnecessary burden” exists in this case, the SEC appears to be distinguishing it from the general situation, presented in the 1933 release, in which no amendment need be filed. See note 98 supra and accompanying text. The 1933 release, however, does not focus on the word “unnecessary,” and it is doubtful that the Commission (in 1933, the Federal Trade Commission) intended the release to be so interpreted.

In addition, the SEC brief cites Franchard and Kinner Airplane & Motor Corp., 2 S.E.C. 943, 951 (1937), but both discuss changes that took place before the effective date and are therefore inapposite.

\(^{110}\) 458 F.2d at 1099 n.23.

\(^{111}\) See note 109 supra.
the language of section 10(a) but its converse as well; and (2) how a post-Manor sticker fits into the statutory process.

On its face, section 10(a)(1) seems to demand only that the prospectus include at least the information contained in the registration statement. The converse of section 10(a)(1) would require that the registration statement contain the information in the prospectus, or, put another way, that the prospectus include only the information contained in the registration statement. Professor Loss states that "the Commission has assumed that the converse [of section 10(a)] is true." But his cited authority does not substantiate that proposition, and it is not a legitimate, logical step to infer that the converse of a statement must be true. If the registration statement need not have all the information that is in the prospectus, it should be possible to allow a prospectus to contain both the information contained in the registration statement and any supplemental information necessary to satisfy the truthfulness requirement read into section 10(a)(1) by the Manor decision. This supplemental information or sticker, though clearly not part of the registration statement, could make the statutory prospectus satisfactory under the Manor court's interpretation of section 10(a)(1). Whether such an interpretation could be sustained, however, depends upon the exact nature of the sticker or supplement.

A sticker by itself normally would not meet the section 10 requirements. It could, however, be considered a separate prospec-

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112 This proposition would apply only to the items in schedule A, 15 U.S.C. § 77aa (1970), that are found in both the prospectus and the registration statement. Items 28 through 32 appear only in the registration statement; the prospectus need not disclose these facts or any changes with respect to them.

113 1 Loss 294.

114 Professor Loss cites FTC Securities Act Release No. 97 (Dec. 28, 1933), as showing that the Commission has assumed the converse of section 10(a) to be true. The release states:

The use of supplementary information, however, does not require an amendment of the prospectus, and no further papers need be filed with the Commission. On the other hand, if it is proposed to substitute new information for that contained in the prospectus, since under the rules of the Commission the prospectus must not omit certain items contained in the registration statement, such changes can be effected only by a regular amendment to the statement filed with the Commission . . . .

This statement does not appear to support the converse of section 10(a); it merely restates the section 10(a)(1) requirement itself. By substituting new information rather than merely supplementing, the issuer changes the prospectus so that it no longer includes the information contained in the registration statement and thereby fails to comply with section 10(a). The release does not state that a prospectus that includes all the information in the registration statement may not contain other information as well.
tus as defined in section 2(10)\textsuperscript{115} and therefore be subject to the section 5(b)(1) prohibition against the use of any prospectus after the filing date except a valid section 10 prospectus. Under the pre-

\textit{Manor} view, the sticker did not cause a section 5 violation because it was accompanied by (in fact attached to) a valid section 10(a) prospectus and therefore was excluded by section 2(10)(a) from the definition of prospectus.\textsuperscript{116} Thus, no separate statutory definition for a sticker was ever needed. The Commission could have its cake and eat it, too; it could say that the prospectus must contain only the matter found in the registration statement \textit{and} allow stickering, because the sticker was not part of the prospectus, but rather a written offer that did not run afoul of section 5(b)(1) because it escaped prospectus status under section 2(10)(a). Under the \textit{Manor} holding, however, this supplemental information is necessary to make the original prospectus satisfy section 10(a)(1). Therefore, only a bootstrap approach would simultaneously allow (1) the prospectus to be valid under section 10(a) (as elaborated by \textit{Manor}) because it is completed by the sticker, and (2) the sticker to be excluded from the definition of prospectus (and therefore nonviolative of section 5(b)(1)) because it is accompanied by a valid section 10(a) prospectus.\textsuperscript{117}

A possible solution to this dilemma that would allow a court following the \textit{Manor} rationale to permit stickering is to consider the sticker as an integral part of the section 10(a) prospectus, without deeming it a separate "prospectus" under section 2(10). This characterization of the sticker serves to avoid amending the registration statement, however, only if it is assumed that the converse of section 10(a)(1) is not true: that the registration statement need not contain all the information in the section 10(a)(1) prospectus.\textsuperscript{118}

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\item \textsuperscript{116} Securities Act § 2(10)(a), 15 U.S.C. § 77b(10)(a) (1970) states that: [A] communication sent or given after the effective date of the registration statement \ldots shall not be deemed a prospectus if it is proved that prior to or at the same time with such communication a written prospectus meeting the requirements of subsection (a) of section 10 at the time of such communication was sent or given to the person to whom the communication was made \ldots.
\item \textsuperscript{117} Without such an interpretation, a seller wishing to use what he believes to be supplemental selling literature also risks a section 5 violation if the prospectus that accompanies or precedes the supplemental selling literature is untrue and does not therefore comply with section 10(a)(1). In that event, the would-be section 2(10)(a) literature will lose its nonprospectus status and will become a section 2(10) "prospectus"; its delivery will violate section 5(b)(1).
\item \textsuperscript{118} Securities Act § 10(c), 15 U.S.C. § 77j(c) (1970), which states that "any pro-
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Thus, if the Commission insists that the converse of section 10(a) (1) is correct, the effect of Manor may well be that corrective material disclosing posteffective changes must be filed as a posteffective amendment to the registration statement. But if the converse of section 10(a) (1) is not true, and if the sticker is not considered to be a prospectus separate from the document to which it is attached, disclosure by stickering the prospectus should suffice.

IV. CONCLUSION

The holding by the Manor court that a prospectus must be truthful up to the date of use to satisfy section 10(a) (1) appears to be both inconsistent with the framework of the Securities Act and exceedingly harsh upon users of prospectuses.

If applied to private actions, Manor will create section 12(1) liability in all cases in which a section 10(a) prospectus contains any misstatement or half-truth. In cases of preeffective error, this section 12(1) liability will supplement any possible section 11 or 12(2) liability; for posteffective error, it will serve in addition to section 12(2). Defendants will have no opportunity to defend, as they would under section 12(2) or 11, since liability is virtually absolute under section 12(1). Also, the defendant group under section 12(1) may be different from the defendants under section 12(2).

Manor may also require that all disclosures of material events in prospectuses be filed as posteffective amendments to the registra-

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110 SEC Rule 424(c), 17 C.F.R. § 230.424(c) (1973), which requires that 25 copies of any “prospectus which purports to comply with section 10 of the act and which varies from any form of prospectus filed” with the registration statement, appears to be grounded upon the premise that a valid prospectus may contain information not contained in the registration statement. Manor plus the converse of section 10(a) (1) would render rule 424(c) obsolete; a prospectus varying from the registration statement could not “purport to comply with section 10.”

120 See notes 39-45 supra and accompanying text.


122 See notes 28, 36 supra.
tion statement. If the *Manor* holding is followed, it will greatly change current practices of disclosure of posteffective events.

MITCHELL B. DUBICK