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NOTE

THE SOLICITATION AND MARKETING OF SECURITIES OFFERINGS THROUGH THE INTERNET

INTRODUCTION

In its short history, the process of offering securities through an Internet web site has evolved from a mere novelty to an increasingly common practice among small and some large issuers today seeking to raise capital from both public and private investors.¹ Although offerings conducted on the Internet continue to be criticized by some commentators, few today would argue that using the Internet during some part of the offering process is indispensable, if not mandatory. On one level, regulators in the United States and abroad have offered their unwavering support for electronic capital-raising efforts, continuing to promulgate new guidelines that clarify how an issuer can use the Internet to offer securities without violating a nation's respective securities laws.² On another level, inves-

¹ See *WitCapital News and Development* (visited July 21, 1998) <http://www.witcapital.com/press/pr_7.htm> (press release about Spring Street Brewing Company's Internet offering—the first securities offering conducted entirely over the Internet). Compare discussion *infra* Parts II.A., IV. (describing the practice today among issuers and Internet-based service providers of offering securities through an Internet web site), with Paul G. Mahoney, *F. Hodge O'Neal Corporate and Securities Law Symposium: Markets and Information Gathering in an Electronic Age: Securities Regulation in the 21st Century: Technology, Property Rights in Information, and Securities Regulation*, 75 WASH. U. L. Q. 815, 823-24 (Summer 1997) (calling Internet offerings since Spring Street “amusing novelties [rather] than the leading edge of finance.”), Jim Gallagher, *Cyber Stocks; Small Firms Turning to the Internet to Raise Capital*, ST. LOUIS POST-DISPATCH, Apr. 11, 1996, at 1E (arguing that it will get harder to attract investors as the novelty of the Spring Street offering wears off), and *Brewer Serves Up On-Line Investment Bank*, 20 INV. DEALERS' DIG. 16, Apr. 15, 1996 (arguing that small Internet offerings will have no effect on large traditional investment banks).

² See *infra* Part II. (discussing regulations promulgated by national securities

tors today expect that a company will maintain a web page, often equating the content and quality of a web page on the Internet with that of the company itself. Thus, more than ever, the absence of an issuer's prospectus or offering documents from an Internet web page may be more the exception than the rule.

Offerings that are exempt from registration under the Securities Act, including privately placed securities, have clearly been the most popular offerings on the Internet so far. This popularity is largely the result of an issuer's ability to solicit and market these offerings to investors without having to comply with the timing and information restrictions that are imposed on registered offerings.³ In addition, the Internet has created a forum through which a company offering exempt securities can market its offering at a centralized location without the use of a "traditional" underwriter.⁴ Issuers offering registered securities, on the other hand, continue to remain cautious, with only a small number of companies that are willing to do more than place their offering documents on a web site where prospective investors can read or print the materials. Often large and highly capitalized, these companies have to comply with the registration requirements of the Securities Act of 1933 and while regulators have encouraged the use of the Internet in the offering process, current regulatory guidance remains unclear, resulting in this cautious approach.

This Note surveys the current regulatory environment for securities offered through an Internet web site with a specific focus on an issuer's ability to solicit and market securities on the Internet. This Note also looks beyond the regulatory uncertainty surrounding Internet offerings today in order to discuss the practical limitations that will continue to exist for small capitalization companies that offer securities without the assistance of a traditional underwriter. While exempt offerings permit an issuer the most freedom in marketing and soliciting

commissions as well as state securities commissions in the United States, that support the use of the Internet to offer securities).

³ See *infra* Parts I.A. and I.B.

⁴ See *infra* Part III.A. (discussing the benefits associated with Internet offerings, including the ability to conduct direct offerings to the public); see also *infra* Part IV. (providing an overview of the development of Internet-based service providers and the services they offer to issuers).

their offering through the Internet, an issuer's ability to market registered offerings on the Internet would change significantly under the SEC's "Aircraft Carrier Release," which this Note will discuss as well.⁵ Although the securities industry has voiced strong opposition to the Proposal in its current form,⁶ the SEC's vision of increasing investors' access to information during an offering, including an issuer's ability to test-the-waters before registering its securities with the SEC, will likely endure in future proposals. In addition, this Note discusses the implications of the SEC staff's recent no-action letter to Wit Capital for underwriters, dealers and selling group members offering registered initial public offering ("IPO") securities to investors prior to effectiveness.⁷

Part I of this Note discusses the statutory requirements of public and private offerings under the Securities Act that are best suited for solicitation and marketing through the Internet. Part II discusses regulations promulgated by securities commissions in the United States and abroad that seek to regulate the offering process when securities are made available on the Internet. Part III considers the practical limitations for small capitalization companies that offer their securities to investors through the Internet. Finally, Part IV discusses likely future developments in the regulation of securities offerings on the Internet, with a specific focus on the proliferation of Internet-based service providers that offer to market and solicit the securities offered by small capitalization companies that cannot obtain the services of a traditional underwriter.

⁵ The Regulation of Securities Offerings, Exchange Act Release No. 33-7606A, 63 Fed. Reg. 67,174 (Nov. 13, 1998) [hereinafter Aircraft Carrier Release]. The release is code-named "Aircraft Carrier" because the proposal is a massive undertaking that would fundamentally change the registration and offering of securities under the Securities Act.

⁶ See, e.g., Joseph McLaughlin, *The SEC's Coming Regulatory Retreat*, 2 WALLSTREETLAWYER.COM No. 8, Jan. 1999, at 6-7 (arguing that the SEC's proposal to increase communications to investors during the offering process would nonetheless discourage the delivery of such information to the marketplace because such communications would be subject to section 11 and/or section 12(a)(2) liability); Sullivan & Cromwell Comment Letter, *Regulation of Securities Offerings (aka "Aircraft Carrier")*, File No. S7-30-98 (filed with the SEC on June 10, 1999).

⁷ See Wit Capital Corp., SEC No-Action Letter, 1999 SEC No-Act. LEXIS 620 (July 14, 1999).

I. AN OVERVIEW OF SECURITIES OFFERINGS BEST SUITED FOR THE INTERNET

A. *Registered Offerings*

In the United States, an issuer of securities must register its offering with state securities regulators⁸ and the Securities and Exchange Commission ("SEC" or "Commission") pursuant to the Securities Act of 1933 unless they qualify for an exemption under the Act.⁹ Compared with many foreign jurisdictions, registering an offering in the United States is typically more burdensome and expensive because of comprehensive disclosure requirements.¹⁰ Moreover, with regard to a registered public offering in the United States, stricter limitations apply than with an exempt offering. For example, the benefits associated with pre-advertising a company's offering to investors in an exempt offering do not exist for an issuer offering registered securities, since an issuer or underwriter is prohibited from conditioning the market or testing-the-waters before a registration statement for securities has been filed with the SEC.¹¹ Furthermore, once the registration statement is filed, an issuer or underwriter is prohibited from making written offers to investors using anything other than a tombstone advertisement or a statutory prospectus, although they can solicit indications of interest and conditional offers to buy from investors.¹² The ability to communicate with investors during the waiting period was broadened to some extent in a recent no-action letter to Wit Capital, in which the SEC staff confirmed

⁸ *But see infra* Part II.A.4. (although the majority of federally registered securities are exempt from state regulation, most of the federally exempt securities must still comply with state securities laws).

⁹ *See* 15 U.S.C. § 77e (1994) (it is unlawful for any person to sell securities unless the securities are "registered" with the SEC). The SEC permits a number of exemptions under the Securities Act through which an issuer is not required to register its securities. *See infra* Part I.B.

¹⁰ *See generally* EUROMONEY PUBLICATIONS, INT'L SECURITIES LAW (3d ed. 1992).

¹¹ An issuer or underwriter "conditions the market" in violation of section 5(c) of the Securities Act if it makes either an oral or written communication prior to filing a registration statement for the securities with the SEC. *See* 15 U.S.C. § 77e(a).

¹² *See* 15 U.S.C. § 77e(b) (see section 5(b)(1), describing activities prohibited by an issuer during the waiting period); *see also infra* Part II.A.2. (discussing electronic indications of interest).

Wit Capital's procedures for confirming an investor's pre-effective offer to buy IPO securities through the Internet.¹³ The SEC staff also confirmed that the company's placement of offering information on certain segregated areas of its web site as well as e-mail communications to its customers relating to the offering and Wit Capital's procedures and rules would not be deemed illegal prospectus materials in violation of section 5(a) of the Securities Act.¹⁴ Finally, the SEC staff confirmed that the company would not violate section 5(b)(1) of the Securities Act by sending an e-mail notification to investors informing them that they have received shares in an offering prior to delivering a required 10b-10 confirmation.¹⁵ While the implications of the Wit Capital no-action letter are notable for underwriters, broker-dealers and selling group members offering securities to investors through the Internet, the SEC staff left several questions unresolved, including whether the electronic and web-based communications that Wit Capital will use to communicate with investors during an offering will be considered written versus oral in character.¹⁶ The staff also expressly noted that it currently has under consideration various issues arising from electronic communications in the offering context and therefore chose not to pass on these issues at the time.¹⁷

¹³ See Wit Capital Corp., SEC No-Action Letter, 1999 SEC No-Act. LEXIS 620, at *1-*2 (holding that by "affirmatively seeking a customer's reconfirmation of his or her pre-effective 'conditional offer to buy' . . . following post-effective pricing of the offering," Wit Capital, broker-dealers and selling group members would not violate section 5(a) of the Securities Act because the procedure "will not be tantamount to a pre-effective sale"); see also *id.* at *48-*49 (Wit Capital relies on Securities Act Rule 134(d) as allowing an investor to submit a conditional offer to buy during the waiting period).

¹⁴ See *id.* at *51-*55 (counsel relies on Rule 134 of the Securities Act).

¹⁵ See *id.* at *2 (because the notification would not be deemed a 10b-10 confirmation it would not have to be accompanied or preceded by a final prospectus pursuant to section 5(b) of the Securities Act); see also *id.* at *52 (the e-mail notification itself would be permitted pursuant to Rule 134).

¹⁶ See 1999 SEC No-Act. LEXIS 620, at *1, *3, *4 (SEC staff neither addressed whether other information available on Wit Capital's web site would constitute illegal offering material nor explained why the no-action relief was limited to registered IPOs that are "underwritten on a 'firm commitment' basis").

¹⁷ Under the SEC's Aircraft Carrier Release, for example, electronic communications would be considered written and not oral in character. See Aircraft Carrier Release, *supra* note 5, at 67,176-78 (Executive Summary); see also *id.* at 67,183 n.52 (stating that "written" communications include "all information disseminated otherwise than orally," which would include electronic communications).

Communications to investors during an offering would be further broadened under the SEC's Aircraft Carrier Release. The Proposal would also significantly change the regulation of registered offerings in general.¹⁸ Under Aircraft Carrier, an issuer would still be required to file a detailed registration statement with the SEC before it could offer securities to the public,¹⁹ although certain disclosure requirements would be eliminated.²⁰ However, the SEC would no longer review the content of an issuer's registration materials for certain offerings, thereby allowing issuers to decide their own "effective date" for their registration statements.²¹ More importantly,

¹⁸ See *id.* at 67,176-78 (Executive Summary).

¹⁹ A registration statement consists of two parts: Part I is a prospectus which must be furnished to investors before they purchase the issuer's securities; and Part II includes information which remains on file with the SEC and which is available for public inspection. See 15 U.S.C. §§ 77g(a), 77aa (1994). Under the Aircraft Carrier Release, the two-part format of the registration statement would remain the same. However, three new registration forms would be available to issuers: Form B (replacing Forms S-3 and F-3) for large seasoned issuers, for small, seasoned issuers that offer non-convertible investment grade debt securities or for issuers that offer or sell securities to certain qualified institutional buyers (QIBs); Form C for corporate combinations; and Form A (replacing Forms S-1 and F-1) for offerings that do not qualify for Form B or Form C status, including offerings by small, seasoned issuers. See Aircraft Carrier Release, *supra* note 5, at 67,181. A proposed Form B issuer must have at least \$75 million in aggregate market value of its outstanding common stock and an average daily trading volume exceeding \$1 million, a one-year reporting history, at least one annual report filed with the SEC, and a demonstrated "market following." *Id.* at 67,185.

²⁰ See Aircraft Carrier Release, *supra* note 5, at 67,181-83. See generally Ronald O. Mueller, *Proposed Changes to Exchange Act Reporting Requirements*, 13 IN-SIGHTS 1, at 27 (Jan. 1999) (discussing Aircraft Carrier's "enhanced reliance on Exchange Act disclosures" as one reason why the SEC has proposed to decrease its involvement in the offering process).

²¹ Under the current system, registered offerings are highly scrutinized by the SEC. See WILLIAM L. CARY & MELVIN A. EISENBERG, CORPORATIONS 1433-73 (7th ed. 1995). Before an issuer can sell its securities to the public, the SEC subjects the offering to an examination for compliance with disclosure requirements. See *id.* The date on which the SEC determines that the offering complies is known as the "effective date"—usually the 20th day after the registration statement has been filed with the SEC. See *id.* However, if a statement appears to be materially misleading, incomplete or inaccurate, the Commission has the authority to refuse or suspend the effectiveness of an issuer's registration statement. See *id.* Moreover, if the Commission concludes that "material deficiencies appear to stem from a deliberate attempt to conceal or mislead the public and such deficiencies cannot be corrected," the SEC may conduct a public hearing to determine if a stop order should be issued to refuse or suspend effectiveness. *Id.* Although Aircraft Carrier would no longer subject registration statements to such scrutiny, the SEC would still review offerings for registration eligibility. See Aircraft Carrier Release, *supra*

several safe harbors would be available that would permit issuers and underwriters to test-the-waters before the traditional waiting period.²² Unlike current regulations that prevent communications to investors before filing a registration statement with the SEC, the proposed rules would instead permit certain issuers and underwriters to make factual business communications about the company and disclose certain forward-looking information.²³ After a registration statement has been filed, moreover, additional safe harbors would be available.²⁴ Thus, during the waiting period, issuers would no

note 5, at 67,246-47.

²² See Aircraft Carrier Release, *supra* note 5, at 67,178.

²³ See *id.* at 67,213-14 (discussing proposed Securities Act Rule 166, 17 C.F.R. § 230.166; Securities Act Rule 167, 17 C.F.R. § 230.167; Securities Act Rule 168, 17 C.F.R. § 230.168; and Securities Act Rule 169, 17 C.F.R. § 230.169). Proposed Rules 166 and 167 are bright line safe harbors for Form A, Form B and Form C issuers, that exempt communications made during the pre-filing period from section 5(c) of the Securities Act. See *id.* Consequently, any offers made prior to registration would be permissible, although certain written offers would have to be filed with the SEC. See *id.* During the pre-filing period, proposed Rule 169 would also provide a specific safe harbor to an issuer or underwriter for factual business communications made during the 30 day period before an issuer files its registration statement, including factual information about the issuer, advertisements about the issuer's products or services, financial developments, and factual information communicated in response to unsolicited inquiries from stockholders and analysts, among others. See *id.* at 67,214. Information about the offering itself would be excluded from the safe harbor. See Aircraft Carrier Release, *supra* note 5, at 67,214. Proposed Rule 168 would, moreover, provide a safe harbor to reporting issuers, underwriters and dealers for forward-looking information, including projected revenues, income, dividends and management's future plans disclosed during the 30 day period before an issuer files its registration statement. See *id.* Rule 168 would allow Form B issuers to disclose such forward-looking information to the public at any time. See *id.* Form A issuers, however, would only be able to disclose such information during the waiting period, and then only if the issuer customarily produces this information on a regular basis. See *id.*

²⁴ Proposed Rule 165 would allow an issuer to distribute and use what the SEC calls "free writing" materials during the waiting period, although such information would have to be filed with the SEC prior to use. *Id.* at 67,183. In addition, free writing materials would be subject to section 12(a)(2) liability. See Aircraft Carrier Release, *supra* note 5, at 67,183 n.56. Free writing materials would include all written information, such as sales literature and forward-looking documents that are "disclosed by or on behalf of the issuer during the offering." *Id.* Free writing would not include "offering information" (including the amount of securities being offered, disclosure of material changes to the issuer's affairs since the prior fiscal year, and disclosures pursuant to Regulation S-K), factual business communications or limited notices of proposed offerings. *Id.* However, additional safe harbors would be available for these communications as well. See *id.* at 67,182-83.

longer be limited to communicating with investors solely through the information contained in a prospectus pursuant to section 2(10) of the Securities Act, "tombstone" advertisements²⁵ and road show presentations.²⁶ Finally, the ability to communicate freely with investors would not be limited to hard-copy forms of communication.²⁷ Therefore, under these safe harbors, an issuer offering registered securities could solicit interest from prospective purchasers and market its offering to investors through the Internet, as well.

B. *Exempt Offerings*

An issuer can qualify for one of several exemptions from registration under the Securities Act, allowing the company to bypass the costly and cumbersome disclosure requirements associated with registered offerings and to advertise and market its securities to investors during the offering process without significant limitation. Congress first provided for such exemptions because, in some instances, it was either not practical for an issuer to register its offering, the benefits from registration were too remote, or registration was not necessary to protect investors because of the small dollar amount of the securities involved or the limited nature of the offering.²⁸ To-

²⁵ See 15 U.S.C. § 77b(10)(b) (1996); 17 C.F.R. § 230.134 (1999). During the waiting period, an issuer may issue a public statement that describes where an investor can obtain a prospectus, identifying the security being offered, and stating the price of the security. See 15 U.S.C. § 77b(10)(b); 17 C.F.R. § 230.134. Because these statements are usually published in a newspaper, they are commonly called "tombstone advertisements." See 69 AM. JUR. 2D *Sec. Reg. Fed.* § 284 (1993). Tombstone advertisements function solely to announce a contemplated securities offering to the public and to permit investors to obtain a prospectus from the issuer. Therefore, tombstone advertisements fail to assist an issuer of registered securities with the marketing or pre-advertising of their offering to investors. See *id.*

²⁶ See *infra* Part II.A.3. (discussing Internet road shows, including the impact that the SEC's Aircraft Carrier Release would have on current regulations).

²⁷ See Aircraft Carrier Release, *supra* note 5, at 67,213, 67,216 (discussing the technology implications of the proposed communications rules).

²⁸ See House Comm. on Interstate and Foreign Commerce, Fed. Supervision of Traffic in Inv. Sec. in Interstate Commerce, H.R. REP. NO. 85, 73d Cong., 1st Sess. 5 (1933) (discussing conditions under which an issuer can offer its securities without registering them with the SEC). Section 3(b) of the Securities Act also grants the SEC the authority to add classes of securities to those exempt from registration if "enforcement . . . is not necessary in the public interest." See 15

day, these circumstances are highly characteristic of exempt securities because the Securities Act limits the amount of securities issued pursuant to section 3(b) of the Securities Act to \$5 million, while a private securities offering may only be sold to certain qualifying investors.²⁹ The current market for securities offered on an Internet web site is thus dominated by companies which seek to raise capital through one of the following public offering exemptions under the Securities Act: (1) Regulation A – Conditional Small Issues Exemption³⁰; (2) Rule 504 of Regulation D³¹; and (3) the Intrastate exemption³², as well as the following exemptions for private offerings: (1) Rule 506 of Regulation D³³ and (2) California Rule 1001.³⁴ Issuers offering their securities pursuant to any of the public offering exemptions discussed *infra*³⁵ may satisfy state registration requirements uniformly by completing a Small Company Offering Registration (SCOR) form with the state or states in which they are offering securities.³⁶

1. Regulation A

Compared to the requirements of a registered public offering, Regulation A subjects an issuer to less burdensome disclosure requirements.³⁷ Although Regulation A is technically an

U.S.C. § 77c(b) (1994).

²⁹ See *infra* Part I.B. (discussing the limitations of offering exempt securities to public and private investors).

³⁰ 17 C.F.R. §§ 230.251-263 (1999).

³¹ *Id.* §§ 230.501-508.

³² 15 U.S.C. § 77c(a)(11) (1994).

³³ 17 C.F.R. § 230.506.

³⁴ *Id.* § 230.1001 [hereinafter California Rule 1001].

³⁵ A discussion of the Rule 701 exemption under section 3(b) of the Securities Act (offers and sales of securities by non-reporting issuers pursuant to a compensatory employee benefit plan or an employment contract) is beyond the scope of this Note. However, many companies have used the Internet and other electronic forms of communication to offer securities to their employees. See generally HOWARD M. FRIEDMAN, SECURITIES REGULATION IN CYBERSPACE 7-01-7-03 (1998) (text and accompanying notes).

³⁶ See *infra* Part II.A.4. (discussing state programs, including SCOR, that allow an issuer offering securities pursuant to a federal exemption to comply with multiple state blue sky laws by completing a single registration form); see also *infra* note 176.

³⁷ See 17 C.F.R. § 230.251 (the Regulation A offering is exempt from federal registration requirements pursuant to section 3(b) of the Securities Act of 1933).

exemption from registration, issuers must still file a Form 1-A "offering statement" and must deliver an "offering circular" to prospective purchasers before any sales of the security occur.³⁸ Furthermore, an issuer cannot sell any of its securities to the public until the offering circular is "qualified" by the SEC.³⁹ But unlike the restrictions on a registered offering, Regulation A takes advantage of a significant benefit associated with the Internet: the ability to pre-advertise an offering to the general public.⁴⁰ Regulation A provides for such an ability by allowing issuers to test-the-waters before they file an offering statement.

The testing-the-waters concept was introduced in 1992 pursuant to the Small Business Initiatives Release.⁴¹ It enables an issuer to solicit indications of interest in a potential Regulation A offering in order to determine the level of interest in the security *before* incurring the costs and burden of preparing and filing an offering statement.⁴² Issuers can test-the-waters using any written statement, such as a scripted advertisement on radio or on television, and such a statement will

³⁸ 17 C.F.R. §§ 230.251(d)(1)(i), 239.90. Unlike a registered offering, issuers filing a Form 1-A may use unaudited financial statements unless the issuer already has audited financial statements prepared, and need only include one year's worth of financial statements as opposed to three years for a registered offering. See Small Business Initiatives Release, Exchange Act Release No. 33-6949, 57 Fed. Reg. 36,442, 36,491-92 (Aug. 13, 1992) (revising Regulation A) (codified at 17 C.F.R. §§ 230.251-263 (1999)). In addition, an issuer may present the offering circular in two formats: a question and answer format using a SCOR form or a form U-7; or a traditional offering circular which requires certain forward-looking information, including projections of revenues, earnings, income and dividends. See *id.* Companies generally use the former format because it is less expensive, easier to complete and there is no potential liability from including forward-looking information in their offering documents. See *id.* To encourage continued use of the traditional offering circular, however, a safe harbor is available to issuers so that forward-looking information will not be deemed "fraudulent" if it was disclosed in good faith and was made with a reasonable basis. 17 C.F.R. § 240.3b-6.

³⁹ 17 C.F.R. § 230.251(d)(2). Qualification of an issuer's offering statement occurs on the 20th calendar day after it is filed with the SEC. See *id.*

⁴⁰ During the pre-filing period, an issuer offering registered securities can issue a press release announcing a proposed public offering; an issuer is prohibited, however, from soliciting indications of interest in the offering until after the registration statement for the securities has been filed. See *id.* § 230.135 (Notice of Certain Proposed Offerings); 15 U.S.C. § 77e(a) (1994).

⁴¹ See Small Business Initiatives Release, 57 Fed. Reg. at 36,442.

⁴² See 17 C.F.R. § 230.254(a). Before using any written materials, however, the issuer must submit a copy to the regional or main office of the Commission. See *id.*

not amount to an offer to sell securities under the Securities Act.⁴³ The written statements may include any factually accurate information, but they must state (i) that the issuer is not soliciting money or other forms of consideration; (ii) that a potential investor makes no commitment to purchasing securities from the issuer when communicating interest; and (iii) the name of the issuer's chief executive officer and a description of the issuer's business practice and products.⁴⁴ Testing-the-waters has assumed even greater significance following several no-action letters that permit an issuer to place such written statements on its web site, or that of a third party's.⁴⁵ In further support of this rule, the SEC has proposed to extend the scope of the testing-the-waters rule to registered initial public offerings ("IPOs") as well.⁴⁶

Although an issuer offering securities pursuant to Regulation A can advertise and market its securities on the Internet before registering its offering, an issuer is at the same time limited. For example, an issuer may only offer up to \$5 million of its securities within a 12-month period, which is an amount usually too small for mature companies, venture-capital firms or start-up firms that need significant amounts of capital to jump-start their business.⁴⁷ Thus, for many issuers an offer-

⁴³ See *id.* Before filing an issuer's offering materials, any solicitation to investors can amount to an offer to sell securities in violation of section 5(c) of the Securities Act. See Solicitations of Interest Prior to an Initial Public Offering, Exchange Act Release No. 33-7188, [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,639, at 86,892 (June 27, 1995) [hereinafter Rule 135d]. But testing-the-waters allows an issuer to solicit investors without violating the Securities Act's provisions.

⁴⁴ See 17 C.F.R. § 230.254(a).

⁴⁵ See M. Louise Rickard & Joseph Kershenbaum, *Securities Offerings Made on the Web are Subject to a Panoply of Federal and State Regulations*, NAT'L L.J., June 8, 1998, at B4.

⁴⁶ See Rule 135d, *supra* note 43, at 86,885 (the SEC would extend the testing-the-waters rule to registered offerings under proposed Rule 135d); see also Securities Act Concepts and Their Effects on Capital Formation, Exchange Act Release No. 33-7314, 61 Fed. Reg. 40044 (July 25, 1996) (the SEC considers whether general solicitation restrictions should be modified to create greater flexibility for issuers); *supra* Part I.A. (proposing testing-the-waters for certain issuers of registered securities under the Aircraft Carrier Release).

⁴⁷ See 17 C.F.R. § 230.251 (limitations are statutorily-imposed). Regulation A also excludes certain company types from exempt status, for example, development stage companies that have no specific business plan or purpose or investment companies registered under the Investment Company Act of 1940. See *id.* (comprehensive list of companies that may not use Regulation A).

ing pursuant to the Regulation A exemption may not be a practical alternative to an unlimited registered public offering.

2. Rule 504 of Regulation D

While the \$5 million ceiling under Regulation A is a severe limitation for many issuers, an offering pursuant to Rule 504 of Regulation D is even more restrictive, as Regulation D mandates a \$1 million ceiling on the amount of securities that can be offered.⁴⁸ Yet Rule 504 is a commonly used exemption by issuers conducting relatively small direct public offerings ("DPOs") over the Internet.⁴⁹ If an issuer sells less than \$1 million of its securities within a 12-month period, it does not have to register its securities with the SEC, nor are the issuer's securities subject to federal securities laws.⁵⁰ As with an offering pursuant to Regulation A, an issuer is permitted to solicit and advertise their offering to investors under Rule 504, thus making the exemption highly amenable to an offering on the Internet.⁵¹ Moreover, an issuer may sell its securities to an unlimited number of investors without any restriction on the resale of the securities.⁵² Yet such an issuer is not exempt from compliance with state "blue sky" laws that govern the

⁴⁸ See 17 C.F.R. §§ 230.501-230.508 (1999). Regulation D also permits two other exemptions from registration under Rules 505 and 506. See *id.* §§ 230.505-230.506. However for purposes of an offering on the Internet, only Rule 506, otherwise known as the "private offering" exemption, is a viable option. See *infra* notes 59-64. Under Rule 505, an issuer can sell up to \$5 million of securities within a 12 month period. However, an issuer cannot solicit investors nor advertise its offering on the Internet. See 17 C.F.R. § 230.505. Even more restrictive is the requirement that there must be fewer than 35 non-accredited purchasers (individuals with an income greater than \$200,000). See *id.* Under these restrictions, the prospect of finding investors who fit this stringent criteria without the ability to advertise the offering over the Internet is a poor combination for conducting a successful offering on the Internet.

⁴⁹ See Revision of Rule 504 of Regulation D, the "Seed Capital" Exemption, Exchange Act Release No. 33-7541, 1998 SEC LEXIS 999, at *7 n.11 (each year approximately 1,500 Rule 504 offerings are filed with the SEC).

⁵⁰ See 17 C.F.R. § 230.504; *id.* § 230.251(d)(i) (an issuer is also not required to file a Form 1-A offering statement: "[e]xcept as allowed by section 230.254, no offer of securities shall be made unless a Form 1-A Offering Statement has been filed with the Commission"). As with a Regulation A offering, neither an investment bank nor a company without a business plan or purpose may offer securities pursuant to Rule 504. See *id.* §§ 230.504(a)(1)-(3).

⁵¹ See generally *id.* §§ 230.501, 230.502, 230.504.

⁵² See *id.*

offer and sale of securities.⁵³ Thus, an issuer must comply with all state regulations relating to registration, issuer disqualification, and filing requirements.⁵⁴ Consequently, an issuer must consider whether the costs that it will incur as a result of complying with multiple state regulations under a Regulation D offering will outweigh the benefits of such a small, limited offering.

3. Intrastate Exemption

An issuer is exempt from registering its securities with the SEC under the intrastate exemption if it offers securities to investors *residing in a single state or territory*, provided that the issuer is either: (1) incorporated in that state or (2) doing business in that state.⁵⁵ Because an issuer can solicit and sell securities only to residents in a single state, the issuer arguably can solicit only a limited number of investors through the Internet. Nonetheless, issuers can offer an *unlimited amount* of securities to state residents during any time period, unlike an offering pursuant to Regulation A or Rule 504 of Regulation D.⁵⁶ A company may also generally solicit and pre-advertise its offering to investors under similar restrictions as those imposed under Regulation A.⁵⁷ Although the intrastate exemption is more flexible compared with other exemptions, the offering may still be subject to state restrictions on the amount of the offering and the time frame in which the securities can be offered.⁵⁸

⁵³ See 17 C.F.R. § 230.504. See also *supra* Part II.A.4. (discussing blue sky laws).

⁵⁴ See 17 C.F.R. § 230.504 (Preliminary Notes).

⁵⁵ See 15 U.S.C. § 77c(a)(11) (1994); 17 C.F.R. § 230.147 (the exemption “appl[ies] only to issuers genuinely local in character, which in reality represent local financing by local industries, carried out through local investment”).

⁵⁶ See 15 U.S.C. § 77c(a)(11).

⁵⁷ See *id.*

⁵⁸ See *id.* Some commentators have suggested that the intrastate exemption may be a viable capital-raising solution for mature companies with a broad customer-base. See, e.g., Mark Kollar, *Do-It-Yourself Public Offerings: The Internet Brings A New Dimension To An Old Financing Vehicle*, INV. DEALERS’ DIG., Mar. 24, 1997, at 14.

4. Rule 506 of Regulation D

As the Internet plays an ever larger role in public offerings, issuers of private securities have also flocked to the Internet to take advantage of its low cost and efficiency. A traditional private placement pursuant to section 4(2) of the Securities Act exempts from registration an offering by an issuer that does not involve a public offering of securities.⁵⁹ Whether an offering qualifies for an exemption under section 4(2), however, is difficult to predict because it is subject to judicial interpretation.⁶⁰ Moreover, neither the Securities Act nor the courts provide a specific definition of a private offering pursuant to section 4(2).⁶¹ Therefore, to clarify when an issuer may conduct a private placement, the SEC adopted Regulation D which provides a limited safe harbor for the offer and sale of securities in a private offering as long as certain statutorily-imposed criteria are met: (1) general advertising and general solicitation are prohibited by the issuer and (2) securities may only be sold to 35 unaccredited investors, in addition to an unlimited number of accredited investors.⁶² Of these criteria, determining whether or not an investor meets the requirements of an accredited investor is the most problematic with regard to an offering on the Internet. This process—establishing

⁵⁹ See 15 U.S.C. § 77(d).

⁶⁰ See, e.g., *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953) (holding that the offering did not qualify for the private offering exemption under section 4(2) of the Securities Act because of the "shear number" of employees that were solicited to purchase the securities, even though the number of investors that ultimately purchased the shares was smaller).

⁶¹ See RICHARD W. JENNINGS ET AL., *SECURITIES REGULATION* 381-82 (8th ed. 1998) (in determining whether an offering qualifies for exempt status under section 4(2) of the Securities Act, courts will generally consider the number of offerees solicited, the availability of information to investors, the accessibility to such information, the level of sophistication of the offerees and whether the resale of the securities is limited).

⁶² See 17 C.F.R. §§ 230.501(a), 230.502(c), 230.506 (1999). A non-accredited investor must either be sophisticated or have a sophisticated purchaser representative. See *id.* § 230.501(a). An accredited investor may be a bank, broker or dealer, investment company, or an employee benefit plan. See *id.* Individuals that qualify for accredited status include any director, executive officer, or general partner of the issuer, or "any natural person [with] an individual income in excess of \$200,000 in each of the two most recent years or joint income with that person's spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year." *Id.*

a "pre-existing relationship" with an investor—is completed by the issuer who contacts potential investors to determine whether they are accredited without informing them of the particular securities offering.⁶³ After establishing that the investor in fact is accredited, the issuer can contact the investor with its offering information.⁶⁴

While finding accredited investors through the Internet has been difficult in the past, the process has become simplified with the advent of electronic "matching systems" that provide a central location where an already accredited investor may be matched with an issuer.⁶⁵ The SEC has consistently held that these matching systems do not violate the private offering exemption's general solicitation ban.⁶⁶ As a result, issuers of private securities offerings have become key players in the utilization of the Internet to seek out qualified investors.

5. Rule 1001

While the private offering exemption under Regulation D strictly prohibits solicitation or advertising to the general public, the SEC relaxed this prohibition with its promulgation of Rule 1001.⁶⁷ Rule 1001 was developed by the SEC in coordination with a California rule that allowed an issuer within California to sell privately placed securities of up to \$5 million.⁶⁸ As with a private offering under Rule 506 of Regulation D, securities offered under Rule 1001 can only be sold to "qualified" investors.⁶⁹ However, unlike Rule 506, an issuer is per-

⁶³ See Donald C. Langevoort, *Angels on the Internet: The Elusive Promise of "Technological Disintermediation" for Unregistered Offerings of Securities*, 2 J. SMALL & EMERG. BUS. L. 1, 6 (Summer 1998). Traditionally, an issuer could establish a pre-existing relationship with an investor by contacting them directly or else by examining an investor's records to determine their status in previous investments. See *id.* at 7.

⁶⁴ See *id.* at 6.

⁶⁵ See *infra* Part IV. (discussing Internet-based service providers that assist private securities issuers).

⁶⁶ See *id.*

⁶⁷ 17 C.F.R. § 230.1001.

⁶⁸ See Small Business Registration Exemption, Exchange Act Release No. 7285, [1996 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,803, at 88,006 (May 1, 1996); see also CAL. CORP. CODE § 25,102(n) (Deering 1977) (enumerating conditions under which an issuer may use the private offering exemption).

⁶⁹ CAL. CORP. CODE § 25,102(n).

mitted to test-the-waters under Rule 1001 *even if non-qualified investors receive the solicitation*.⁷⁰ Although the SEC has not indicated whether an issuer under Rule 1001 can use the Internet to solicit interest from investors, the California Securities Commissioner has expressly authorized Internet-based contacts for testing-the-waters purposes.⁷¹

Rule 1001 departs from a principle long-held by the Commission that an issuer may not generally solicit investors in a non-public offering.⁷² Under Rule 1001, an issuer may test-the-waters with a written announcement of the proposed offering that is available to the "general" public.⁷³ Once the announcement is made, a disclosure statement must be filed with the SEC and then provided to all investors prior to any actual sales of the security, unless the investor qualifies for an exemption.⁷⁴ Thus, a Rule 1001 offering differs from a traditional private offering in that it allows an issuer to test-the-waters through an Internet web site without violating any *general* solicitation ban.

C. *Exempt Offerings "Setting the Stage" for Registered Offerings*

For an issuer seeking to raise capital, the Internet significantly reduces the costs associated with delivery and solicitation of an issuer's offering materials.⁷⁵ At the same time issuers potentially have access to an unlimited number of inves-

⁷⁰ See *id.*

⁷¹ See Commissioner's Opinion 96/2C, Cal. Dept. of Corp., 1996 Cal. Sec. LEXIS 3, 5-13 (Oct. 17, 1996).

⁷² See *infra* notes 103-125 and accompanying text (discussing limitations of private securities offerings).

⁷³ 17 C.F.R. § 230.1001 (1999). Section 25,102(n)(5)(A)(iv) of the California Corporations Code requires that the statement include the name of the issuer, the title of the security, the suitability standard of prospective purchasers and a series of disclaimer statements. See *id.* The statement must also indicate that no money or other consideration is being solicited or accepted, and that indications of interest do not obligate a purchaser to subsequently purchase the securities. See *id.* An issuer must also provide investors with a description of the issuer's business and the price of the security being offered. See *id.*

⁷⁴ See *id.*; see also CAL. CODE REGS. tit. 10, § 260.102.13 (1997) (listing of persons exempt from receiving a disclosure statement).

⁷⁵ See generally John C. Coffee, Jr. & Adolf A. Berle, *Brave New World?: The Impact(s) of the Internet on Modern Securities Regulation*, 52 BUS. LAW. 1195 (August 1997).

tors.⁷⁶ Moreover, an offering pursuant to an exemption under the Securities Act allows an issuer to take advantage of many of the benefits associated with the Internet, including testing-the-waters before making an offering to investors, soliciting investors with offering materials available on an Internet web site, and seeking out qualified investors in a private offering.⁷⁷ Yet exempt offerings are at the same time limited. Whether the exemption places a ceiling on the amount of securities an issuer may sell or limits sales to the general public, conducting an offering on the Internet pursuant to one of the federal exemptions is often inadequate, especially for those companies seeking to raise large amounts of capital.⁷⁸ Exempt securities offered through the Internet, however, represent only a preview for things to come: already investment banks and issuers offering registered securities are using the Internet to make offering materials available to investors, while the SEC has proposed new rules that would permit testing-the-waters for registered securities.⁷⁹ Furthermore, issuers of registered securities have already received approval for some form of solicitation of interest, namely, the ability to conduct a road show over the Internet.⁸⁰ Thus, current regulations governing testing-the-waters and Internet-based communications for exempt securities are some indication of how the SEC will treat these same activities in the context of a registered offering on the Internet.

II. REGULATION OF SECURITIES OFFERINGS ON THE INTERNET

A. *The Removal of Regulatory Constraints in the United States*

With the advent of the Internet and other electronic forms of communication, the securities industry has undergone enormous changes.⁸¹ For example, public companies now file all

⁷⁶ See *id.*

⁷⁷ See *id.*

⁷⁸ See *id.* (typically only small issuers have used the Internet to offer securities because of the limitations associated with an exempt offering).

⁷⁹ See *supra* note 43 and accompanying text (discussing proposed Rule 135d).

⁸⁰ See *infra* Part II.A.3. (discussing Internet road shows).

⁸¹ See Leslie Eaton, *Wall Street Without Walls*, N.Y. TIMES, Nov. 11, 1996, at A1 (discussing innovations in technology such as the Internet and its effect on

documents electronically with the SEC,⁸² while several on-line brokerage firms have evolved that distribute IPO shares to their customers and permit secondary trading through the Internet.⁸³ In addition, companies now use the Internet to transfer information to investors instantaneously.⁸⁴ While generally supportive of the use of the Internet to replace traditional forms of communication, the SEC has further recognized in its Aircraft Carrier Release that the current regulatory system for offerings under the Securities Act needs to reflect this new technology.⁸⁵ But while the Aircraft Carrier Release eases registration for issuers and allows for increased communications during a registered public offering, it does not specifically authorize Internet offerings, nor does it address an issuer's liability for placing information on an Internet web site while conducting a public offering of securities.⁸⁶ Furthermore, the Release does not extend to private securities offerings, thereby failing to eliminate the general solicitation ban, even though "free" communications would be permitted during the offering period for registered offerings.⁸⁷ Consequently, regardless of whether or not the Proposal is implemented in

Wall Street); Ruth Simon, *An SEC Commissioner Sizes Up the Net's Pros and Cons for Investors*, MONEY, Oct. 1996, at 29 (brief interview with Commissioner Wallman on how the Internet is "revolutionizing the financial markets" for small businesses).

⁸² See generally *Office of Filings and Information Services* (visited July 28, 1999) <<http://www.sec.gov/asec/ofis/ofisweb.htm>>. In 1984, the SEC initiated the Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system, requiring companies to submit public filings electronically with the Commission. See *id.*

⁸³ See, e.g., *Fixing What is Broking: Why, But Not When, Wall Street Will Go Wired*, ECONOMIST, Oct. 26, 1996, at S10 (discussing retail brokers, such as Charles Schwab, offering services to customers on-line); see also *Virtual Wall Street, Online Brokerage Firms* (visited July 2, 1999) <http://www.virtualwallstreet.com/cgi/index.cgi?about/community/a_afinancial_sites/b_online_brokers> (listing brokerage firms that operate exclusively on the Internet and detailing services offered by each).

⁸⁴ See *infra* Part III.A. (discussing benefits to issuers that use the Internet in the offering process).

⁸⁵ See Aircraft Carrier Release, *supra* note 5, at 67,216 ("[t]he proposed communications rules would enable issuers and market participants to take significantly greater advantage of the Internet and other electronic media to communicate and deliver information to investors" more efficiently).

⁸⁶ See *id.* at 67,216 n.327.

⁸⁷ *Id.* at 67,213 n.297 (stating that the bright line safe harbor proposed to increase communications to investors would "not permit issuers to avoid the prohibition on general solicitation when conducting a private offering").

the future, issuers of registered and private offerings will have to continue to refer to SEC staff no-action letters and SEC guidance to clarify the practice of offering IPO shares through the Internet.

The SEC was the first securities commission in the world to embrace the use of the Internet for offering securities to investors. In a 1995 no-action letter to Brown & Wood, the SEC staff defined a prospectus to include not only a traditional paper version, but one in an electronic format as well.⁸⁸ As a result, a company could offer its prospectus on-line through an Internet web site.⁸⁹ Investors could simply elect to receive delivery of the electronic prospectus instead of a paper version.⁹⁰ In two interpretive releases issued by the Commission several months later, the SEC clarified how electronic information, such as a prospectus, should be delivered.⁹¹ Generally, the electronic document has to convey the same material information as its written counterpart in substantially the same order, while those providing the information have to take "reasonable

⁸⁸ See Brown & Wood, SEC No-Action Letter, 1995 SEC No-Act. LEXIS 281, at *1 (Feb. 17, 1995).

⁸⁹ See *id.*

⁹⁰ See *id.* at *2. Investors could elect to receive the electronic version, but according to the SEC staff, such election will be revocable. Thus, if an investor no longer wants electronic delivery of the offering materials, the issuer, underwriter or broker must send to them a paper version. See *id.* at *4. The SEC has made it very clear that it does not want to permit companies to offer materials to investors exclusively over the Internet until access to the Internet is widespread among the general public. See *Report to the Congress: The Impact of Recent Technological Advances on the Securities Markets* (last modified Nov. 26, 1997) <<http://www.sec.gov/news/studies/techrp97.htm>> [hereinafter SEC Technology Report] (report prepared by the SEC staff of the U.S. Securities and Exchange Commission pursuant to section 510(a) of the National Securities Markets Improvement Act of 1996). But see generally FRIEDMAN, *supra* note 35, at 3.05(b) (under the SEC's current guidelines, an issuer or underwriter can refuse to send a paper version of a prospectus or accept a bid from an investor that signs an agreement to receive electronic delivery of a prospectus).

⁹¹ See Use of Electronic Media for Delivery Purposes, Exchange Act Release No. 33-7233, 60 Fed. Reg. 53,458 (Oct. 6, 1995) [hereinafter October 1995 Interpretive Release]; Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information, Part VI, Exchange Act Release No. 33-7288, 61 Fed. Reg. 24,644 (May 15, 1996) [hereinafter May 1996 Interpretive Release] (additional examples of how an issuer may use electronic media for delivery of offering documents to investors). Pursuant to the October 1995 and May 1996 Interpretive Releases, an issuer of securities can post a prospectus on its web site that may be read or printed by prospective investors. See October 1995 Interpretive Release at 53,460-61; May 1996 Interpretive Release at 24,646.

precautions" to ensure the integrity and security of the information.⁹² Moreover, a recipient must be able to adequately access the offering information.⁹³ With an issuer's ability to make offering materials available to investors on an Internet web site, the interpretive releases paved the way for issuers, underwriters and brokers to offer securities to investors on the Internet, in the United States.⁹⁴

Other securities commissions have followed the SEC's lead.⁹⁵ For example, the Australian Securities Commission ("ASC") issued a Policy Statement in 1998 that permits electronic delivery of a prospectus through an Internet web site.⁹⁶ The ASC permits an issuer to distribute a prospectus to investors on the Internet if it takes "reasonable steps" to ensure that each investor receives a prospectus.⁹⁷ An issuer must also ensure that the prospectus is complete, unaltered, and contains the same information in the same sequence as the paper version.⁹⁸

Subsequent SEC guidance has also clarified the acceptability of delivering offering information to investors through an Internet web site.⁹⁹ For example, in 1995, the Spring Street Brewing Company conducted the first securities offering on the

⁹² See October 1995 Interpretive Release, *supra* note 91, at 53,460 & n.20.

⁹³ See October 1995 Interpretive Release, *supra* note 91, at 53,460 n.24. For examples on how to deliver an electronic prospectus and thus satisfy prospectus delivery requirements, see October 1995 Interpretive Release, *supra* note 91, at 53,461-67; see also May 1996 Interpretive Release, *supra* note 91, at 24,649.

⁹⁴ The Interpretive Releases, however, do not apply to written testing-the-waters materials since such information is not deemed a prospectus pursuant to section 2(10) of the Securities Act). See Additional Small Business Initiatives, Exchange Act Release No. 33-6996, 58 Fed. Reg. 26,509, 26,513 (Apr. 28, 1993).

⁹⁵ See, e.g., *Delivery of Documents by Issuers using Electronic Media Concept Proposal, Canadian Securities Administrators Request for Comments 11-401* (visited Feb. 2, 1999) <<http://www.osc.gov>> (the Ontario Securities Commission ("OSC") solicits comment on whether the OSC should adopt guidelines similar to those adopted by the SEC in its interpretive releases).

⁹⁶ See Australian Securities Commission, *Policy Statement 107, Electronic Prospectuses* (last modified Feb. 10, 1999) <<http://www.asic.au.com>>.

⁹⁷ *Id.* at 1.

⁹⁸ See *id.*

⁹⁹ As with small issuers, major investment banks, including Salomon-Smith Barney, increasingly use the Internet to deliver offering materials to prospective investors. See, e.g., Bradford P. Weirick, *Regulatory Hurdles May Impede IPOs on the Web*, NAT'L L.J., May 6, 1996, at B5 (discussing Berkshire Hathaway Inc.'s stock offering where its prospectus could be obtained from Salomon-Smith Barney's web site).

Internet.¹⁰⁰ Although the offering did not fully comply with the SEC interpretive releases on electronic delivery, the SEC staff indicated nevertheless that posting offering information on a web site in combination with electronic delivery was permissible under Regulation A.¹⁰¹ Today, the securities industry widely recognizes the practice of transmitting offering information to investors through the Internet. Moreover, since the Spring Street letter, the SEC has begun to clarify several other practices relating to offering both exempt and registered securities on the Internet.¹⁰²

1. Private Placements and "Solicitation"

In a private securities offering on the Internet, anyone can access the offering materials on a web site. However, under Regulation D, general solicitation and advertising to non-qualified investors are prohibited.¹⁰³ As a result, simply posting offering materials on an Internet web site with unlimited access to the public is a general solicitation in violation of section 502(c) of Regulation D.¹⁰⁴ To clarify how an issuer could avoid the general solicitation ban while using the Internet to offer securities, the SEC staff referred to two prior no-action letters.¹⁰⁵

¹⁰⁰ See Christina K. McGlosson, *Who Needs Wall Street? The Dilemma of Regulating Securities Trading in Cyberspace*, 5 COMMLAW CONSPECTUS 305, 307 (Summer 1997) (discussing Spring Street's offering from its Internet web site).

¹⁰¹ See Spring Street Brewing Co., SEC No-Action Letter, 1996 SEC No-Act. LEXIS 435, at *4-*5 (Apr. 17, 1996) (using electronic delivery in a Regulation A offering is "acceptable, although [Spring Street] should consider the Commission's interpretive guidance regarding electronic delivery").

¹⁰² See generally October 1995 Interpretive Release, *supra* note 91; May 1996 Interpretive Release, *supra* note 91 (the Securities Act was written based on assumptions that are now out-of-date; consequently, the issues that arise from using the Internet in the offering process typically require a novel response by the SEC).

¹⁰³ *But see supra* notes 67-74 and accompanying text (discussing California Rule 1001).

¹⁰⁴ Indeed, the Commission has stated that posting a *general* notice of an exempt private offering on an issuer's web site constitutes a general solicitation. See October 1995 Interpretive Release, *supra* note 91, at 53,463-64 (example number 20). For a discussion of the general solicitation ban under section 502(c) of Regulation D, see *supra* note 62 and accompanying text (outlining requirements for conducting a private securities offering over the Internet).

¹⁰⁵ See Bateman-Eichler, SEC No Action Letter, 1985 SEC No-Act. LEXIS 2918 (Dec. 3, 1985); Woodtrails-Seattle, Ltd., SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2662 (Aug. 9, 1982).

Before the advent of the Internet, the SEC staff determined in *Woodtrails-Seattle* that mailing a written offer to approximately 330 persons who had previously invested in other limited partnerships sponsored by the general partner of the company would not constitute a general solicitation.¹⁰⁶ First, the proposed offerees were held to have a pre-existing business relationship with the issuer¹⁰⁷ because of their prior investment with its general partner.¹⁰⁸ Second, the general partner had previously determined that each of the offerees met the sophistication standard of Rule 506 at the time of the original investment.¹⁰⁹ Thus, the written offer to prior investors was not a general solicitation.¹¹⁰

In a no-action request several years later, the SEC staff again had to address the issue of solicitation, but for a solicitation program even broader than that proposed in *Woodtrails-Seattle*.¹¹¹ Instead of contacting those investors with whom the general partner already had established a pre-existing relationship through prior investments, the broker, acting on behalf of the general partner, sought to contact businesses and professionals with whom the broker initially had no relationship at all.¹¹² The broker would seek out qualified investors with a letter and questionnaire that it would send to the business community about the securities offering.¹¹³ If the questionnaire was completed satisfactorily, the investor was placed on a list of prospective offerees.¹¹⁴ Even though the company had no prior contacts with any of the investors, the SEC staff took the position that as long as the broker could determine whether or not each investor was "sophisticated", the responses provided by the investor in the questionnaire would establish a pre-existing relationship with the company.¹¹⁵ Furthermore,

¹⁰⁶ See *Woodtrails-Seattle, Ltd.*, 1982 SEC No-Act. LEXIS 2662, at *1-3.

¹⁰⁷ See *supra* notes 63-64 and accompanying text (to avoid violating the general solicitation ban of Regulation D, an issuer must have a pre-existing relationship with qualified investors).

¹⁰⁸ See *Woodtrails-Seattle, Ltd.*, 1982 SEC No-Act. LEXIS 2662, at *1-2.

¹⁰⁹ See *id.* at *2.

¹¹⁰ See *id.*

¹¹¹ See *Bateman Eichler*, 1985 SEC No-Act. LEXIS 2918, at *1.

¹¹² See *id.* at *4.

¹¹³ See *id.*

¹¹⁴ See *id.* at *4-5.

¹¹⁵ See *id.* at *2.

the SEC staff held that seeking out investors through the use of the questionnaire did not constitute an offer to sell securities because it was generic and contained no reference to specific investments currently offered by the company.¹¹⁶ Thus, a broker or issuer could establish a pre-existing relationship with an investor through the use of a generic questionnaire without violating the general solicitation ban under Regulation D.

More than ten years later, the SEC staff was asked to grant no-action relief to an issuer of privately placed securities that wanted to place its offering materials *on a web site*.¹¹⁷ The SEC had thus far maintained that posting a general notice of an exempt offering on an issuer's web site *would* constitute a general solicitation.¹¹⁸ In *IPONET*, the broker W.J. Gallagher & Company, Inc. sought to ascertain whether prospective investors were accredited or sophisticated through the use of a general questionnaire.¹¹⁹ If the investor was deemed accredited or sophisticated, the broker would provide them with a password that permitted them access to its web site—*IPONET*—containing the offering materials of multiple issuers.¹²⁰ Following the reasoning set forth in its previous no-action letters, the SEC staff held that the broker's invitation to investors to complete the questionnaire was not a general solicitation since the questionnaire provided a means for

¹¹⁶ See Bateman Eichler, 1985 SEC No-Act. LEXIS 2918, at *2. The Commission also noted that this type of contact with potential investors was permissible under Regulation D, so long as no offering material would be sent to the investor for a minimum of 45 days after mailing the questionnaire. See *id.*

¹¹⁷ See *IPONET*, SEC No-Action Letter, 1996 SEC No-Act. LEXIS 642 (July 26, 1996).

¹¹⁸ See October 1995 Interpretive Release, *supra* note 91, at 53,463-64 (example number 20).

¹¹⁹ See *IPONET*, 1996 SEC No-Act. LEXIS 642, at *9 (July 26, 1996). Investors could obtain a questionnaire at the Company's web site under a section entitled "Accredited Investors." See *id.* Previous *IPONET* members were invited to complete the questionnaire on the web site or else print out the questionnaire and return it to the company in hard-copy format. See *id.* at *8-*9.

¹²⁰ See *id.* at *9; see also Angel Capital Electronic Network, SEC No-Action Letter, 1996 SEC No-Act. LEXIS 812, at *1-*5 (Oct. 25, 1996). The Small Business Association was granted relief by the SEC staff in creating a web site designed to match small businesses with accredited investors for Regulation A or Regulation D offerings. See *id.* Like *IPONET*, the site was password-protected and only investors who filled out an application form and were deemed accredited were able to view the offering materials. See *id.*

establishing a pre-existing relationship and was generic, that is, not specific to any one securities offering.¹²¹ In addition, the broker could post a notice of the private offering on IPONET with the use of a password-protection system.¹²²

In another no-action request in 1997, Lamp Technologies sought to post information that related to private investment companies on a web site, including descriptive information such as offering memoranda and performance information.¹²³ The staff once again required the issuer to maintain a password-protected web site with limited access to accredited subscribers.¹²⁴ By implementing such a system, the materials placed on the web site would not be deemed a "general solicitation."¹²⁵ Thus, after *IPONET* and *Lamp Technologies* two requirements must be met in order to avoid general solicitation of a private offering on the Internet. First, the issuer or broker must use a generic questionnaire to determine whether an investor is accredited or sophisticated, and second, a company must implement a password-protection system on the web site where the offering materials are placed.

2. Electronic Indications of Interest and Conditional Offers to Buy

In a registered public offering, once an investor has received a preliminary prospectus, an underwriter or broker can send a communication to the investor during the waiting period requesting that they indicate their interest or submit a conditional offer to buy securities pursuant to Rule 134(d) of the Securities Act.¹²⁶ However, an underwriter or broker is prohibited from accepting an investor's offer to buy until after effectiveness of the registration statement and pricing of the

¹²¹ See *IPONET*, 1996 SEC No-Act. LEXIS 642, at *1-*2.

¹²² See *id.* However, the Commission would only permit IPONET members to access the offering materials. Thus accredited investors were required to become a client of IPONET before they could receive an issuer's offering materials. See *id.*

¹²³ See *Lamp Technologies Inc.*, SEC No-Action Letter, 1997 SEC No-Act. LEXIS 638, at *16-*17 (May 29, 1997).

¹²⁴ See *id.* at *4-*5. Subscribers also had to pay a subscription fee of \$500 each month. See *id.* at *4.

¹²⁵ *Id.* at *6; see also *supra* note 62 and accompanying text (discussing Rule 502(c) of Regulation D).

¹²⁶ See 17 C.F.R. § 230.134(d) (1999).

security.¹²⁷ While electronic communications have provided a more efficient and convenient way to solicit interest or an offer to buy from an investor, the language contained in Rule 134(d) does not specifically address the sending or the receipt of such communications *electronically*.¹²⁸ However, in 1996, the SEC staff confirmed that it would permit an investor to submit an indication of interest in an offering electronically.¹²⁹ In a no-action letter to IPONET, the SEC staff held that Rule 134(d) contemplated the use of an electronic coupon or card to indicate interest in an offering.¹³⁰ Under the IPONET system, investors access a preliminary prospectus on IPONET's web site and then connect to the electronic coupon through a "hyperlink"¹³¹ embedded within the prospectus document.¹³² Investors then complete and return their indication of interest to their broker through a communication link on the web site, e-mail or by printing the coupon or card and sending it by regular mail.¹³³

More recently, the SEC staff issued no-action relief to Wit Capital, implicitly confirming that Securities Act Rule 134(d) permits electronic condition offers to buy.¹³⁴ Under Rule 134(d), an electronic conditional offer may only contain the information permitted by Rule 134 and must provide that acceptance of the offer must occur after effectiveness, that any offer may be withdrawn before acceptance, and that indications of interest involve no obligation.¹³⁵ The SEC staff also con-

¹²⁷ See 15 U.S.C. § 77e(a) (1994) (under section 5(a), no sale of a security is permitted prior to effectiveness).

¹²⁸ See 17 C.F.R. § 230.134(d) (an underwriter or broker may accept an indication of interest by a "coupon or card, or *in some other manner*") (emphasis added).

¹²⁹ See generally IPONET, SEC No-Action Letter, 1996 SEC No-Act. LEXIS 642 (July 26, 1996).

¹³⁰ See *id.* at *1.

¹³¹ To use a hyperlink, a user places her cursor on a highlighted phrase or term, e.g., the term "Prospectus". The user then clicks on the term with her mouse and is automatically connected to the web page containing the prospectus. A hyperlink may lead the visitor either to a web page that is hosted by the issuer or hosted by a separate company or individual.

¹³² See IPONET, 1996 SEC No-Act. LEXIS 642, at *8.

¹³³ See *id.*

¹³⁴ See Wit Capital Corp., SEC No-Action Letter, 1999 SEC No-Act. LEXIS 620, at *1-*2 (July 14, 1999).

¹³⁵ Rule 134(d) requires inclusion of the following legend:

No offer to buy the securities can be accepted and no part of the pur-

firmed that Wit Capital could send a requesting e-mail to an investor two days prior to effectiveness of the offering, requesting reconfirmation of an investor's conditional offer.¹³⁶ After effectiveness, no further action by the investor is required so that the investor's conditional offer could be accepted by Wit Capital immediately after pricing of the offering.¹³⁷ By responding to Wit Capital's requesting e-mail, an investor's indication of interest is converted into a "firm" offer to buy without it being tantamount to a sale in violation of section 5(a) of the Securities Act, as the SEC staff expressly noted.¹³⁸ The SEC staff's acceptability of Wit Capital's pre-effective confirmation procedures thus allows issuers, underwriters and brokers flexibility in receiving and accepting an investor's indication of interest or offer to buy electronically.

3. Road Shows Transmitted Over the Internet

One of the more complex issues addressed by the SEC is whether the Internet may be used to transmit a road show presentation to investors. A road show consists of a series of meetings in major cities across the United States and abroad that give institutional investors, investment advisers, broker-dealers, securities analysts, and large investors an opportunity to meet with the issuer's management.¹³⁹ Most road shows

chase price can be received until the registration statement has become effective, and any such offer may be withdrawn or revoked, without obligation or commitment of any kind, at any time prior to notice of its acceptance given after the effective date. An indication of interest in response to this advertisement will involve no obligation or commitment of any kind.

17 C.F.R. § 230.134(d) (1999).

¹³⁶ See Wit Capital Corp., 1999 SEC No-Act. LEXIS 620, at *1-*2. The investor's reconfirmation is valid for five business days after Wit Capital transmits it to investors, if effectiveness of the offering is delayed beyond the two days anticipated. See *id.* at *27. In addition, investors can withdraw their offers at any time until accepted (after pricing). See *id.* at *2.

¹³⁷ See *id.* at *34 (acceptance may occur an hour after pricing if during trading hours, and after 11:00 p.m. (Eastern time) if pricing occurs after the market closes); see also *OpenIPO: Participation Agreement* (visited July 29, 1999) <<http://www.openipo.com/OpenIPO/base/HiWorks/HiW4da.html?REF=HiW4da>> [hereinafter *Participation Agreement*] (discussing W.R. Hambrecht's post-effective reconfirmation procedures).

¹³⁸ See Wit Capital Corp., 1999 SEC No-Act. LEXIS 620, at *46-*50.

¹³⁹ See JENNINGS, *supra* note 61, at 143 (road shows are usually done after

are conducted by the underwriters of large registered and private offerings¹⁴⁰ who help to create and assess interest in a future stock offering.¹⁴¹ Such presentations are also an opportunity for investors to receive information about an issuer, so that they may make a more informed investment decision.¹⁴²

In the United States, the SEC has long permitted and encouraged road shows.¹⁴³ Its attitude toward the use of the Internet to transmit a road show presentation has not been any different. Electronic road shows level the playing field for institutional investors who cannot attend a live presentation—creating a more efficient securities market, while issuers and underwriters are more careful in how they present information to investors as the SEC can, in theory, easily view an on-line road show transmission.¹⁴⁴ The electronic road show also provides faster transmission of the preliminary prospectus because current SEC guidance requires an investor to view it prior to or at the same time that they view the road show on-line.¹⁴⁵

securities are registered with securities regulators).

¹⁴⁰ There is evidence, however, that issuers of exempt securities have also conducted road shows. For example, in 1996, Primary Care Centers (PCC) used a comprehensive multi-media presentation on the Internet to promote its Rule 504 Regulation D offering. See Mark Hendrickson, *Small IPO Promoted by Virtual Road Show*, SEC. INDUSTRY NEWS, Dec. 16, 1996, at 5; Kimberly Weisul, *First Internet Roadshow Launched by Small Company*, INV. DEALERS' DIG., Dec. 9, 1996, at 18. PPC's road show used video, slides and audio narration, including interviews with PPC's founder, an offering prospectus and a virtual tour of the company's headquarters. See Hendrickson at 5. Access to the site was limited to qualified investors. See *id.* Compared to this type of road show, traditional road shows consist of a live presentation in which members of the general public are not permitted to attend.

¹⁴¹ See *Electronic Commerce: Firm Wins Staff Clearance for Internet "Road Show" Presentation*, 29 SEC. REG. & L. REP. 36, at 1279 (Sept. 12, 1997). A road show may be equated with an issuer's ability to test-the-waters in an exempt securities offering, since an issuer can assess potential interest in its offering. See *supra* notes 37-46 and accompanying text (discussing testing-the-waters pursuant to the Regulation A exemption).

¹⁴² See Aircraft Carrier Release, *supra* note 5, at 67,215.

¹⁴³ See Julia B. Strickland & David Neier, *Regulation of Road Shows*, 28th Annual Institute on Securities Regulation, in CORPORATE LAW AND PRACTICE HANDBOOK SERIES NO. 962, at 133 (PLI ed. 1996).

¹⁴⁴ See Net Roadshow Inc., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 864, at *10 (Sept. 8, 1997).

¹⁴⁵ See *id.*

Since 1997, the SEC staff have released five no-action letters permitting issuers of registered and private securities offerings to transmit road shows over the Internet.¹⁴⁶ While historically road shows have been considered oral presentations and thus are not subject to the securities laws governing written prospectus materials, the SEC staff's primary concern with an electronic road show was whether transmitting it over the Internet transformed it into a written presentation.¹⁴⁷ Thus, for registered offerings, the SEC had to consider whether an issuer could permissibly structure an electronic road show transmission so that it would not constitute transmission of a prospectus in contravention of section 5 of the Securities Act.¹⁴⁸ For private offerings, the issue was whether the transmission could be structured in such a way so that only qualified investors would view the road show transmission, in accordance with the "general solicitation" ban under section 502(c) of Regulation D.¹⁴⁹ To ensure compliance with securities laws the SEC staff first requires that the underwriter or issuer hosting the on-line road show limit the viewing audience to qualified investors.¹⁵⁰ Second, the road show presentation is

¹⁴⁶ See Thomson Financial Servs., Inc., SEC No-Action Letter, 1998 SEC No-Act. LEXIS 837, at *1 (Sept. 4, 1998); Net Roadshow, Inc., SEC No-Action Letter, 1998 SEC No-Act. LEXIS 107, at *1-*2 (Jan. 30, 1998) (road shows are consistent with private securities offerings pursuant to Rule 144A(d)(1), as long as issuers transmit the roadshow over the Internet *solely* to qualified buyers); Bloomberg L.P., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 1023, at *1 (Dec. 1, 1997) (road show can be transmitted through third-party web site—Bloomberg); Net Roadshow, Inc., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 864, at *2; Private Financial Network, SEC No-Action Letter, 1997 SEC No-Act. LEXIS 406, at *1 (Mar. 12, 1997).

¹⁴⁷ See, e.g., Net Roadshow, Inc., 1997 SEC No-Act. LEXIS 864, at *1.

¹⁴⁸ See *id.* A prospectus must conform with the provisions set forth in section 2(10) of the Securities Act, otherwise it would constitute an illegal prospectus in violation of section 5 of the Securities Act. See *id.*; see also Private Financial Network, 1997 SEC No-Act. LEXIS 406, at *10 (even though a road show uses aspects of television technology, the transmissions themselves are not considered a prospectus because the road show is oral and visual; not written).

¹⁴⁹ Net Roadshow, Inc., 1998 SEC No-Act. LEXIS 107, at *9-*10.

¹⁵⁰ See Net Roadshow, Inc., 1997 SEC No-Act. LEXIS 864, at *5-*6; Private Financial Network, 1997 SEC No-Act. LEXIS 406, at *11-*13 (because only qualified investors may view the offering materials, the road show is transmitted to a discrete invited audience). The issuer must use an access-code restricted web site so that only qualified investors—those customarily invited to a road show (typically large and institutional investors)—can view the transmissions. See Net Roadshow, Inc., 1997 SEC No-Act. LEXIS 864, at *6. The access code is changed each day,

only permitted *after* the registration statement has been filed with the SEC.¹⁵¹ Third, subscribers who wish to view the road show presentation must receive and review a copy of the preliminary prospectus or offering materials before the road show is aired.¹⁵² The final restriction requires the issuer or underwriter hosting the road show to take "reasonable steps" to ensure that information presented in the road show is not inconsistent with that contained in its prospectus.¹⁵³ If the issuer or underwriter complies with these restrictions, the road show transmission will not be viewed as a form of prospectus with regard to a registered offering nor as a general solicitation in the case of a private offering.

With advances in technology, the SEC has suggested a move away from its traditional rulemaking. In a recent no-action letter, the SEC staff granted relief to NetRoadshow which sought to transmit a road show presentation on the Internet to *accredited investors* who would customarily attend a live presentation, instead of permitting access solely to institutional investors.¹⁵⁴ In *Aircraft Carrier*, the SEC has further

and a log is kept of investors. Moreover, investors may view the transmissions one day only. *See id.*

¹⁵¹ *See* Net Roadshow, Inc., 1997 SEC No-Act. LEXIS 864, at *5. After registration, the road show may be transmitted over the Internet on a live or delayed basis. *See id.* at *6-*7.

¹⁵² *See* Private Financial Network, 1997 SEC No-Act. LEXIS 406, at *7. If the road show is transmitted during the waiting period, a subscriber must receive a section 10(b) preliminary prospectus (red herring); if the road show is transmitted after the effective date, a subscriber must receive a section 10(a) statutory prospectus. *See id.* Subsequent no-action letters permit investors to receive the requisite prospectus either before the road show or *during* the road show. *See* Net Roadshow Inc., 1997 SEC No-Act. LEXIS 864, at *7. To receive the prospectus during the electronic road show, a "large and obvious button" for the preliminary prospectus is placed on the bottom of the computer screen. *Id.* By clicking on the button, an investor can view the prospectus online, or download it to his or her computer screen. *See id.* However, the button must be displayed throughout the road show. *See id.*

¹⁵³ Private Financial Network, 1997 SEC No-Act. LEXIS 406, at *6. However, the issuer or underwriter can edit out dead time, misstatements or mistakes contained in the road show transmission. *See* Net Roadshow Inc., 1997 SEC No-Act. LEXIS 864, at *7 n.1. In addition, if the road show is transmitted on a live basis, subscribers can submit questions through their e-mail to representatives at the show. *See* Bloomberg L.P., 1997 SEC No-Action Letter 1023, at *6.

¹⁵⁴ Allyson Vaughan, *Firm Gets Approval From SEC to Include Individuals in Virtual Roadshows*, 25 CORP. FINANCING WEEK 6, Feb. 8, 1999, at 1 (according to the article, the SEC staff's oral no-action relief to NetRoadshow was driven by the evolving sophistication of the market and the benefits to investors from increasing

proposed to make road shows available online to *all* investors without restriction.¹⁵⁵ Consequently, issuers would no longer have to implement a password-protection system on a web site in order to restrict the audience to qualified investors.

The SEC has also proposed to eliminate other restrictions on road shows, as part of Aircraft Carrier's freer communications scheme. For example, road show transmissions of registered offerings today may only be viewed during the waiting period because even oral communications may be deemed an offer to sell during the pre-filing period.¹⁵⁶ In addition, a prospectus and a Rule 134 Notice are currently the exclusive written documents permitted to solicit interest from investors during the waiting period.¹⁵⁷ Instead of limiting when and how an issuer can conduct a road show on the Internet, Aircraft Carrier would permit what the SEC calls "free writing" before and during the waiting period.¹⁵⁸ Under such a scheme, certain issuers would be permitted to air road show transmissions before they file a registration statement with the SEC, while any materials used during the road show, other than a prospectus, would not constitute a transmission of a prospectus in contravention of section 5 of the Securities Act.¹⁵⁹ However, an issuer would have to file all free written materials available at the road show presentation with the SEC as part of the issuer's registration statement. Therefore, an issuer would be subject to additional liability for any false statements or omissions contained in the written road show materials.¹⁶⁰

access to road show presentations); *see also supra* Part I.B.4. (discussing Regulation D and defining accredited investors).

¹⁵⁵ *See* Aircraft Carrier Release, *supra* note 5, at 67,215 & n.313 (in an effort to make information available to issuers earlier on in the investment decision process and because the Internet may permit transmission of a road show on a real-time basis to the investing public, the SEC proposes to allow road show transmissions to be viewed by all investors).

¹⁵⁶ *See supra* notes 147-148.

¹⁵⁷ *See also supra* note 25 (discussing tombstone advertisements).

¹⁵⁸ Aircraft Carrier Release, *supra* note 5, at 67,215; *see also supra* note 24 (defining "free writing materials").

¹⁵⁹ *See* Aircraft Carrier Release, *supra* note 5, at 67,215 & n.312.

¹⁶⁰ *See id.* (free writing would be subject to the liability provisions of section 12(a)(2) of the Securities Act). Although oral communications during the road show would not have to be filed, the requirement of filing all written materials may have the opposite effect than the SEC intends. *See, e.g.,* Linda C. Quinn and Otilie L. Jarmel, *SEC Communications Initiative: Welcome Reform or Regulatory Retrenchment?*, 13 *INSIGHTS* 1, at 15 (Jan. 1999).

Although Aircraft Carrier proposes to eliminate some of the current restrictions on Internet road shows for registered offerings, the SEC failed to clarify whether private offering road show presentations would receive similar treatment. Thus, even under Aircraft Carrier, an issuer or underwriter would violate the general solicitation ban in a private offering if they allowed the general public to view their online road show presentation.¹⁶¹ Nevertheless, Aircraft Carrier would significantly alter the SEC's existing guidance on Internet road show transmissions for registered offerings.

4. Blue Sky Laws

In addition to complying with federal securities laws pursuant to the Securities Act, issuers must comply with state securities regulations, known as blue sky laws.¹⁶² Most blue sky laws require an issuer to register its offering with state securities regulators or else claim an exemption from state regulation whenever the security is offered or sold to state residents.¹⁶³ This broad regulatory ability, however, has caused concern with regard to offerings on the Internet, where simply placing offering materials on an Internet web site could be deemed an offer to state residents in every jurisdiction.¹⁶⁴ Thus, many states have developed criteria to determine when an offering over the Internet is subject to a state's securities laws.

The most significant state development comes from the Pennsylvania Securities Commission ("PSC").¹⁶⁵ Under a pro-

¹⁶¹ See Aircraft Carrier Release, *supra* note 5, at 67,213 n.297.

¹⁶² Blue sky laws are a "popular name for state statutes" that govern registration and disclosure of securities offerings in a particular state. See BLACK'S LAW DICTIONARY 173 (6th ed. 1990). Most blue sky laws are based upon the Uniform Securities Act of 1956, adopted by thirty nine states. See UNIF. SEC. ACT § 410 (1956). *But see* JENNINGS, *supra* note 61, at 108 (New York and California have not adopted either the Uniform Securities Act or the Revised Uniform Securities Act; in addition, enforcement practices as well as statute requirements in states vary significantly).

¹⁶³ See K. Robert Bertram, *Offers and Sales of Securities on the Internet: State Registration and Enforcement Issues*, WALLSTREETLAWYER.COM, July 1997, at 14.

¹⁶⁴ See McGlosson, *supra* note 100, at 309-10.

¹⁶⁵ See Pennsylvania Securities Commission, *In Re Offers (But Not Sales) Effected Through the Internet That Do Not Result in Sales in Pennsylvania* (visited Jan. 27, 1999) <http://www.state.pa.us/PA_Exec/Securities/corpfm/interord.html>.

posal by the PSC, an issuer offering its securities on the Internet is not required to register its offering with the PSC if (1) the issuer places language in its offering materials that clearly states that the securities are not intended for Pennsylvania residents; (2) an issuer has no direct communications with state residents concerning the offering, for instance, an issuer cannot respond if a resident contacts them about the offering; and (3) the issuer does not sell its securities to state residents.¹⁶⁶ Following Pennsylvania's lead, the North American Securities Administrators Association ("NASAA") has encouraged states to adopt similar provisions as those contained in the PSC proposal.¹⁶⁷ Today, twenty-nine states have adopted such provisions, thus giving issuers an exemption from state registration when they comply.¹⁶⁸

The SEC has generally supported state rules governing Internet offerings, seeking to create uniformity among both federal and state regulatory systems.¹⁶⁹ However in 1996, Congress passed the National Securities Markets Improvement Act ("NSMIA").¹⁷⁰ NSMIA was designed to have a direct effect on a state's ability to regulate and control the sale of certain securities offerings within the state.¹⁷¹ In effect, NSMIA gives the SEC the authority to preempt state regulation of securities whenever the security offered falls under those "covered," as defined in the Act.¹⁷² Securities covered include

¹⁶⁶ See *id.*; see also Bruce Rule, *State Regulators Wrestle with Internet Issues; More Cooperation may be on the Horizon*, INV. DEALERS' DIG., Oct. 21, 1996, at 8.

¹⁶⁷ See *NASAA Internet Resolution* (visited July 21, 1998) <<http://www.nasaa.org/bluesky/guidelines/resolu.html>>.

¹⁶⁸ See *id.* In addition, 15 states, including New York and California have indicated that they will adopt the NASAA Internet Resolution sometime in the future, while 4 states have not indicated either way. See *id.*

¹⁶⁹ See *Wallman Urges Consideration of Offerings Published on Internet*, 28 SEC. REG. & L. REP. 43, at 1337 (Nov. 1, 1996) (the SEC looked to Pennsylvania's proposal for a framework on which to base its guidelines for Internet offerings placed offshore); see also Annual Conference on Uniformity of Securities Law, Exchange Act Release No. 33-7277, 61 Fed. Reg. 15,847, 15,848 (Apr. 9, 1996) (stating that there is a need to improve cooperation among regulatory bodies in electronic offerings so that capital formation is made easier while investor protections are retained).

¹⁷⁰ 15 U.S.C. § 78a (1994) [hereinafter NSMIA].

¹⁷¹ See 15 U.S.C. § 77r (1996) (listing exemptions from state regulation of certain securities offerings). Before adoption of NSMIA, the Securities Act of 1933 did not preempt state blue sky laws. With the adoption of NSMIA, section 18 of the Act was amended to partially preempt state blue sky laws.

¹⁷² *Id.* § 77r(a)(1)(A)-(B). State anti-fraud provisions, however, still remain in

those offered on an exchange, issued by an investment company, sold to qualified purchasers, certain exempt securities under the Securities Act, as well as any other class of securities that the SEC deems to be exempt.¹⁷³ Most securities offered or sold in transactions exempt from registration under the Securities Act, however, are *not* exempt from state regulation under NSMIA, including Regulation A, Rule 147, and Rule 504 offerings.¹⁷⁴ Except for private offerings, issuers seeking to conduct an exempt public offering under the Securities Act on the Internet must still comply with each individual state's securities laws.¹⁷⁵ Blue sky laws thus remain a significant deterrent for companies seeking to conduct certain exempt offerings on the Internet.

In lieu of an exemption under NSMIA, issuers may seek to qualify their offering for exempt status under state blue sky laws. For example, the majority of states have adopted the SCOR form for offerings up to \$1 million.¹⁷⁶ In addition, a majority of blue sky laws permit an exemption from registration if the offering qualifies as a "small offering," that is, an

effect. *See id.* § 77r(c). In addition, states may still require issuers to file documents required by the SEC with state securities commissioners and charge a filing fee. *See id.*

¹⁷³ *See id.* § 77r(b)(1)-(4).

¹⁷⁴ *See* 15 U.S.C. § 77r(b)(1)-(4). Among the few exceptions, Rule 505 offerings are specifically covered by NSMIA because they are exempt from federal registration pursuant to section 4(2) of the Securities Act. *See id.* § 77r(b)(4)(D). Although registered securities are covered, some commentators suggest that registered offerings are essentially unaffected by NSMIA since most registered offerings already qualified for an exemption under most state blue sky laws before NSMIA was enacted. *See generally* Douglas J. Dorsch, *The National Securities Market Improvement Act: How Improved is the Securities Market?*, 36 DUQ. L. REV. 365 (Winter 1998).

¹⁷⁵ For example, Spring Street's Internet offering was registered in 18 states and the District of Columbia. *See also* McGlosson, *supra* note 100, at 306 (a 50-state securities offering is not only expensive, but can be a "daunting" task).

¹⁷⁶ *See* Small Corporate Offering Registration Form (Form U-7), 34 NASAA Rep (CCH) ¶¶ 5057, 5197 (July 1989); Small Corporate Offering Registration Program and Form U-7, 1 Blue Sky L. Rep. (CCH) ¶ 6461, at 2557 (Dec. 1996) (forty-three states have adopted the SCOR form); *see also supra* notes 48-54 (discussing Rule 504 of Regulation D). The SCOR form was devised by NASAA (North American Securities Administrators Association) and the American Bar Association (ABA) for small businesses to take advantage of Rule 504. *See* Roberta Reynes, *Financing for Do-It-Yourselfers*, NATION'S BUS., May 1998, at 38. The number of SCORs have risen steadily, from 6 in 1990 to 126 in 1997. *See id.* Today, all but four states allow an issuer to use a SCOR form. *See id.*

offering with a restricted number of investors and limitations on the resale of the securities.¹⁷⁷ Finally, a majority of states have adopted a Uniform Limited Offering Exemption ("ULOE").¹⁷⁸ However, these coordinated efforts do not provide sufficient assurance to an issuer conducting an offering over the Internet, since the rules vary in each state and an issuer runs the risk of failing to qualify for an exemption in one or several states.¹⁷⁹ Unless all states follow Pennsylvania's lead and adopt a uniform policy for offerings on the Internet, the impact of blue sky laws on such offerings—especially securities offered pursuant to an exemption under the Securities Act—will remain unclear.

Offshore securities offerings conducted on the Internet are another area of concern, not only for federal securities regulators, but for state securities regulators as well.¹⁸⁰ Unlike domestic offerings, securities offered on an international level create additional regulatory hurdles for issuers.¹⁸¹ Issuers must not only comply with multiple foreign regulations in an offshore offering, but they may also be subject to state regulation when the securities are sold to residents within that state.¹⁸² For example, in 1997, the Ohio Securities Commission issued a cease and desist order against a foreign issuer that had made its securities available to Ohio residents on the Internet without registering its offering in Ohio.¹⁸³ Although

¹⁷⁷ See Rutheford B. Campbell, Jr., *Blue Sky Laws and the Recent Congressional Preemption Failure*, 22 IOWA J. CORP. L. 175 (1997).

¹⁷⁸ See Uniform Limited Offering Exemption, 20 NASAA Rep. (CCH) ¶ 6201 (May 1989).

¹⁷⁹ See Campbell, *supra* note 177.

¹⁸⁰ See Wallman *Urges Consideration of Offerings Published on Internet*, 28 SEC. REG. & L. REP. at 1337-38 (describing Pennsylvania's view of offshore securities offerings).

¹⁸¹ See *infra* Part II.B. (discussing offshore securities offerings made available on the Internet).

¹⁸² See *id.*

¹⁸³ See *In re Kevin G. Duffy*, No. 97-259, 1997 Oh. Sec. LEXIS 213 (Dep't of Commerce July 10, 1997) (Division Order; Cease and Desist Order). Gaming World, located and doing business in Antigua, West Indies, had offered its shares in a direct public offering from the company's web site. The Ohio Division held that the language contained in the offering materials permitted Ohio residents to access the company's prospectus and subscription agreement, thus violating Ohio law which prohibits sales to residents in Ohio of non-exempt securities. See *id.*

regulatory action by state securities commissions against foreign issuers may have come to an end following the SEC's March Interpretive Release, the issue remains unclear.¹⁸⁴

5. Web Site Maintenance During an IPO

As more investors use the Internet, many companies have begun to use their corporate web sites as a medium to supplement traditional investor relations.¹⁸⁵ For example, a company may place textual materials about the company on its web site, such as research reports or factual information about the company's business operations and products, as well as hyperlinks that can connect investors directly to relevant third party web sites.¹⁸⁶ Once the company is involved in a securities offering, however, there is some uncertainty as to whether the company has a duty to remove such information or hyperlinks from its web site.¹⁸⁷ Because the SEC has not yet addressed this issue in an interpretive release, there is particular concern that, during the waiting period, the information available on an issuer's web site may impermissibly condition the market in violation of section 5(b)(1) of the Securities Act.¹⁸⁸ In addition, while issuers receive a safe harbor for oral

¹⁸⁴ See *infra* Part II.B.2. (discussing the SEC's regulation of offshore offerings and offerings by foreign issuers). It is unclear whether the SEC guidelines on offshore securities offerings will pre-empt state guidelines, or if states will continue to take enforcement action against foreign issuers that violate state securities laws.

¹⁸⁵ See generally Lisa Klein Wager, *Safe Harbors in Cyberspace*, N.Y. L.J., Aug. 20, 1998, at 3. For example, a company may place information on its web site that it customarily would provide through the mail, or else that an investor would acquire through a third party.

¹⁸⁶ See generally Linda C. Quinn & Otilie L. Jarmel, *Securities Regulation and the Use of Electronic Media*, in *SECURITIES LAW AND THE INTERNET: DOING BUSINESS IN A RAPIDLY CHANGING MARKETPLACE*, at 869 (PLI Corp. Law Practice Series No. 1046, 1998) (discussing issues that require the SEC's guidance); *SECURITIES REGULATION IN CYBERSPACE 3-1-3-40* (1998) [hereinafter *SECURITIES REGULATION*].

¹⁸⁷ See Laura S. Unger, *The "Aircraft Carrier": Technological Implications and Unresolved Issues*, 13 *INSIGHTS* 1, at 32 (Jan. 1999) (discussing concerns raised from placing hyperlinks on an issuer's web site, including the possibility that an investor may infer that the issuer has adopted or approved the linked information); Quinn & Jarmel, *supra* note 186, at 869-93. *But see* October 1995 Interpretive Release, *supra* note 91, at 53,458-59 (the SEC promises that it will issue guidelines to assist issuers in managing the content of their web sites).

¹⁸⁸ See 15 U.S.C. § 77e(b) (1994); *see also* Quinn & Jarmel, *supra* note 186, at

statements made during the waiting period, such a safe harbor may be lost if, for example, a speech by the company's CEO is converted into a written statement that is made available on the company's web page.¹⁸⁹ Moreover, if information on the issuer's web site is deemed to be part of its registration statement, such information may be subject to the liability provisions of section 11 of the Securities Act.¹⁹⁰

The SEC has attempted to clarify the acceptability of these practices on several occasions. One example is the safe harbor that the SEC staff has granted to issuers when they refer to their corporate web sites in their registration statements. When companies offer their securities on the Internet they typically place their preliminary prospectuses on their corporate web sites (as well as on various third party sites). Therefore, many issuers also place a statement in their registration statements informing investors that their SEC filings are available for downloading or viewing from their web sites. The issue that arises from such a practice is whether reference to an issuer's web site in its registration statement would incorporate not just the prospectus, but all of the textual information and hyperlinks available on its web site, thereby subjecting the entire site to the liability provisions of section 11 of the Securities Act.¹⁹¹ Moreover, the reference may impermissibly condition the market in contravention of section 5(b)(1) of the Securities Act which permits an issuer, underwriter or broker to make a written offer to an investor only through a preliminary prospectus.¹⁹² A qualifying tombstone advertisement is also permitted because under the safe harbor of Rule 134 it is not considered an offer to sell nor a solicitation of an offer to buy.¹⁹³ Consequently, any information contained on the issuer's web site that is not a qualifying prospectus or a Rule 134 communication would contravene section 5(b)(1).

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¹⁸⁹ See Wager, *supra* note 185, at 4-5.

¹⁹⁰ See 15 U.S.C. § 77k (under section 11 of the Securities Act, an issuer has absolute liability for misstatements or omissions appearing in their registration materials).

¹⁹¹ See *id.*

¹⁹² See *id.* § 77e(b).

¹⁹³ See 15 U.S.C. § 77b(10)(b) (1996); 17 C.F.R. § 230.134 (1999); see also *supra* note 25 and accompanying text.

In two no-action letters, the SEC staff expressly permitted reference to an issuer's web site and a statement in the issuer's registration statement informing investors that the company's SEC filings are also available for downloading and viewing from its corporate web site.¹⁹⁴ The SEC maintained that simply identifying a company's web site in its registration statement did not incorporate all information hyperlinked or otherwise available on the site into its registration statement.¹⁹⁵ Consequently, only the information contained in the registration statement would be subject to the liability provisions of section 11.¹⁹⁶ The SEC staff's response, however, did not explicitly confirm that the availability of the textual materials and hyperlinks on the company's web site would be permissible under section 5(b)(1) of the Securities Act.¹⁹⁷ Nevertheless, the staff did recognize that a web site can contain different kinds of information. While there is potentially an infinite amount of information available on a web site, an issuer may only intend to refer to some information, i.e., to an issuer's preliminary prospectus. As a result, an issuer may be able to post information on its web site in such a manner that an investor can easily distinguish between information intended for a securities offering and other information that may be relevant to the company but is not part of such an offering. The SEC staff's no-action letter to Wit Capital supports this proposition.¹⁹⁸

¹⁹⁴ See generally Baltimore Gas & Electric Co., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 14 (Jan. 6, 1997); ITT Corp., SEC No-Action Letter, 1996 SEC No-Act. LEXIS 895, at *1-*4 (Dec. 6, 1996).

¹⁹⁵ See ITT Corp., 1996 SEC No-Act. LEXIS 895, at *1.

¹⁹⁶ Many companies, nevertheless, are cautious about such a practice. See Judith Burns, *E-Commerce: Companies Try to Avoid SEC Web Site Proposal*, NEWSDAY, Jan. 18, 1999, at C7 (a prospectus containing the issuer's web site address draws unnecessary attention to the company's web site; moreover, under current practices, most web sites receive only a quick review for gun-jumping or other violations of the Securities Act).

¹⁹⁷ But see Aircraft Carrier Release, *supra* note 5, at 67,216. See Quinn & Jarmel, *supra* note 186, at 902, 903 n.17 (if an investor visits the web site independently, the SEC also has not passed on whether other information available on the corporation's web site would then be considered a corporate communication on which an investment decision can be based).

¹⁹⁸ See generally Wit Capital Corp., SEC No-Action Letter, 1999 SEC No-Act. LEXIS 620 (July 14, 1999).

In the Wit Capital letter, the SEC staff did not recommend enforcement action against Wit Capital for placing information relating to an issuer's IPO in certain *segregated areas* of Wit Capital's web site, including a Rule 134 notice, a prospectus, as well as other web pages relating to the offering or Wit Capital's procedures and rules.¹⁹⁹ Wit Capital could also include a hyperlink to a "gateway page" for an initial public offering that lists the basic information permitted under Rule 134, as well as hyperlinks to open a new account, place a conditional offer, and to link to an issuer's preliminary prospectus.²⁰⁰ Although the implications of the Wit Capital letter are significant for issuers, underwriters and broker-dealers, the SEC staff expressly did not address whether other material on Wit Capital's web site may constitute unlawful offering material, nor whether the segregated IPO web pages were sufficiently distinguishable from the company's general web page.²⁰¹ Moreover, the SEC staff notes that the Wit Capital no-action response could be re-evaluated or changed in the future.²⁰²

The SEC also continues to prohibit an issuer from simultaneously placing on its web site both a prospectus and a hyperlink that provides direct access to a particular research report about the issuer.²⁰³ Some commentators have suggest-

¹⁹⁹ See *id.* at *10-*11.

²⁰⁰ See *id.* at *11-*12.

²⁰¹ See *id.* at *2-*3.

²⁰² See *id.* at *4; see also Aircraft Carrier Release, *supra* note 5, at 67,213 (the fact that Aircraft Carrier would expressly prohibit certain free writing materials on an issuer's web site once the offering period begins, including any factual information about the company and certain forward-looking information, may further undermine the significance of the Wit Capital letter for other similarly situated underwriters, brokers and issuers).

²⁰³ See October 1995 Interpretive Release, *supra* note 91, at 53,463. Example number 16 provides:

Company XYZ places a preliminary prospectus on its Internet Web site and provides direct access via a hyperlink to a research report on the Company written by ABC Corporation, a registered brokerage firm. The investor reviewing the preliminary prospectus can click on a box marked "ABC's research report" and the investor will be linked to the brokerage firm's Web site where the research report is available

. . . This direct and quick access to ABC's research report would be similar to the Company including the paper version of the research report in the same envelope that it is using to mail the paper version of the preliminary prospectus to potential investors [T]herefore, its use of the research report under these circumstances would not be permissible.

ed that it may be permissible for an issuer to list on its web site *all* analysts' reports that cover the company's securities, as long as the list is complete and in alphabetical order.²⁰⁴ Aircraft Carrier implicitly confirms the acceptability of this practice by seeking to increase the flow of information to investors around the time of the offering. For example, Aircraft Carrier would grant several safe harbors to analysts who customarily provide information about the particular issuer, around the time of an offering.²⁰⁵ The provision of a list of all research analysts' reports on a company's web site is not explicitly permitted under the Proposal. However, the prohibition of such a list would hinder an investor's ability to review all available information about the issuer, and thus defeat the SEC's goal of increasing communications to investors.

Until more definitive guidelines are issued, most practitioners agree that during an offering issuers must exercise caution by actively reviewing any information that may be available to investors on their web pages, including eliminating any hyperlinks to an individual research analyst report about the company.²⁰⁶

B. *International Regulation*

While domestic issuers must adhere to regulations on both a federal and state level, the international regulatory environment adds another element of uncertainty.²⁰⁷ Of foremost concern is that the Internet lacks a single regulatory body and

Id.

²⁰⁴ See *Avoiding Spiders on the Web: Rules of Thumb for Issuers Using Web Sites and E-Mail* (visited Aug. 11, 1997) <<http://www.ffhsj.com>>. By listing all investors that cover the company, the issuer arguably is not endorsing any particular research report; especially one that reports favorably on the issuer. See *id.*

²⁰⁵ See Aircraft Carrier Release, *supra* note 5, at 67,216-22 (discussing Proposed Rule 137, 17 C.F.R. § 230.137; Rule 138, 17 C.F.R. § 230.138; and Rule 139, 17 C.F.R. § 230.139).

²⁰⁶ See SECURITIES REGULATION, *supra* note 186, at 3-25-3-28; see also Wit Capital Corp., 1999 SEC No-Act. LEXIS 620, at *3 ("We do not address Wit Capital's responsibilities under federal securities laws to cleanse (or otherwise modify) its general website of any information that could be deemed illegally to condition the market for a particular IPO security.")

²⁰⁷ See, e.g., Sarah Hewitt & Gerard R. Boyce, *Use of Internet Web Sites In Offshore Offerings*, N.Y. L.J., May 14, 1998, at 5. See also SEC Technology Report, *supra* note 90, at 59.

therefore an offering on the Internet to residents in one country may inadvertently be subject to the regulations of any nation that determines that the offering comes under its securities laws.²⁰⁸

Unlike a domestic offering, an issuer in an offshore offering has registered to sell its securities in one or more foreign jurisdictions, but not to domestic investors.²⁰⁹ The Internet complicates matters because it has no geographic or political boundaries. Therefore, if offering materials are posted on an issuer's web site, the materials are available to domestic investors as well.²¹⁰ The question then is, under what circumstances should a nation claim jurisdiction over an offering made available on an Internet web site?

1. Cooperative Efforts

Since 1974, the International Organization of Securities Commissions ("IOSCO") has sought to encourage cooperation among securities commissions around the world to "unite their efforts to establish standards and an effective surveillance of international securities transactions."²¹¹ With the growth of the Internet, IOSCO has encouraged regulators to recognize the Internet's usefulness in disseminating information about securities to a global audience in a quick and accurate manner and in providing up-to-date information to individual investors who may otherwise lack access to such information.²¹² IOSCO, however, has no authority to issue binding uniform regulations, including regulations governing Internet offerings and instead encourages national regulators to establish their own individual standards.²¹³ At least three securities com-

²⁰⁸ See Hewitt & Boyce, *supra* note 207, at 5 (a transmission across the Internet is "almost entirely independent of physical location").

²⁰⁹ See Hewitt & Boyce, *supra* note 207, at 5.

²¹⁰ See Hewitt & Boyce, *supra* note 207, at 5.

²¹¹ IOSCO, *Objectives and Principles of Securities Regulation* (last modified Sept. 19, 1998) <<http://www.iosco.org/docs-public/1998-objectives.html>>.

²¹² See *An IOSCO Public Document: Report on Enforcement Issues Raised by the Increasing Use of Electronic Networks in the Securities and Futures Field* (Sept. 9, 1997) <http://www.iosco.org/docs-public/1997-report_on_enforcement_issues.html>, at 3.

²¹³ See *An IOSCO Public Document: Securities Activity on the Internet* (last modified Oct. 10, 1998) <http://www.iosco.org/docs-public/1998-internet_security-

missions thus far have released guidelines on securities offerings available on an Internet web site, namely, the securities commissions of the United States, the United Kingdom, and Australia. Although the guidelines share many similarities, they are nonetheless based on three different securities systems. As a result, there are marked differences in how an issuer must set up its Internet web site to avoid being subject to the securities laws of any one nation.

2. United States

In 1998, the SEC issued an interpretive release to clarify when an issuer "may use Internet web sites to solicit offshore securities transactions and clients without the securities . . . being registered with the Commission under the Securities Act of 1933."²¹⁴ Before the SEC Internet Release was issued, foreign and domestic issuers relied exclusively on Regulation S when conducting an offshore placement of securities.²¹⁵ Under Regulation S, an issuer does not have to register its offering unless the offering materials are "made available" to U.S. investors.²¹⁶ Under Regulation S, placing offerings materials on a web site offshore resulted in such materials being made available to U.S. investors.²¹⁷

The SEC Internet Release eliminates such a result. Instead, an issuer can avoid having to register its securities with the SEC by complying with various guidelines so that the Internet offer, solicitation or other communication is not "*targeted at the United States*".²¹⁸ The Release only pertains to

document02.html> ("It is not the role of IOSCO . . . to provide legal interpretations or set universal standards with respect to the use of the Internet . . .").

²¹⁴ Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Service Offshore, Exchange Act Release No. 33-7516, 63 Fed. Reg. 14,806, 14,806, (Mar. 27, 1998) [hereinafter SEC Internet Release] (citations omitted).

²¹⁵ See Regulation S - Rules Governing Offers and Sales Made Outside the United States Without Registration Under the Securities Act of 1933, 17 C.F.R. §§ 230.901-230.904 (1999).

²¹⁶ *Id.*

²¹⁷ *See id.*

²¹⁸ SEC Internet Release, *supra* note 214, at 14,808 (emphasis added). In general, an offshore offering through the Internet would not be deemed to target U.S. investors if the issuer implements measures that are "reasonably designed to guard against sales to U.S. persons." *Id.* Internet offers that are "targeted at the

communications that are made to investors through an Internet website; "more targeted" methods of communication, such as e-mail, are strictly prohibited and constitute targeted selling efforts to U.S. investors.²¹⁹ The Release also makes an important distinction between securities offered by foreign versus domestic issuers. Unlike foreign issuers, U.S. issuers must undertake "more restrictive measures" if they use the Internet to make an offering offshore.²²⁰

A foreign issuer can avoid the registration requirements of the U.S. securities laws by placing a prominent disclaimer on its web site which clearly states that the securities offering is being directed to countries other than the United States.²²¹ The disclaimer should, at a minimum, indicate a particular region or country at which the securities are targeted.²²² Issuers should also make every effort to obtain information about the residence of a prospective purchaser to better guard against sales to U.S. investors.²²³ Even if a foreign issuer satisfies both of these conditions, however, the content of an issuer's web site may still indicate that the offer is being targeted at U.S. investors.²²⁴

United States" refer to offers targeted at any U.S. resident, regardless of whether the person is located outside of the United States. *Id.* Importantly, the March 1998 Interpretive Release does not replace Regulation S, but works with it in tandem. As the SEC stated in the Release, "[if] the offering is made pursuant to Regulation S, the offering must comply with all of the applicable requirements under [Regulation S], including the requirement that all offers and sales be made in [an] 'offshore transaction[.]'" *Id.* at 14,809 (citation omitted).

²¹⁹ *Id.* at 14,807. E-mail is distinguished, however, from Internet search engines (e.g., Infoseek, Excite, or Yahoo!). Issuers that register their Internet web site with search engines may use "tags" that categorize the site as relating to investments or securities, without transforming the site into a "targeted" communication. The SEC permits the use of tags in order to facilitate investor searches over the Internet. *See* SEC Internet Release, *supra* note 214, at 14,807.

²²⁰ *Id.* at 14,807, 14,810 (additional precautions are justified: because of a domestic company's substantial contacts with the United States, the securities offered offshore will most likely enter into U.S. trading markets, and issuers and investors in the United States expect that securities offerings by domestic companies will be regulated under U.S. securities laws).

²²¹ *See id.*

²²² *See id.* at 14,808.

²²³ This may include the prospective purchaser's address and telephone number. *See id.*

²²⁴ For example, if an issuer places a statement on its web site indicating that the offshore offering can assist U.S. investors by avoiding U.S. income taxes, the offering would be considered targeting U.S. investors. *See* SEC Internet Release,

U.S. domestic issuers must further limit access to offering materials on their web site by implementing a password-protection system.²²⁵ Under such a system, only investors who provide sufficient information indicating that they are not U.S. residents are provided with a password to access the offering materials on the web site.²²⁶ Third-party web sites are subject to similar requirements.²²⁷ A third party who hosts a web site containing a hyperlink to an issuer's offering materials is also required to implement a password-type system.²²⁸

3. United Kingdom

The Financial Services Authority ("FSA") of the United Kingdom published a Release on the *Treatment of Material on Overseas Internet World Wide Web Sites Accessible in the UK but Not Intended for Investors in the UK*.²²⁹ In this Release, the FSA considers when offering materials placed on an Internet web site would violate the advertising provisions of the Financial Services Act of 1986.²³⁰ A violation occurs, and thus an issuer must register its offering with the FSA, if the

supra note 214, at 14,808. However, the same would not be true merely because the offering is posted in English. *See id.*

²²⁵ *See id.* at 14,810. Arguably, a foreign issuer should also be required to implement a password-protection system. Without such a requirement, a foreign issuer need only place a disclaimer statement on its web site, and check the residence information of an investor to avoid U.S. registration requirements. Compare the regulations of Australia and the United Kingdom. *See infra* notes 228 and 249 (requirement of password-protection would apply to foreign and domestic issuers uniformly).

²²⁶ *See* SEC Internet Release, *supra* note 214, at 14,810.

²²⁷ *See id.* at 14,809. Third party web sites include search engines such as Yahoo! or Excite, or another company's web site including the underwriter responsible for the securities offering.

²²⁸ *See id.* A password-protection system should also be used when many U.S. investors can view the offering materials. *See id.*

²²⁹ (Sept. 1998) <<http://www.fsa.gov.uk/pubs/guide.htm#1998>>, at 2 [hereinafter UK Internet Proposal]; *see also* McLaughlin, *supra* note 6, at 12 (noting that unlike the SEC Internet Release, the UK Internet Proposal has no legal effect: "This statement is an expression of the enforcement policy of the FSA, and as such, does not bind any Court or any other body . . .").

²³⁰ *See* UK Internet Proposal, *supra* note 229, at 2-3 (under section 57(1) of the Financial Services Act of 1986 ("1986 Act"), advertisements of securities offerings that are issued in the UK must be issued or approved by someone that takes regulatory responsibility for the content of the materials under the Act, unless an exemption applies under section 58 of the Act).

securities offering is deemed "an investment advertisement" under section 57(2) of the 1986 Act.²³¹ An offering by a domestic issuer is subject to the UK's jurisdiction if the investment advertisement is accessible by a UK person via his or her computer.²³² However, if the advertisement has been issued *outside of* the UK, the investment advertisement must either be "directed at" or "made available" to UK persons.²³³

An investment advertisement will not be deemed to be "made available" to UK persons if, as with the SEC guidelines, an issuer places a disclaimer on its web site stating that its offering materials are not aimed at UK persons.²³⁴ In addition, an issuer should take "positive steps" to limit access to its web site, such as employing a system to ascertain the country of origin of prospective investors.²³⁵ Unlike SEC guidance, however, an Internet offering is deemed to be made available to UK investors if the offering materials are placed on a particular server or if the issuer uses local media such as trade journals or magazines to advertise the offering to UK investors.²³⁶

Whether an investment advertisement is specifically "directed at" UK investors depends on several other factors. For example, the content of an issuer's web site should be written in a manner that would not be of significant interest to a UK person.²³⁷ In promoting the site, an issuer must also avoid

²³¹ *Id.*

²³² *See id.* at 3.

²³³ *Id.*; *cf. supra* note 218 (offerings that are "targeted at" U.S. investors fall within the SEC's jurisdiction). Advertisements published in periodical publications, including a sound or television broadcast outside of the UK are excluded as "investment advertisements." But the FSA does not consider Internet materials to be either a "sound or television broadcast," and thus advertisements on the Internet are subject to the UK securities laws. UK Internet Proposal, *supra* note 229, at 3.

²³⁴ *See* UK Internet Proposal, *supra* note 229, at 6 (an issuer may also indicate the particular jurisdictions where the offering is aimed). Visitors should be able to view the disclaimers on the site in the same browser format as the rest of the site. *See id.*

²³⁵ *See id.* at 5-6. An ineffective system, for example, is one that permits a visitor to enter the site by "clicking" on a box indicating that he or she is not from the UK. *See id.* at 6 n.7. A better system would employ a pre-registration process and issue passwords to investors—similar to the system suggested by the SEC. *See id.*

²³⁶ *See* UK Internet Proposal, *supra* note 229, at 6 n.7.

²³⁷ *See id.* at 6. For instance, financial projections should be given in a currency other than pounds sterling, and the UK should not be listed in a country of origin

notifying UK search engines or UK sections of a search engine about the existence of its web site.²³⁸ Finally, if the issuer has established a newsgroup or bulletin board that is associated with the web site, including any hyperlink set up to promote the investment or unsolicited e-mails regarding the offering, the issuer's Internet offering would also be considered directed at UK investors.²³⁹

4. Australia

In September 1998, the Australian Securities and Investments Commission ("ASIC") published guidelines on *Offers, Invitations and Advertisements of Securities on the Internet*.²⁴⁰ An offer or invitation to an investor is made in Australia if it is "received" in Australia.²⁴¹ Therefore, Australian law may apply to an offer of securities on an Internet web site that is accessible from Australia "irrespective of where the offeror is located."²⁴²

As with SEC and FSA guidance, offering materials must contain meaningful "jurisdictional disclaimers" in order to avoid having to register an issuer's offering with the ASIC.²⁴³ The disclaimer "must clearly indicate" that the securities are not available to Australian persons.²⁴⁴ In addition, the disclaimer statement must be viewed either with the offering materials or before the investor can view the offering materials, so that Australian investors are aware that they may not

"drop down box" option on the web site. *Id.*

²³⁸ *See id.*

²³⁹ *See id.* at 7; *cf. supra* note 219 (while unsolicited e-mails regarding the offering would be a targeted communication under the U.S. guidelines, Internet search engine "tags" are expressly permitted).

²⁴⁰ *ASIC Policy Proposal* (ASIC Sept. 1998) (on file with the *Brooklyn Law Review*).

²⁴¹ *Id.* at 8.

²⁴² *Id.*

²⁴³ *Id.* at 6, 9-11.

²⁴⁴ *Id.* at 6, 11. For example, an issuer can list the individual countries where the security is being offered or else declare that the securities are not available to Australian residents. *See ASIC Policy Proposal, supra* note 240, at 6, 11. A statement that "the offer is not being made in any jurisdiction in which the offer could or would be illegal" does not, however, clearly indicate the jurisdictions in which the securities are available, and thus would not satisfy this requirement. *Id.* at 11.

purchase any of the securities.²⁴⁵ The offer also may not “target” persons located in Australia.²⁴⁶ The ASIC states very broadly that if an issuer has a significant number of Australian consumers or contacts, or the offering simply attracts significant interest from Australian investors, the ASIC will find that the issuer is targeting Australian investors.²⁴⁷ An issuer, however, may take certain precautions to guard against such a broad finding.²⁴⁸ As with the SEC and FSA guidelines, precautions *may* include checking the residence of potential investors to ensure that individuals are not located in Australia,²⁴⁹ ensuring that the offering materials do not appeal to persons in Australia,²⁵⁰ avoiding any distribution of an issuer’s offering materials by other means in Australia, for example, by mail or by advertisement in a local newspaper,²⁵¹ and ensuring that the securities are not directed or “pushed” to individuals “who the offeror should reasonably know reside in Australia.”²⁵²

Although the ASIC guidelines are similar to those promulgated by the United States and the United Kingdom, the Australian Proposal nevertheless leaves more room for potential regulation by Australian authorities. For example, in determining whether or not to regulate a securities offering on the Internet, the ASIC considers whether an issuer’s offering significantly affects consumers or markets in Australia,²⁵³ for

²⁴⁵ See *id.* at 6, 11.

²⁴⁶ *Id.* at 11.

²⁴⁷ See *id.* at 5.

²⁴⁸ See *ASIC Policy Proposal*, *supra* note 240, at 5, 11.

²⁴⁹ See *id.* at 11. For example, an issuer may “check[] the e-mail, mailing address or telephone area code; [or] us[e] a gateway, blocking or other limiting device.” *Id.* However, any “[p]recautions that place the responsibility on the applicant, such as simply asking a person whether they are from an appropriate jurisdiction, would not alone be sufficient to guard against sales in Australia.” *Id.*

²⁵⁰ See *id.* at 5, 11. For instance, the issuer should not place any information in its offering materials of particular relevance to persons in Australia, such as the local tax treatment of securities purchases, the use of local currency or information concerning local distributors. See *ASIC Policy Proposal*, *supra* note 240, at 11.

²⁵¹ See *id.* at 11; *cf.* U.K. Internet Proposal, *supra* note 229.

²⁵² *ASIC Policy Proposal*, *supra* note 240, at 5, 11. Securities will be considered “pushed” if, for instance, the issuer solicits the offering by broadcasting a message to a large audience via e-mail. *Id.* at 11.

²⁵³ See *id.* at 8-9, 12. However, the offering must have a “significant” effect on consumers in order to be subject to its securities laws, since regulation of every offer on the Internet would severely hamper the use of the Internet (and other

example, when the issuer has a large number of Australian consumers or contacts.²⁵⁴ Consequently, these factors extend beyond the particular securities offering, and consider a company's business affairs in general.²⁵⁵

5. Conflicting International Regulations

As other nations promulgate their own guidelines to determine when an offering on the Internet will be subject to its securities laws, domestic and foreign issuers will find it even more difficult to comply with a multitude of varying guidelines. Discrepancies already exist among the guidelines issued by the securities commissions in United States, the United Kingdom and Australia. For example, an issuer will not be subject to United States securities laws if its web site contains a disclaimer, requests the residence of an investor before permitted access to its offering materials, and utilizes a password-protection system.²⁵⁶ However, that same issuer may be subject to UK securities laws if the issuer has inadvertently placed its offering on a UK server, and it may be subject to Australian securities laws if it has a substantial number of contacts or consumers in Australia.²⁵⁷ Issuers are thus subject to the increasing risk that they will fail to comply with a multitude of conflicting national guidelines.

The consequences of complying with regulations on state, federal and international levels are a tremendous burden on

electronic technologies) for financial transactions. *Id.* In addition, over-regulation would conflict with goals set forth by the Australian government regarding electronic commerce. *See id.* at 8. Yet the language itself may allow for such "over-regulation."

²⁵⁴ *See ASIC Policy Proposal, supra* note 240, at 12.

²⁵⁵ In the Policy Proposal, the ASIC sets forth three steps that an issuer must take to ensure that the offering is not subject to the securities laws of Australia: (1) the offering cannot target Australian persons; (2) the offering materials must contain a disclaimer stating that securities are not available to Australian investors; and (3) the issuer cannot be involved in any misconduct regarding the offering. *See id.* at 5-6. However, even if an issuer complies with each requirement, the issuer is subject to regulation if the offering has a significant effect on Australian persons. *See id.*

²⁵⁶ *See supra* notes 218-228 (discussing the United States' treatment of securities offered offshore).

²⁵⁷ *See supra* notes 229-255 and accompanying text (discussing UK and Australian treatment of Internet offers).

issuers. At the same time, regulators have recognized that over-regulation of the Internet will hinder, rather than encourage, competition. In all likelihood, therefore, regulators will take enforcement action against an issuer under the most exceptional circumstances, for example, when an issuer has *blatantly* failed to adhere to their proposed guidelines.

III. ANALYZING THE BENEFITS AND PROBLEMS ASSOCIATED WITH SECURITIES OFFERED BY SMALL CAPITALIZATION COMPANIES ON THE INTERNET

While current regulations governing offerings on the Internet are unclear in many respects, regulators will inevitably continue to clarify how an issuer may use the Internet during each stage of the offering process without violating a nation's securities laws and without incurring liability for information available on its web site during an offering. From the point of view of large, highly capitalized companies, once the regulatory environment settles, the benefits to issuers from delivering, soliciting and marketing an offering on the Internet will be obvious. These companies will be in the best position to benefit from the Internet because they not only receive the assistance of an underwriter to market their offering to investors, but the risks to investors are generally low. Small capitalization companies, on the other hand, are at a relative disadvantage. These companies will have to overcome several practical limitations because of their small size and lack of reputation in the securities market. The foregoing discussion provides an overview of some of the issues that a small capitalization company must consider in deciding whether to use the Internet to offer securities to investors.

A. *Benefits Associated with Securities Offerings on the Internet*

The Internet has created an easily accessible means for the general public to seek out investment opportunities domestically and abroad.²⁵⁸ Consequently, an investor no longer has to rely exclusively on a traditional financial intermediary, such

²⁵⁸ See Uri Geiger, *The Case for the Harmonization of Securities Disclosure Rules in the Global Market*, 1997 COLUM. BUS. L. REV. 241 (1997).

as a broker, to purchase shares in an offering.²⁵⁹ With regard to direct public offerings available on the Internet, an investor can simply search the Internet for an offering and then download the respective prospectus or offering memoranda to his or her computer.²⁶⁰ An investor can even indicate his or her interest in the offering on-line by completing documentation at the issuer's web site.²⁶¹ In addition, Internet-based service providers have evolved that permit a member investor to purchase shares directly from an issuer.²⁶²

Marketing and selling an offering to investors has changed as well. For DPOs, investors typically relied on mailings or other indirect solicitations to purchase securities.²⁶³ However, placing offering materials on an Internet web site can generate interest in an offering from the general public directly. Consequently, the Internet allows the general public to eliminate both the costs associated with traditional financial intermediaries as well as the premium paid for the securities in an initial public offering.²⁶⁴ The Internet has also created a more informed market.²⁶⁵ The general public can potentially equip

²⁵⁹ See Andrew Osterland, *IPOs in Cyberspace*, FIN. WORLD, Apr. 22, 1996, at 24.

²⁶⁰ See McGlosson, *supra* note 100, at 307.

²⁶¹ See *id.*

²⁶² See *infra* Part IV. (discussing Internet intermediaries).

²⁶³ See, e.g., Lorrie Grant, *Small Firms Take Direct Route to Stock Offerings*, USA TODAY, Apr. 29, 1997, at 4B (small companies traditionally sell securities through company newsletters, advertising in product packages, bulk mailings, or at their place of business); Stephanie Gruner, *When Mom and Pop Go Public, Inc.*, GOLDHIRSH GROUP, INC., Dec. 1996, at 66 (small companies sell securities by catalogue, advertisements placed in targeted magazines, mailing lists targeting customers, and by telephone).

²⁶⁴ There are additional benefits for an issuer that does not use a traditional underwriter. For instance, the issuer can price its own stock, there are no underwriter costs, which can range from 15-25%, and the issuer decides how to distribute the stock. See Kollar, *supra* note 58, at 14; Reynes, *supra* note 176, at 38. In addition, DPOs can be quite successful. In 1985, for example, Ben and Jerrys raised \$30 million from local investors directly. See Kollar, *supra* note 58, at 14. However, the majority of offerings on the Internet today that do not use an intermediary fail or else raise only a portion of the capital sought. See Gruner, *supra* note 263, at 66. Even the highly publicized first direct public offering over the Internet in 1995, Spring Street Brewery, could only raise \$1.6 million in an attempt to raise \$5 million. See McGlosson, *supra* note 100, at 307.

²⁶⁵ The general public, institutional investors and brokers have access to the same information through the Internet, since geographic differences no longer create an informational disadvantage. See Coffee & Berle, *supra* note 75, at 1195. This is true, however, only if all individuals and businesses have access to the

itself with the same information that in the past has been exclusively available to financial intermediaries.²⁶⁶

From an issuer's point of view, using the Internet to market and sell its securities is highly attractive because of the low costs and the increased marketability of an issuer's securities.²⁶⁷ A company may lower the costs associated with a public offering by using a web site for electronic delivery of its offering materials and thereby avoiding traditional underwriting fees in the case of a direct offering.²⁶⁸ There is also the added potential of boosting a company's product sales by advertising and soliciting its offering over the Internet.²⁶⁹ Finally, an issuer has access to a potentially worldwide market with more investors to choose from and thus a greater chance of selling its securities.²⁷⁰

B. *Problems Associated with Securities Offerings on the Internet*

While the Internet has allowed an investor a sense of independence, it also comes with several limitations. For example, an investor must consider whether he or she will be able to locate a potential investment on the Internet, avoid investing in a fraudulent offering, or assume greater risks than he or she can understand or is able to assume.

The Internet is generally considered user friendly. An individual signs up with a service provider and learns how to use the various search engines such as Yahoo!, Excite, and HotBot. Finding a securities offering on the Internet, however,

information, and many today still have no access to the world wide web. *See id.*

²⁶⁶ While in the past, retrieving performance data or third party reports on a particular company required substantial time and money, the information is now available on an Internet web site for the general public to view. *See, e.g., Suretrade Research* (visited July 27, 1999) <<http://www.suretrade.com>> (on-line brokerage company that offers clients access to Reuters information service and stock and bond analysis through third party sources).

²⁶⁷ *See* Coffee & Berle, *supra* note 75, at 1195.

²⁶⁸ Underwriting fees are on the average a flat rate of 7% of the per-share offering price. *See* Geoffrey Smith & Paula Dwyer, *Coincidence - or Collusion?*, *BUS. WK.*, Nov. 9, 1998, at 163.

²⁶⁹ *See* Reynes, *supra* note 176, at 38.

²⁷⁰ *See generally* Warren S. Hersch, *Direct Public Offerings Take off on the Web—Companies find going public much easier via the Internet*, *COMPUTER RESELLER NEWS*, Jan. 12, 1998.

is not a simple matter. An investor may locate a few offerings, but the investor may not meet the purchaser qualifications for the offering or the offering may not be what the investor is looking for.²⁷¹ Moreover, without the help of a broker, investors must not only spend the time searching for a potential offering on the Internet, but researching each individual company as well.²⁷²

Investors are also subject to the risk of investing in either a fraudulent or deceptive securities offering on the Internet, an additional deterrent for investors who consider purchasing the securities of a small capitalization company from an Internet web site.²⁷³ With hundreds of offerings now available on the Internet, coupled with millions of web pages that can change on a daily basis, there is an obvious and ever-growing gap in regulators' ability to successfully protect investors from fraudulent offerings.

International organizations, such as IOSCO, as well as national securities regulators have responded to the occurrence of securities fraud on the Internet.²⁷⁴ Since 1995, the SEC has taken enforcement action against more than 70 companies that offered fraudulent or deceptive securities to investors on the Internet.²⁷⁵ However, the SEC has recognized that it

²⁷¹ See *supra* Part I.B.4. (discussing limitations of a private offering).

²⁷² See Osterland, *supra* note 259, at 24.

²⁷³ See *id.*

²⁷⁴ See IOSCO Press Communiqué: *Report on Enforcement Issues Raised by the Increasing Use of Electronic Networks in the Securities and Futures Field* (last modified Sept. 17, 1997) <http://www.iosco.org/docs-public/enforcement_issues/document01.html> (IOSCO supports international cooperation among securities regulators to combat Internet fraud).

²⁷⁵ For a complete list and description of enforcement action taken by the SEC against issuers offering fraudulent securities, see *Litigation Releases* (visited July 26, 1999) <<http://www.sec.gov/enforce/litig.htm>>. Some of the more publicized actions include *SEC v. Block*, Litigation Release No. 14598, No. 95-1174BRCL, 1995 SEC LEXIS 2056 (Aug. 10, 1995) (company offering fraudulent securities with falsified financial instrument and promising to double investors' funds), and *SEC v. Spencer*, Litigation Release No. 14856, 1996 SEC LEXIS 975, at *1-*2 (Mar. 29, 1996) (company offering fraudulent securities through solicitations on the Internet promising 50% or greater potential returns). The SEC, however, is not the only government body in the United States seeking to end fraud on the Internet. NASD is also combating securities fraud with the use of computer search engines that can seek out suspicious phrases with regard to an offering, including messages posted in chat rooms and bulletin boards that are meant to cause investors to purchase the stock. See Rebecca Buckman, *NASD to Study Stock Claims on Internet*, WALL ST. J., Mar. 24, 1997, at 1. See generally SEC Technology Report,

alone lacks the manpower to combat Internet securities fraud and continues to rely more heavily on investor awareness. For instance, the SEC's web site advises investors not to make an investment decision about an offering on the Internet based solely on what he or she reads in an on-line newsletter or Internet bulletin board, "especially if the investment involves a small, thinly-traded company that isn't well known."²⁷⁶ The SEC has also set up an "Internet Fraud" site that provides more detailed information to investors on how to spot Internet securities fraud.²⁷⁷ Although regulators' initiatives have helped to decrease the number of fraudulent offerings, even reliance on consumer awareness may not be enough to reduce the risk of fraud to investors who use the Internet.²⁷⁸

Offerings that are not associated with an underwriter—typically direct offerings that are exempt from registration under the Securities Act ("exempt DPOs")—may also pose a risk to investors.²⁷⁹ First, there are few disclosure requirements for an exempt DPO, while underwritten offerings are either registered so that issuers must disclose a significant amount of information to investors or privately placed and therefore not available to the general public.²⁸⁰ Second, because the securi-

supra note 90; SEC Enforcement Release No. 98-117, *SEC Charges 44 Stock Promoters in First Internet Securities Fraud Sweep* (Oct. 28, 1998) <<http://www.sec.gov/news/netfraud.htm>> [hereinafter SEC Enforcement Release] (SEC announced an "unprecedented nationwide sweep" against securities violators on the Internet, charging forty-four individuals and companies across the country with deceiving investors into purchasing shares through the use of Internet web sites, bulletin boards, and e-mail).

²⁷⁶ SEC Enforcement Release, *supra* note 275, at 2 (investors should assume that information they find on an Internet web site is "not trustworthy").

²⁷⁷ See *Investor Complaints and Assistance* (visited Feb. 1, 1999) <<http://www.sec.gov/invkhome.htm>> ("Internet Fraud" site warns investors about riskier and fraudulent offerings available on the Internet).

²⁷⁸ See Richard W. Stevenson, *Greenspan Sees Calming of Markets*, N.Y. TIMES, Nov. 6, 1998, at 1 (with the use of technology increasing, regulators are going to have trouble keeping up with the policing of securities markets in the future; "21st century financial regulation is going to increasingly have to rely on private counterparty surveillance to achieve safety and soundness").

²⁷⁹ See Wesley R. Iversen, *IPOs on the Web*, FIN. SERV. ONLINE, Jan./Feb. 1997, at 22; see also PUB. COMM. DIV., U.S. SBA, FACTS ABOUT SMALL BUSINESS AND THE U.S. SMALL BUSINESS ADMINISTRATION 3 (1981) (NASAA accuses the SEC of facilitating the sale of the "riskiest" securities in the market by allowing small businesses to offer securities under the Regulation A exemption).

²⁸⁰ See *supra* Part I. (discussing disclosure requirements for registered and exempt securities offerings).

ties in an exempt DPO are sold to the public without the use of a traditional underwriter, there is generally no third party that can attest to the company's financial viability.²⁸¹ Third, while an issuer who uses an underwriter typically receives assistance in marketing its shares to investors, an issuer offering an exempt DPO lacks visibility.²⁸² Finally, most companies that offer securities through an exempt DPO are start-up companies with no financial or operating history.²⁸³ An investor therefore knows very little about a company offering securities through an exempt DPO when making his or her investment decision. Another consequence of not using an underwriter is that most issuers fail to implement a viable marketing plan for their offering and are frequently forced to cancel the offering.²⁸⁴ Finally, securities that are sold through an exempt DPO are highly illiquid. Unlike a large, registered offering where an underwriter will often make a market for the securities after its initial offering, e.g., on the NASDAQ, an issuer in a direct offering typically cannot provide liquidity for its shares. Moreover, unlike NASDAQ or other trading systems that provide buyers and sellers with a medium for trading securities, securities purchased in a DPO have few centralized locations for trading.²⁸⁵ Without a secondary market in which to trade their shares, investors can only view the securities as

²⁸¹ See Rickard & Kershenbaum, *supra* note 45, at B4 (stating investment banks increase market potential by performing due diligence for an issuer).

²⁸² See Rickard & Kershenbaum, *supra* note 45, at B4; see also Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984). An issuer can rely on the established reputation of an underwriter to back sales of the security to investors. See Gilson & Kraakman at 619-20 (most underwriters are "repeat players," and consequently, underwriters are relied on by the financial industry to accurately present information about an issuer and assert the value of an issuer's securities).

²⁸³ See Gilson & Kraakman, *supra* note 282, at 619-20.

²⁸⁴ See generally Hersch, *supra* note 270.

²⁸⁵ See Gruner, *supra* note 263, at 66 (the Pacific Stock Exchange has SEC approval to trade SCOR and Regulation A offerings); Robert L. Lowes, *Try A Do-It-Yourself Public Offering*, MED. ECON., Apr. 14, 1997, at 50 ("a SCOR offering can be traded on a regional exchange or on NASDAQ's over-the-counter bulletin board or pink sheets with National Quotation Bureau"). *But see Pacific Exchange Likely to Drop SCOR Marketplace*, BUS. WIRE, Mar. 9, 1998, at 1 (trading through pink sheets or via a bulletin board often results in very insignificant sales because these mechanisms are used by only a small percentage of investors, while the company itself is typically unknown); Lowes at 50 (analysts typically do not follow companies listed on these exchanges).

a long-term investment with the possibility that the company will one day conduct a registered offering where the shares will be traded on a reputable exchange.²⁸⁶

While there are several limitations for investors, small capitalization companies that use the Internet to offer securities encounter difficulties as well. For example, selling shares through an offering on the Internet can be a slow process without the assistance of a third party.²⁸⁷ A company must therefore develop a viable marketing plan, which may include placing its offering materials on several key web sites and supplementing its Internet advertising with traditional marketing techniques.²⁸⁸ Finally, particularly with exempt DPOs, many investors are unwilling to invest in the offering because they typically know very little about the company and therefore consider the investment too risky.²⁸⁹

C. *Impact of the Internet on the Offering Process*

Given the prominence of fraud associated with Internet offerings today, the assumption of greater risks for investors and the practical limitations for conducting such offerings successfully, small capitalization companies have several overarching issues that they should consider before they decide whether to offer their securities on the Internet. Clearly, the protection of public and private parties from a risky or fraudulent offering on the Internet will increase. Securities regulators will continue to increase the level of monitoring of Internet activity and to educate the general public on to how to detect fraudulent offerings and understand the risks associated with direct offerings to the public. However, two issues will remain. First, can a small capitalization company successfully solicit and market its securities offering to investors through the Internet? Second, can an issuer offer or provide sufficient

²⁸⁶ See Jennifer Genevieve, *U.S. Firms Seek On-Line Solutions To Raise Capital*, REUTERS BUS. REP. (Feb. 28, 1996).

²⁸⁷ See, e.g., Rickard & Kershenbaum, *supra* note 45, at B4.

²⁸⁸ See generally Hersch, *supra* note 270.

²⁸⁹ See Gruner, *supra* note 263, at 66.

liquidity to its investors? Without the ability to market securities to investors effectively and to provide liquidity for its stock in some secondary market, small capitalization companies using the Internet to offer their securities will reap little benefit from it.²⁹⁰

IV. INTERNET-BASED SERVICE PROVIDERS AND THE FUTURE OF SECURITIES OFFERED ON THE INTERNET BY SMALL CAPITALIZATION COMPANIES

In deciding whether to use the Internet to offer its securities to investors, the principal concern for the small capitalization company in the future will not be whether such an offering is possible, but whether the company will benefit from using the Internet in the offering process. As this Note has suggested, the greatest advantage to issuers conducting an offering over the Internet is the potential for soliciting interest and marketing the offering to a large number of prospective investors.²⁹¹ A second advantage is the ability to provide an inexpensive and centralized location for investors to indicate their interest in an offering.²⁹² However, placing offering materials on a web site does not automatically guarantee that an issuer will successfully solicit interest from investors. Among other factors, investors must know about the offering, they must be convinced that the company issuing its shares is financially viable, and they must have some assurance that the stock has some liquidity.²⁹³ Clearly, if investors are not persuaded to invest in a company, the use of the Internet in the offering process will have a minimal impact on whether the offering will be successful. To this end, the use of an underwriter in the offering process can be a significant advantage to

²⁹⁰ See Mahoney, *supra* note 1, at 823-24 (stating that intermediaries are an integral part of the offering process and will remain regardless of the efficiencies created by the Internet).

²⁹¹ See *supra* notes 258-270 and accompanying text (discussing benefits associated with Internet offerings).

²⁹² See *id.*

²⁹³ See *supra* 279-284 and accompanying text (discussing benefits associated with underwriters).

an issuer, as it can provide the reputational backing necessary to complete an offering, in addition to a viable marketing plan and sales force.²⁹⁴

From a practical standpoint, it remains to be seen how quickly traditional underwriters will embrace the Internet in the offering process.²⁹⁵ Only a handful of investment banks today, such as Salomon Smith Barney and Goldman Sachs, have only now begun to place their clients' prospectuses on their web sites.²⁹⁶

Although the use of a traditional underwriter is a significant boon to using the Internet in the offering process, the majority of issuers offering securities on the Internet today cannot gain access to an underwriter, often because of practical limitations, such as the costs associated with a traditional underwriter.²⁹⁷ Consequently, these small capitalization companies have trouble attracting interest in their offering,²⁹⁸ since they provide limited financial information to investors and an illiquid market for trading their securities.²⁹⁹ Issuers of private securities offerings face similar obstacles, while also having the additional hurdle of attracting interest in their

²⁹⁴ Typically, an underwriter has a large sales force that can sell securities to its repeat clients and institutional investors. An underwriter will also adamantly market the securities since any failure to do so can result in losses to the underwriter directly. See Gilson & Kraakman, *supra* note 282, at 616 & n.182, 617-18 (describing "firm commitment underwriting" where an underwriter purchases the securities from the issuer directly, making the underwriter—not the issuer—responsible for selling and distributing shares to investors).

²⁹⁵ If the SEC's proposed revamping of the securities industry occurs, an issuer will have the ability to test-the-waters through an Internet web site to determine interest in its offering before incurring the costs and expenses associated with registration, and will be able to place its offering materials on an Internet web site where prospective investors can read or download the information. See Aircraft Carrier Release, *supra* note 5, at 67,178.

²⁹⁶ See *supra* note 99 and accompanying text.

²⁹⁷ A traditional underwriter typically has no interest in small offerings because of the cost associated with marketing and distributing the offering materials to investors, and because they often market securities to institutional investors that have no interest in purchasing small amounts of stock. See Wit Capital Pioneers *Public Venture Capital investing; Five Million Dollars Financing to be Announced this week* (Sept. 30, 1997) <http://www.witcapital.com/press/pr_13.html>.

²⁹⁸ See *supra* note 282 and accompanying text. Compared to a small issuer, an investment bank has access to large institutional entities that are repeat investors. See *id.*

²⁹⁹ See *id.*

offering from qualified investors.³⁰⁰ During the last few years, however, Internet-based service providers have emerged that offer services similar to those offered by a traditional underwriter, but at significantly lower costs.

A. *Marketing, Advertising and Solicitation on the Internet*

In the last few years, several Internet-based service providers have emerged that offer to market an issuer's securities offering on the Internet.³⁰¹ The services offered can range from inexpensive "listing services" to more costly and comprehensive marketing plans and due diligence investigations. A "listing service," for example, offers to advertise a company's securities offering at a centralized location on the Internet that typically boasts a minimum level of "traffic," thus guaranteeing a certain level of visibility for the offering.³⁰² For a large issuer seeking to market its registered offering on the Internet, several service providers have emerged to assist with electronic prospectus delivery to investors.³⁰³ Other Internet intermedi-

³⁰⁰ See *id.*

³⁰¹ Not only have Internet intermediaries developed in the United States, but Internet-based service providers have also developed abroad. See, e.g., *Cybercapital* (visited Oct. 1, 1998) <<http://www.cybermedia.com.au/capital/default.htm>> (Australian Internet-based service provider that will market and advertise a company's direct equity offerings to Australian residents as well as to investors outside of Australia).

³⁰² See *About IPO.COM* (Feb. 28, 1998) <<http://www.ipo.com/about.asp>>. IPO.COM hosts a company's offering materials for DPOs, IPOs, and private placements on its web site. See *id.* The company claims that the site is "one of the most visible, highly targeted investing sites on the Internet" and guarantees a certain level of traffic on the web site to issuers. See *id.*; see also *Direct Stock Market* (Feb. 26, 1998) <<http://www.dsm.com>> (offering listing service where an issuer's offering documents, company description and press releases are available to investors from its web site. Costs include \$500 for the initial set up of the company's documents on its web site, with additional costs for maintaining the materials on its site each quarter); *R.R. Donnelley Financial and IPO Crossroads Launch Highly Searchable IPO Database Web Site*, PR NEWSWIRE, Dec. 4, 1996, available in LEXIS, Financial News Library (web site containing prospectuses for all U.S. IPOs).

³⁰³ See *Nationsbanc Montgomery Securities Uses Thomson Prospectus to Implement Electronic Prospectus Delivery*, PR NEWSWIRE, Sept. 24, 1998, at 1; *Prospectus Online* (visited July 27, 1999) <<http://www.prospectusonline.com>> [hereinafter *Prospectus Online*] (services include archiving and delivering an issuer's prospectus documents to investors). For a fee, Thomson Prospectus will get investors' e-mail addresses, supply them with the required software and obtain consent from investors for electronic delivery of the prospectus. See *Prospectus Online*. The company

aries offer to conduct a comprehensive marketing and advertising plan for an issuer.³⁰⁴ Such a plan may include preparing the issuer's offering materials and marketing the offering on the Internet by placing its offering materials on hundreds of key investment web sites.³⁰⁵ Some intermediaries offer not only a comprehensive marketing plan but more traditional underwriting services such as conducting a due diligence investigation of the company.³⁰⁶ Consequently, Internet-based service providers help to attract interest from investors on the Internet and ensure issuers greater exposure by creating centralized locations where investors can seek out investment opportunities and access additional information about an issuer.

Finally, a few investment banks have recently emerged that operate exclusively on the Internet to offer the IPO securities of small and medium-sized companies to member investors, including E*Offering, W.R. Hambrecht & Co.'s OpenIPO and Wit Capital.³⁰⁷ For example, W.R. Hambrecht & Co.'s

will either send an e-mail message containing the prospectus or else a hyperlink that directs investors to the Internet address where it may be read or printed. *See id.* Once delivery is completed, Thomson generates a report confirming receipt of the prospectus by investors. *See id.* The company's services attracted the attention of Nationsbanc, which plans to use Thomson for all future electronic prospectus delivery. *See id.*

³⁰⁴ *See generally Direct IPO Corp.* (visited Sept. 7, 1999) <<http://www.webipo.com/serv/services.html>> (discussing services offered, including a listing and marketing service that places the issuer's offering materials on its web site and drums up interest among its member investors about the issuer's offering, for a fee of \$10,000; the company also offers a test-the-waters service for an upcoming offering using its staff of experts, at a rate of \$3,500 for a six month testing period); *Virtual Wall Street* (visited July 7, 1998) <<http://www.virtualwallstreet.com>>.

³⁰⁵ *See, e.g., Internet Marketing Pros Help Small Companies Go Public over the Internet*, BUS. WIRE (June 5, 1997) (The Elysian Group screens candidate companies interested in raising up to \$5 million over Internet, prepares the issuer's offering materials and then markets the securities offering over the Internet).

³⁰⁶ *See FairShare Inc.* (visited July 27, 1999) <<http://www.fairshare.com>> (issuers undergo a due diligence test, and then can solicit member investors of FairShare to buy its stock; the issuer can utilize a network of lawyers, accountants and consultants to produce a company report for members to review); *see also* Tatiana Helenius, *How Much is that DPO Under Windows?*, WALL ST. J., July 1, 1997, at 90 (arguing that issuers offering securities on the Internet require an intermediary to conduct a full due diligence investigation of the company or to price an offering commensurate with investor demands so that issuers are ensured that they can sell their shares).

³⁰⁷ *See* Richard A. Shaffer, *IPOs for Everyone; Why Investment Banks Don't*

OpenIPO is an on-line auction system in which member brokers submit bids on behalf of their customers for securities offered by small technology companies.³⁰⁸ Investors enter a conditional bid with a broker, indicating the number of securities that the investor is willing to purchase, and the highest price that the investor is willing to pay.³⁰⁹ Because the OpenIPO system is driven by market demand, as opposed to traditional offerings where the securities are sold at a discount to institutional investors, and because Hambrecht charges issuers a 4% underwriting spread, which is significantly lower than the typical IPO spread of 7-8%, issuers are able to receive more capital for their shares up front.³¹⁰

B. *Providing Liquidity*

A second type of Internet-based service provider offers to provide a secondary market for investors who purchase the securities of small capitalization companies and companies offering privately placed securities, using an on-line trading bulletin board. An electronic bulletin board is set up either at an issuer's or an intermediary's web site and typically displays the names and addresses of prospective buyers and sellers for a particular stock.³¹¹ Many bulletin boards on the Internet

Need to Worry About Online IPOs – Yet, FORTUNE, Mar. 29, 1999, at 176; see also Edward Wyatt, *Goldman Sachs to Take Stake in Wit Capital*, N.Y. TIMES, Mar. 30, 1999, at 1 (discussing Goldman Sachs' purchase of 22% of Wit Capital's shares and the trend among traditional investment banks to form alliances with companies, like Wit Capital, that can "include individual investors in initial public offerings" by distributing securities to investors exclusively on the Internet).

³⁰⁸ See Saul Hansell, *Internet Auction System Set for Pricing Stock Offerings*, N.Y. TIMES, Feb. 8, 1999, at 7; see also *OpenIPO: How It Works* (visited July 29, 1999) <<http://www.openipo.com/OpenIPO/base/HiWorks/HiW4da.html?REF=HiW4da>> (discussing procedures for becoming a member and bidding, and listing current IPO offerings).

³⁰⁹ See *Participation Agreement*, *supra* note 137 (pursuant to the participation agreement, if the bid exceeds the "clearing price," defined as "the price at which sufficient OpenIPO bids have been submitted," the investor's broker will accept the bid and transact for the sale of the securities on behalf of the investor); see also Wit Capital Corp., SEC No-Action Letter, 1999 SEC No-Act. LEXIS 620 (July 14, 1999) (describing Wit Capital's procedures for offering IPO shares to investors of large underwritten offerings).

³¹⁰ See Shaffer, *supra* note 307, at 176 (discussing the benefits of the OpenIPO system, as well as the concern that the new Internet investment banks lack sufficient credibility to effectively compete against traditional investment banks).

³¹¹ See, e.g., Real Goods Trading Corp., SEC No-Action Letter, 1996 SEC No-

are hosted by an intermediary acting as a centralized location for investors to buy or sell the securities of dozens or perhaps hundreds of public companies. For example, Niphix maintains a bulletin board matching system on its web site in which member investors can trade stock in various small capitalization companies.³¹² Electronic trading systems for privately placed securities have developed as well.³¹³ One such system, ACE-Net, was developed by the Small Business Association in 1996.³¹⁴ The ACE-Net system (managed by a network of universities) provides accredited investors with a password to access a database of issuers offering privately placed securities.³¹⁵ Secondary-trading of the private securities is also permitted on the bulletin board trading system, but again only among accredited investors.³¹⁶

Since the creation of the first on-line bulletin board trading system in 1996, the Commission and the SEC staff have questioned the legality of such systems on the Internet.³¹⁷

Act. LEXIS 566, at *10 (June 24, 1996); *IBC Internet Bulletin Board Trading System* (visited June 24, 1999) <<http://www.ibchannel.com/dpo/trading.shtml>> (IBC will set up a bulletin board trading system for secondary trading of an issuer's securities at its web site, for a fee).

³¹² See generally Niphix Trading system (visited July 2, 1999) <<http://www.niphix.com/demotrading.htm>> (The system is described as "a fully automated trade execution system that matches buyers' and sellers' orders. When there is a match, the trade is executed instantly."). Investors can view all current and executed trades. See *id.*

³¹³ For a discussion of electronic trading systems prior to the development of Internet-based systems, see generally Exchange Act Release No. 34-27956, 55 Fed. Reg. 18,781 (May 4, 1990) (as early as 1990, an electronic trading system known as PORTAL was introduced by the NASD and received SEC approval for trading privately placed securities).

³¹⁴ See generally *The Process and Analysis Behind ACE-NET* (visited Feb. 1, 1999) <<http://www.sba.gov/advo/acenet/report.html>> (ACE-Net web site describing its electronic trading system).

³¹⁵ See *id.*

³¹⁶ See *id.* Since ACE-Net, several other Internet-based trading systems for privately placed securities have also developed. See Lamp Technologies, Inc., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 638, at *1 (May 29, 1997); Niphix Investments, Inc., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 566, at *4-*6 (Apr. 18, 1997).

³¹⁷ See Spring Street Brewing Co., SEC No-Action Letter, 1996 SEC No-Act. LEXIS 435, at *1 (Apr. 17, 1996). In 1996, Wit Capital set up an online bulletin board trading system called Wit-Trade. See *Wit Capital Corporation: Wit Beer Founder to Build World's First Digital Investment Bank and Stock Exchange, Wit Capital News and Development* (visited July 21, 1998) <http://www.witcapital.com/press/pr_1.htm>. The SEC staff immediately requested

The primary concern was that the issuer or intermediary hosting the web site would have to comply with the regulatory requirements regarding broker-dealers, stock exchanges or investment advisers.³¹⁸ The SEC staff has since confirmed that these regulatory requirements are inapplicable to a company hosting an on-line bulletin board trading system so long as the host of the web site follows certain precautions.³¹⁹ For example, an intermediary hosting a bulletin board trading system must avoid participating in the execution of the trades between buyer and seller.³²⁰ Thus, a bulletin board typically contains only the names and addresses of prospective buyers and sellers.³²¹ It is then up to the buyer and seller to contact one another if they are interested in trading the security.³²² Alternatively, the buyer and seller can use a third-party transfer agent, such as a bank, to complete the deal for a small fee.³²³

Although current Internet trading systems are "passive," relying exclusively on individual investors to seek out and complete a trade, some commentators have suggested that

Wit to halt trading over concerns that investors did not understand the risks involved in purchasing the illiquid and speculative stock, and because buyers did not know the last sale prices. In addition the SEC halted trading because of Wit's involvement in the execution of trades. *See* Spring Street Brewing Co., 1996 SEC No-Act. LEXIS 435, at *1; *see also* Staff Clears Way for N.Y. Concern to Resume Stock Trading on Internet, 28 Sec. Reg. & L. Rep. (BNA) No. 13, at 437 (Mar. 29, 1996) (discussing SEC staff's reaction to Wit Capital's bulletin board trading).

³¹⁸ *See* Internet Capital Corp., SEC No-Action Letter, 1998 SEC No-Act. LEXIS 18, at *1 (Jan. 13, 1998); Flamemaster Corp., SEC No-Action Letter, 1996 SEC No-Act. LEXIS 972, at *1 (Oct. 29, 1996); Angel Capital Electronic Network, SEC No-Action Letter, 1996 SEC No-Act. LEXIS 812, at *1-*5 (Oct. 25, 1996); PerfectData Corp., SEC No-Action Letter, 1996 SEC No-Act. LEXIS 700, at *1 (Aug. 5, 1996); Real Goods Trading Corp., SEC No-Action Letter, 1996 SEC No-Act. LEXIS 566, at *10 (June 24, 1996); *see also* Securities and Exchange Act of 1934, 15 U.S.C. §§ 78c(a)(4)-(5), 78c(a)(1), 78c(a)(20) (1996) (defining "broker" and "dealer," "exchange" and "investment adviser"); 15 U.S.C. § 80b-1 (1994) (describing services performed by an "investment adviser").

³¹⁹ *See generally* Internet Capital Corp., 1998 SEC No-Act. LEXIS 18; Real Goods Trading Corp., 1996 SEC No-Act. LEXIS 566.

³²⁰ *See* Real Goods Trading Corp., 1996 SEC No-Act. LEXIS 566, at *3.

³²¹ *See id.* at *6, *8.

³²² *See id.*

³²³ *See, e.g.,* Real Goods Off-the-Grid Trading Systems, *Paying for Stock and Transferring Certificates* (visited June 1, 1998) <<http://www.realgoods.com/cgi-bin/rghsystem/rghsystem.pl>> (a list of alternatives for investors seeking to complete transactions over RGTC's trading system).

these systems are only the beginning of an evolution of Internet-based trading systems.³²⁴ For example, Wit Capital has plans to develop an after-hours "Digital Trading Facility," where individual issuers will handle the allocation of shares among investors and investors will create their own auctions for stocks.³²⁵ E-Trade Group Inc., an on-line brokerage firm, also announced that it is teaming up with Compaq Computer Corporation to create an on-line stock exchange for small capitalization companies.³²⁶ Because these proposed digital stock markets would more closely resemble traditional exchanges, increased regulation of such systems should result.³²⁷ Regulators, however, encourage development of new Internet trading systems, recognizing that these systems can offer investors more cost-effective services than traditional exchanges, such as NYSE or NASDAQ.³²⁸

Whether investors trade their securities through an on-line bulletin board or a digital stock exchange, such systems invite the prospect of liquidity without the use of a traditional

³²⁴ See generally FRIEDMAN, *supra* note 35, at 6-01-6-07 (describing current Internet and electronic stock trading). Although bulletin board trading systems on the Internet are currently unregulated, it is unclear whether the SEC's proposed regulation of alternative trading systems, see *infra* note 327, will in fact cover such systems. See FRIEDMAN, *supra* note 35, at 6-07 (arguing that if the proposed regulations cover the passive trading systems, it will "drive the systems out of existence" because the host of the bulletin board system would have to register as a broker-dealer).

³²⁵ See generally Helen Huntley, *Brokers Push Web Exchange*, ST. PETERSBURG TIMES, Mar. 7, 1997, at 1E (discussing development of an Internet-based stock market, called Globe Net Stock Exchange); Mary Shroeder, *After-Hours Trading is Coming*, INVESTOR REL. BUS., Mar. 15, 1999, available in 1999 WL 5954107 (discussing development of an on-line electronic trading system, the IndivEx system, allowing retail investors to trade 200 of the most frequently traded stocks during a few hours each day); Wit Capital, *Our Services* (visited June 24, 1999) <<http://witcapital.com/welcome/services.html>>.

³²⁶ See Ianthe J. Dugan, *Compaq, E-Trade Plan Online Stock Exchange*, WASH. POST, Nov. 10, 1998, at C01 (E-Trade is currently awaiting SEC approval).

³²⁷ See generally Regulation of Exchanges and Alternative Trading Systems, Exchange Act Release No. 39884, 1998 SEC LEXIS 743 (Apr. 17, 1998) (proposing that alternative trading systems, including Internet-based digital stock exchanges, may choose between regulation as either an exchange or else as a broker-dealer).

³²⁸ See Steven M.H. Wallman, *The Global Capital Market: What Next: Global Finance and Markets: What is Next*, 21 FORDHAM INT'L L.J. 404, at 408-09 (Dec. 1997) (while encouraging the growth of these trading systems, the SEC also recognizes that such systems will not provide certain benefits common to current regulated exchanges, including "monitoring, surveillance and ensuring the integrity of the market").

underwriter. Therefore, by registering with an alternative trading system, an investor may be more willing to invest in an issuer's offering on the Internet.³²⁹

CONCLUSION

In less than four years, the Internet has added a new dimension to securities offerings. Not only has it become an effective medium for testing-the-waters and for solicitation of offering materials, but it has also spurred new business forms and expanded services to small capitalization companies and investors as well. As regulators continue to clarify how an issuer may, without liability, use the Internet to make a public or private offering, more companies will begin to incorporate the Internet in the offering process. For small capitalization companies, Internet-based service providers will become necessary to assist in marketing and soliciting a company's offering to investors and to provide liquidity for investors in a secondary market. With liability concerns removed and the promise of benefitting from use of the Internet in the offering process, an offering on the Internet will become a commonplace practice among small and large issuers seeking to raise capital from both public and private investors.

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³²⁹ See generally Constance E. Bagley & Robert J. Tomkinson, *Internet is Seeing its Share of Securities Offerings*, NAT'L L.J., Feb. 2, 1998, at C3.

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