Corporate Advisor

2000-08-01

Legal Updates for Internet Times

The State of Delaware and the U.S. Securities and Exchange Commission recently updated their regulatory schemes to address some of the issues and opportunities arising from the growth and popularity of various forms of electronic communications, including email and the Internet. Effective July 1, 2000, the Delaware statute was amended to embrace the use of electronic communications in connection with meetings of directors and stockholders. Effective May 4, 2000, the SEC issued new interpretive guidance on a wide range of issues relating to the Internet. The following two articles, which were originally published by Hale and Dorr's Internet Law Group as email alerts, discuss these important developments.

Delaware Law e-Upgrades

The Delaware General Corporation Law statute has been amended, effective July 1, 2000, to permit Delaware corporations to take fuller advantage of email and other technological advances.

Delaware has the best-known and most important corporate law in the United States. A majority of all public companies, and over a quarter million private companies, are incorporated in Delaware. With these amendments, Delaware has resolved some lingering uncertainties, and enabled Delaware corporations to utilize modern technology in their corporate governance and communications with stockholders.

Scope of New Provisions

The new provisions of Delaware law affect electronic communications relating to stockholder meetings, director consents and meetings, stockholder notices, and stockholder consents and waivers.

The amendments define "electronic transmission" as "any form of communication, not directly involving the physical transmission of paper, that creates a record that may be retained, retrieved, and reviewed by a recipient thereof, and that may be directly reproduced in paper form by such a recipient through an automated process."

This definition encompasses email as well as other current or future forms of electronic

communications. The amendments do not mandate any particular form of technology and are intended to be flexible enough to encompass current and future technology.

The amendments apply only to Delaware corporations. They do not apply to limited liability companies or limited partnerships organized in Delaware.

Stockholder Meetings

The section of the Delaware statute governing stockholder meetings has been rewritten to permit:

- stockholder meetings to be held entirely by remote communication without any physical location
- stockholders who are not physically present at a meeting to participate by remote communication, and
- stockholders to submit votes by electronic transmission in place of written ballots, provided there is sufficient information to determine that such transmission was authorized by the stockholder

The existing requirement that the stockholder list be available at the place of the meeting or another specified place in the city where the meeting is being held for ten days prior to the meeting has been deleted. A new provision requires the list to be available for the ten-day period either on a reasonably accessible electronic network or at the corporation's principal place of business. If the meeting is to be held solely by remote communication, the list must be available during the meeting on an electronic network.

The type of materials that inspectors of election may rely on in determining the validity of proxies or ballots sent by electronic transmission has been expanded.

Stockholder Notices

The statute now provides that notices to a stockholder under a corporation's charter, bylaws or Delaware law may be given by electronic transmission if the stockholder has consented to the giving of notice by that particular form of electronic transmission. The amendments do not specify the form of such consent or require that it be in writing.

The amendments state that consents to receive electronic notices may be revoked by written notice. Although consents to receive electronic notices need not be in writing, revocations of those consents apparently must be in writing.

Consent to receive electronic notices is deemed revoked if the corporation is unable to deliver two consecutive electronic notices and such inability becomes known to the corporation or the person responsible for giving notice. However, the inadvertent failure to treat such inability as a revocation of consent will not invalidate the meeting or other action.

Stockholder Consents and Waivers

The statute has been revised to permit electronic stockholder consents in lieu of meetings. However, electronic consents must be reduced to paper and delivered as mandated by the statute

unless the Board provides otherwise.

Stockholders may now provide waivers by electronic transmission of any notice required under a corporation's charter, bylaws or Delaware law.

Director Consents and Meetings

Unless prohibited by the corporation's charter or bylaws, directors are now permitted to take actions by consent, and to submit resignations, by electronic transmission. The right to tender electronic resignations does not appear to extend to officers.

Unless prohibited by the corporation's charter or bylaws, directors are now permitted to hold meetings by any form of communications equipment, so long as all directors can hear each other. This is a broadening of the former provision permitting meetings by telephone conference call and "similar" communications equipment.

Conclusions and Action Items

Coupled with the SEC's rules relating to the electronic delivery of documents under the federal securities laws, the new Delaware provisions will enable public Delaware corporations to communicate more quickly and efficiently with their stockholders. Private Delaware companies will also be able to benefit from the statutory changes, especially those changes relating to stockholder consents and notices. Both public and private Delaware corporations will need to review and revise their charters and bylaws to take full advantage of the new legislation.

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SEC Provides Internet e-Guidance

On April 28, 2000, the SEC published an interpretive release providing guidance on the use of the Internet and other electronic media. The release covers a number of topics of great importance to public companies, broker-dealers and other participants in the securities markets. The interpretations contained in the release became effective on May 4, 2000. The release:

- discusses an issuer's liability for web site content
- updates the SEC's previous guidance on the use of electronic media to deliver documents under the federal securities laws
- outlines basic principles to be considered in conducting online offering, and
- solicits public comment on a number of technology concepts that the SEC is reviewing in order to determine whether further regulatory action is necessary or appropriate.

For a summary of the guidance contained in the release relating to electronic delivery and online

offerings and of the technology concepts on which the SEC requested comments, please read the full version of this article on the Internet Law Group web site.

The most important parts of the new release address a company's liability for information on third-party web sites to which it has established hyperlinks from its web site or SEC filings, and a company's responsibility for the contents of its own web site. Some of the SEC's guidance relating to web site liability may seem surprising. Although the SEC's views carry substantial weight, the release is not binding in private litigation.

The release indicates that the SEC recognizes that it will need to re-examine its regulatory system and interpretive guidance as technology evolves. The release says the SEC will continue to examine and consider the removal of regulations that pose unnecessary barriers to electronic commerce and maintain those regulations that are essential to protect investors. As a result, additional interpretive releases and rulemaking on these topics, and other topics relating to the Internet, can be expected over time.

Responsibility for Web Site Content

The release discusses the responsibility of issuers for the content of their web sites, both when they are preparing or conducting a public offering (that is, "in registration") and when they are not. As a general matter, the release emphasizes that the federal securities law apply in the same manner to the content of an issuer's web site as to any other statements made by, or attributable to, the issuer.

Responsibility for Hyperlinked Information in Prospectuses and Other SEC Documents. The release states that if an issuer includes a hyperlink within a prospectus or other document filed under the federal securities laws, the hyperlinked information becomes part of the prospectus or other document and must be filed as part of the prospectus or other document. The issuer assumes responsibility for the hyperlinked information and the information becomes subject to liability under the federal securities laws.

The release acknowledges that the SEC is aware that many standard software programs, including Microsoft Word and WordPerfect, can automatically convert an inactive URL into an active hyperlink, either at the time the document is created or when it is later accessed. Unfortunately, the release provides that, even in the case of an unintentional hyperlink, the issuer is responsible for the information contained on the site that is accessible through the resulting hyperlink.

The release provides only two exceptions. Inclusion of the URL to the SEC's web site and inclusion of the URL to an issuer's web site in a prospectus along with the statement "Our SEC filings are also available to the public from our web site" will not, by itself, include or incorporate by reference the information on the site into the prospectus if the issuer takes reasonable steps to ensure that the URL is inactive. The release gives as an example that the issuer could remove any embedded "tagging" which converts the URL into an active hyperlink and include a statement that the URL is an inactive textual reference only.

For issuers making their SEC filings available electronically, the SEC's position calls into question

the common practice of including an issuer's web site address, even if accompanied by a disclaimer, in a prospectus or other SEC filing. A company wishing to include its web site address in an SEC filing beyond the narrow exception provided in the release should remove any embedded "tagging" which converts the URL into an active hyperlink and include the address in the following manner:

"Our web site address is www.XYZ.com. The information on our web site is not incorporated by reference into this document and should not be considered to be a part of this document. Our web site address is included in this document as an inactive textual reference only."

Even with these precautions, however, an issuer's inclusion of its web site address in an SEC filing could subject the issuer to liability for the contents of its entire web site if the SEC's guidance is strictly applied.

***Responsibility for Hyperlinked Information in Issuer Web Sites*.** Issuers are responsible for the accuracy of their statements that reasonably can be expected to reach investors regardless of the medium, including the Internet, through which the statements are made. The release states that issuers can be liable for information contained on third-party web sites to which they have hyperlinked from their web sites under either an "entanglement" theory or an "adoption" theory.

Liability under the "entanglement" theory depends upon an issuer's level of involvement in the preparation of the information. The release provides no new guidance on how this should be applied in the case of hyperlinked information, and prior interpretations of the actions necessary to support an entanglement conclusion presumably remain applicable.

The release does discuss the factors that the SEC believes are relevant in deciding whether an issuer has "adopted" information on a third-party web site to which it has established a hyperlink. The release emphasizes that the factors discussed are neither exclusive nor exhaustive, that there is no bright line mechanical test to determine liability, and that no single factor, standing alone, will or will not dictate the outcome of the analysis.

In determining whether an issuer will have liability for hyperlinked information under the adoption theory, the release describes three factors:

- ***Context of the Hyperlink.*** Whether third-party information to which an issuer has established a hyperlink is attributable to the issuer is likely to be influenced by what the issuer says about the hyperlink or what is implied by the context in which the issuer places the hyperlink. Most importantly, the release states that if an issuer imbeds a hyperlink to a web site within a document required to be filed or delivered under the federal securities laws, the issuer "should always be deemed to have adopted" the hyperlinked information.
- ***Risk of Confusion.*** Another relevant factor is the presence or absence of precautions against investor confusion about the source of hyperlinked information. For example, the release states that hyperlinked information may be less likely to be attributed to an issuer if the information is preceded or accompanied by a clear and prominent statement – such as an intermediate screen – that indicates that the third-party information is not provided by the issuer and that the issuer disclaims responsibility for the information. In contrast, the

release indicates that the risk of investor confusion is higher when information on a third-party web site is framed or inlined on the issuer's site. The release cautions, however, that a disclaimer alone is not sufficient to insulate an issuer from responsibility for hyperlinked information.

- ***Presentation of Hyperlinked Information.*** The presentation of hyperlinked information by an issuer is relevant in determining whether the issuer has adopted the information. Examples provided by the release include selectively providing hyperlinks so that information accessed is not representative of available information, and selectively establishing and terminating hyperlinks to third-party web sites depending upon the nature of the information about the issuer. The release also says that screen layouts which disproportionately influence an investor's decision to view particular hyperlinks, through the use of different color, type face or size, suggest that the issuer has adopted the hyperlinked information.

Responsibility for Contents of Issuer Web Sites. Not surprisingly, the release states that issuers are responsible for the contents of their web sites. When an issuer is in registration, its web site content must be reviewed in its entirety to determine whether it contains impermissible information. This is true whether or not the issuer posts a prospectus on its web site, and regardless of where on its web site a prospectus is posted. The release further states that the SEC will continue to raise questions about information contained on an issuer's web site that is either inconsistent with the contents of a prospectus or that would constitute an "offer" under federal securities law. In addition, if an issuer in registration establishes a hyperlink from its web site to information that meets the definition of an "offer" under federal securities law, the release states that a "strong inference" will arise that the issuer has adopted that information for purposes of the antifraud provisions of federal securities law. The release urges an issuer in registration to carefully review its web site and any information on third-party web sites to which it hyperlinks.

Internet Communications During Registration. The release contains guidance on the permissible content of Internet communications by issuers in registration. The guidance is similar to the principles that have long guided issuer conduct while in the "quiet period" accompanying public offerings. The release says that permissible statements while in registration may also be posted on an issuer's web site when in registration.

An issuer in registration should avoid distributing materials or information that might have the effect of promoting or eliciting interest in the issuer or its stock. The SEC has not established comprehensive rules as to what kind of information may be disseminated by a company in registration. However, the SEC has indicated that a company may continue, in a manner consistent with past practice, to advertise its products and services, issue press releases announcing factual business developments and distribute periodic reports to stockholders. The SEC has also stated that a company in registration should not issue or disclose any forecasts, projections or predictions relating to its financial performance or value (even if the release of this information is consistent with its past practice).

The release notes that this guidance applies to all issuers that have established a history of

ordinary course business communications through their web sites. The release cautions, however, that issuers pursuing an IPO may need to apply this guidance more strictly because they may not have established a history of ordinary-course business communications with the marketplace.

Practical Tips for Web Site Management

The guidance contained in the SEC's new release, and its prior releases and rules, reinforce the conclusion that the federal securities law apply in the same manner to the content of an issuer's web site as to any other statements made by, or attributable to, the issuer. In light of the proliferation of web sites and their increasing importance as a medium to communicate with investors, we offer the following practical tips for web site management:

1. Appoint one person with responsibility for reviewing and approving all materials before posting on your web site. This person should be familiar with the risks and legal rules applicable to public disclosures generally and web site postings in particular, and should be knowledgeable about the company, its business and significant recent or pending developments.
2. Date all materials, and periodically review all information on the web site for the purpose of updating or deleting outdated or inaccurate information. Place older information that you wish to retain for informational purposes (such as press releases and SEC filings) in an "archive" section and include a disclaimer such as: "This part of our web site contains archival information, which should not be considered current and may no longer be accurate."
3. Do not place confidential information on your web site. Do not place material information (such as a press release) on your web site until it has been publicly disseminated. At this point, posting information on a web site is not sufficient public dissemination to discharge disclosure obligations.
4. Exercise caution in posting, or providing hyperlinks to, articles or documents written or prepared by third parties because of the risk of assuming liability for inaccurate or misleading statements contained in such materials. As noted above, issuers can be liable for information contained on third-party web sites to which they have hyperlinked from their web sites. If you choose to link to third-party web sites, you should include a clear and prominent statement – such as an intermediate screen – that indicates that any third-party information accessible through hyperlinks is not provided by the issuer and that the issuer disclaims responsibility for the information. An example is: "You are now leaving XYZ's web site. XYZ assumes no responsibility for information or statements you may encounter on the Internet outside of XYZ's web site. Thank you for visiting www.XYZ.com."
5. Do not place financial projections on your web site, whether prepared by the company, financial analysts or other third parties.
6. Avoid or minimize the use of other types of predictive statements, such as the dates of future product releases, expectations of market share to be achieved, and similar predictions about future events. Include appropriate "safe harbor" language to protect any forward-looking statements under The Private Securities Litigation Reform Act of 1995.
7. Do not include quotes from, or reports of, financial analysts on your web site. If for investor

relations reasons you have a strong desire to list the securities analysts who publish reports on the company, you should list all securities analysts, not just the favored analysts or the analysts whose reports are positive. You should also list the analysts in alphabetical order, without giving disproportionate prominence to any through the use of different color, type face or size.

8. Do not place the transcripts of conference calls with analysts on your web site. The "safe harbor" warning given orally at the beginning of an analyst call most likely cites cautionary language by referring to risk factor-type disclosure in an SEC filing rather than stating such cautionary language. This type of a disclaimer is valid to protect oral forward-looking statements but is not sufficient for written forward-looking statements, such as those that are created by the reproduction of a transcript of the call.
9. Avoid hyperbolic or excessively optimistic statements on your web site, just as you do in press releases. Think of your web site as less of a sales platform for unbridled hype or optimism and more as an integral element of your disclosure obligations to investors.
10. Before posting, review any technical information or computer software for export control compliance. Technical information or computer software made available on a web site is generally considered to constitute an "export" and may require an export license from the U.S. Government.
11. Apply extra diligence and caution to these guidelines when you are in registration.

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