SEC Cracks Down on Internet Stock Giveaways

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Web site traffic is the name of the game for generating e-commerce transactions, ad revenue and, in some cases, securities valuation. Realizing this, Internet company entrepreneurs have offered "free" stock to attract visitors, build databases and create customer loyalty.

Stock giveaways sound like a nifty and essentially harmless promotional technique, and have been all the rage over the past year. Numerous stock giveaways can be found on the Web, and entire Web sites are devoted to providing links to stock giveaways. Many of these promotions reward visitors who refer others to the issuers' Web sites, causing the promotions to be widely disseminated through spam and other email. Some of the promotions even claim, incorrectly, that Yahoo! gave away stock before going public.

The appeal of stock giveaways may stem from greed, or they may be popular simply because they are fun. Either way, the SEC has decided they are illegal.

In three recent no-action letters, the SEC ruled that proposed Internet stock giveaways would constitute unlawful "sales" of securities:

- In *Vanderkam & Sanders* (January 27, 1999), an unnamed operator of an Internet-based auto referral service proposed to issue free stock to anyone who registered at the company's Web site or who referred others to its Web site. Visitors would complete a simple registration form and would not be required to provide cash, property or services for their shares. The SEC ruled that "the issuance of securities in consideration of a person's registration on or visit to an issuer's Internet site would be an event of sale" and would be unlawful unless "the subject of a registration statement or a valid exemption from registration".
- In *Simplystocks.com* (February 4, 1999), a Web-based provider of financial information proposed to distribute free stock from a pool of entrants who logged in to

the company's Web site and provided their name, address, social security number, phone number and email address and then chose a login name and password. Visitors would receive one entry in the stock pool for each day they logged in to the Web site. After 180 days, the stock would be randomly allocated among the entrants in the stock pool. The SEC stated that the Simplystocks.com stock giveaway would be unlawful unless registered or exempt from registration.

- In *Andrew Jones* (June 8, 1999), the promoter proposed to issue free stock to the first one million people who signed up or referred others to sign up. Shares would be claimed either by sending a self-addressed stamped envelope to the issuer along with the person's name, address and email address, or by visiting the issuer's Web site and providing the same information. The company said the information provided by shareholders would be used solely for corporate purposes and would not be sold or given to others or used for advertising purposes. The SEC ruled that "the issuance of securities in consideration of a person's registration with the issuer, whether or not through the issuer's Internet site, would be an event of sale" and would be unlawful unless registered or exempt from registration.

Following these no-action letters, the SEC brought enforcement actions against four promoters and two Internet companies in July. In each case, visitors were offered stock for registering at the issuer's Web site and providing personal information. Some recipients were given additional shares for referring other visitors or for linking their Web sites to the issuer's Web site. Several of the issuers were also charged with making false claims about the value of the stock or the nature of their businesses. In each of the enforcement proceedings, the respondents agreed to cease and desist from future securities laws violations.

The SEC's position on stock giveaways has been criticized by some commentators, especially for the conclusion that the issuance of stock merely for visiting a Web site constitutes a "sale." Even if the SEC softened its stance, however, an Internet company giving away stock would face at least two other challenges: the need to begin public company reporting if at its fiscal year-end it has more than 500 stockholders and $10 million in assets, and state corporate laws requiring shares to be issued for cash, services and/or property.

In cases not involving fraud, pyramiding schemes, misuse of personal information or other abusive or deceptive tactics, it's hard to see the harm to the recipients of free stock, even if the stock is worthless. The potential for securities fraud on the Internet is enormous, and perhaps the SEC's view can best be understood as an attempt to rein in Internet stock giveaways before they mushroom out of control.

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