
SEC Updates Internet Guidance

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On April 28, 2000, the SEC published an interpretive release, [Release No. 33-7856](#), 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; and
- outlines basic principles to be considered in conducting online offerings.

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 it will need to reexamine 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 explains, 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:

1. 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 .

2. 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 .

3. 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. The release says that 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.

At the end of this summary, we suggest some practical tips for web site management based on the SEC's guidance in the new release and in prior releases.

Electronic Delivery of Documents

The SEC has previously published its views on the use of electronic media to deliver information to investors in two principal releases. In [Release No. 33-7233](#) (October 6, 1995), the SEC focused on electronic delivery of prospectuses, annual reports and proxy materials. In [Release No. 33-7288](#) (May 9, 1996), the SEC focused on electronic delivery of required information by broker-dealers, transfer agents and investment advisers. Subsequent releases addressed the use of electronic media in the context of offshore sales of securities ([Release No. 33-7516](#) (March 23, 1998)) and

cross-border tender offers ([Release No. 33-7759](#) (October 22, 1999)).

In its newest release, the SEC states that it believes the framework for electronic delivery established in its prior releases continues to work well in the current technological environment. The release says that issuers must continue to assess their compliance with legal requirements for electronic delivery in terms of the three areas identified in its prior releases: (1) notice, (2) access and (3) evidence of delivery. These requirements are designed to ensure that electronic delivery provides notice and access that are comparable to paper delivery and that companies can verify stockholder receipt of electronic documents.

The release clarifies several issues relating to electronic delivery:

Telephonic Consent . The SEC's prior releases provided that the evidence of delivery requirement is satisfied if the recipient provides informed consent to receive electronic deliveries, and that informed consent could be provided by written or electronic means. The new release clarifies that informed consent can also be provided by telephone, so long as a record of the consent is retained and the consent is obtained in a manner that assures its authenticity. The record of the telephonic consent should contain as much detail as a written consent, including the scope of the consent and the type of electronic media that will be used.

Global Consent . The 1995 release stated that consent to electronic delivery could relate to all documents to be delivered by or on behalf of a single issuer, and that an issuer could rely on consent obtained by a broker-dealer or other market intermediary. The new release clarifies that an investor may give a "global consent" to a market intermediary to receive all documents from any issuer electronically, so long as the investor has provided informed consent. The release describes the requirements for informed consent in the context of a global consent to electronic delivery.

Use of PDF Format . The 1995 release stated that the use of a particular electronic medium should not be "so burdensome that intended recipients cannot effectively access the information provided." The new release clarifies that Portable Document Format (PDF) can be used if investors are informed of the necessary requirements to download PDF documents at the time consent to electronic delivery is obtained and are provided with any necessary software and technical assistance without cost. For an issuer placing its securities documents in PDF format on its web site, the release indicates that the software and technical assistance requirements will be satisfied if the issuer places a link on the same screen enabling users to download a free copy of Adobe Acrobat and provides a toll-free telephone number that investors can use to contact the issuer during business hours for technical assistance or to request a paper copy of the document.

Please note that the new requirements governing the use of PDF format apply only to issuers who satisfy their delivery requirements to consenting investors by placing electronic versions of their SEC filings on their web sites and notifying such investors of the availability of the such documents. These PDF requirements do *not* apply to issuers who place electronic documents on their web

sites as a convenience to investors while continuing to satisfy their delivery requirements through traditional means.

Online Offerings

Public Offerings. The release discusses the increasing prevalence of online public offerings, and notes that this development presents both potential benefits and dangers to investors. The release states that the SEC has reviewed numerous procedures in connection with online IPOs, but does not prescribe any specific procedures that must be followed. Instead, the release emphasizes that two fundamental legal principles should guide issuers and underwriters in online public offerings:

First, offering participants cannot sell or contract to sell any security before the related registration statement becomes effective. Second, written offers can be transmitted only pursuant to a prospectus meeting the requirements of federal securities law.

The release notes that the SEC will continue to analyze online public offerings as practice, procedures and technology evolve, with a view toward further regulatory action in the future. In addition, the SEC will continue to review proposed procedures submitted in connection with online public offerings.

Private Placements. The release notes that broad use of the Internet for exempt offerings under Regulation D is problematic because of the requirement that private offerings not involve a general solicitation or advertising. The release discusses web sites that invite prospective investors to qualify as accredited or sophisticated as a condition to participating, on an access-restricted basis, in private placements available on those web sites. Some of these web sites do not require prospective investors to complete questionnaires to establish accreditation or sophistication, and instead permit visitors to certify that they are accredited or sophisticated. The release notes that these web sites, particularly those allowing for self-accreditation, raise significant concerns as to whether the offerings that they facilitate involve general solicitations. The release also notes that web site operators must consider whether their activities require them to register as broker-dealers, noting that broker-dealer registration generally is required to effect transactions in exempt securities.

Request for Comments on Technology Concepts

The release requests comments before June 19, 2000 on a number of issues to determine if further regulatory action is necessary or appropriate. The technology concepts on which the SEC has requested comment are:

- **Access Equals Delivery:** Are there circumstances where issuers should be allowed to deliver documents solely by posting on a web site, on the assumption that investors should be assumed to have access to the Internet?
- **Electronic Notice:** Should broker-dealers be allowed to notify investors of the availability of electronic disclosure documents by posting messages to investor accounts at the broker-dealer web site without forwarding the message directly to investors?
- **Implied Consent:** Are there particular circumstances in which it would be appropriate for

issuers to rely on electronic delivery if investors do not affirmatively object when notified of the intentions of the issuer or intermediary to deliver documents in electronic format?

- **Electronic-Only Offerings:** Should issuers be permitted to make electronic-only offerings, in which back-up paper copies are not required even if investors request them or revoke their consent to electronic delivery?
- **Access to Historical Information:** How can the availability of historical information on the Internet be facilitated in a manner consistent with the federal securities laws?
- **Communications When in Registration:** When a web-based issuer is in registration, how can it comply with its obligations under the federal securities laws while maintaining communications to the marketplace related solely to its legitimate business activities?
- **Internet Discussion Forums:** The SEC requests comment on any issues relating to Internet discussion forums.

Practical Tips for Web Site Management

The guidance contained in the SEC's newest 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.

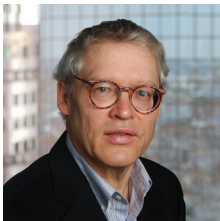
In light of the proliferation of web sites and their increasing importance as a medium to communicate with investors, we offer the following practical tips for web site management:

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 periodic 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 states 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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