# THE EVOLVING USE OF THE INTERNET IN CONNECTION WITH SECURITIES LITIGATIONS

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During the go–go years of the now–infamous Internet bubble, many referred to "Internet Time" to signify the increasingly fast–paced changes brought about by reliance on the Internet. The perception seemed to be that, somehow, the growth of the Internet and the rise of the Web required faster decision–making, faster turnaround time, and faster responsiveness. To some extent securities litigations seemed shielded from the perceived pace of Internet Time. That, however, is changing.

Like the slow, yet inexorable, creep of a clinging vine, the Internet is worming its way into every nook and cranny of securities litigations.

- The Federal Rules of Civil Procedure have been amended to allow for electronic service of suit papers with the parties' consent – suddenly placing front and center the need for scanning equipment and sophisticated document management systems just to manage the process of serving the many filings that securities litigations entail. Judges are engaged in subtle arm twisting to prompt the parties before them to consent to electronic service of suit papers and, in some instances, electronic filing with the Court. In other instances, Courts are going further and are asking the parties to construct extranets (secure Web sites) where counsel for the parties can upload electronic files, thereby effecting service.

- The Web is being used to speed delivery of information of interest to securities litigators including information about new lawsuits, case developments, legislative initiatives and the like. Whereas a decade ago it took days before such information was widely–disseminated, now it takes hours – if not minutes.

- Class Plaintiffs' counsel, cognizant of a long–standing culture of "me–too" filings in which the first lawsuit against a set of parties quickly prompts five or six

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similar suits, are cognizant of the fact that the Internet has only made the problem worse. They are fighting back. In a few instances they are including copyright notices on copies of complaints posted to their Web sites. In many instances, they are using simple technologies to block the ability of visitors to their Web sites to download, copy or print copies of complaints.

- Class counsel continue to scrutinize issuers' Web sites, Webcasts and broadcast e–mails to investors searching for alleged misrepresentations or omissions of material fact that might form the basis for a lawsuit.

- Class counsel monitor financial message boards looking for leads and evidence for their cases.

- New categories of securities lawsuits, arbitrations and enforcement proceedings are emerging.

- Shareholder activists are using electronic bulletin boards and chat rooms to keep tabs on management and to learn about and involve themselves in securities class actions.

- Plaintiffs' counsel are using so–called data clearinghouse Web sites to exchange data regarding securities suits.

- The practice by class plaintiffs' counsel of using their law firm Web sites to make it easier to retain them to represent allegedly aggrieved shareholders has grown much more widespread in the last year or so.

Perhaps the most significant change in the last year involves the clear signal from some courts that they expect counsel to use the Web to ease the administration of large, complex securities litigations. This is only the beginning. . . .

## I. Amendments to the Federal Rules of Civil Procedure To Allow Consent to Electronic Service

### A. The Amendments

Effective December 1, 2001, Rules 5(b), 6(e) and 77 of the Federal Rules of Civil Procedure and Rules 9006 and 9022 of the Federal Rules of Bankruptcy Procedure were amended to allow electronic service of pleadings (excluding the summons and complaint), motions, briefs and the like when the parties to an action have consented in writing. The rules apply to all district and bankruptcy courts and are not limited to courts that accept electronic filing. These provisions are incorporated by reference into Criminal Rule 49(b) and Bankruptcy Rule 7005. Any form of electronic service is permitted, provided the parties agree, including service by e–mail, Web site posting, fax, etc.

Service, by consent, under these new rules is complete on transmission ***unless*** a party learns that the attempted service did not reach the person to be served. FRCP 6(e) – and Bankr. R. 9006 – provide that service by electronic means is to be treated the same as service by ordinary mail for the purpose of adding three days to respond to the papers that are served.

Consent to receive service cannot be implied – it must be express and in writing. Such a writing may, however, be electronic (e.g., an e–mail expressing consent to such service) and should express the scope and duration of the consent.

According to an announcement and a series of questions and answers regarding the amendments available on the Web site of the Office of Administration of the U.S. Courts, other sets of related procedural rules are in the process of being amended similarly:

> The Committee on Rules of Practice and Procedure wanted the rules governing electronic service to be parallel to the extent possible across all the sets of rules. Thus, relevant sections of Appellate Rules 25, 26 and 45 and Criminal Rules 45 and 49(c) (to the extent the latter do not incorporate relevant Civil Rule provisions) are in the process of being amended in ways that will make their provisions similar if not identical. . . .[1]

**B. Practical Effects of the Amendments.**

Federal Courts now have an effective tool that they can leverage – and are leveraging – to push counsel into the world of electronic service. Some courts are cajoling. Others, effectively, are decreeing the need for "consent". Yet others are merely making it known how much they want the parties to consent – typically enough to prompt the requisite consent.

Some counsel are scrambling. They are asking their IT Departments such questions as:

- Do we have scanning equipment that is fast enough and sophisticated enough to handle our peak volume with adequate speed?

- Is the equipment capable of handling multiple resolutions so that basic black and white text can be scanned at low resolutions but old, faded and tiny print exhibits can be scanned at higher resolutions so they can be read?

- Will our scanning equipment permit us to create color images for filings that include color exhibits that were not created inside our office? Assembling sophisticated color exhibits seems quite useless if there is a risk that Courts and parties will only review a black and white scanned image of the material.

- Some courts may require Adobe Portable Document Format (PDF) files that are searchable, whereas others may require PDFs that are not searchable because they are concerned about electronic file size. Will our scanning system create both searchable and non–searchable PDFs? What about Tagged Image Files

(TIFs), which are used in most discovery imaging systems? Can you specify the format you need for each job?

- Have we developed a workflow to ensure that the people within our office who are responsible for service and filing are part of the electronic workflow and are adequately and properly trained in the process of creating electronic files, overseeing or assisting with the process of serving (and filing) those files, and administering the electronic records to ensure that appropriate records of instances of effected service and filing are maintained.

Such questions may seem arcane, but they are growing increasingly critical. One case in point: *In re: Initial Public Offering Securities Litigation*, Action No. 21 MC 92 (SAS) (S.D.N.Y., Hon. Shira A. Scheindlin).

Nearly one thousand securities actions alleging misconduct in connection with the initial public offerings of nearly 300 companies have been filed and have been consolidated before Judge Scheindlin. Last September, even before the amendments to the Federal Rules of Civil Procedure became effective, Judge Scheindlin suggested to counsel for the parties that they create an extranet (a secure Web site) available to lawyers involved in the matter for the posting of motions and pleadings.

The site was completed by late December and is hosted by Verilaw Technologies, Inc. Counsel and the Court can access the site with assigned User Ids and Passwords from any location with Internet access and a browser. Rather than serve each party individually, counsel for the parties in the cases before Judge Scheindlin can post the materials as a PDF to the case extranet or can fax the materials to a dedicated Verilaw Technologies number and rely on Verilaw to post the material to effect service. All parties, including the Court, receive e–mail notification that a new item has been posted to the extranet.[2]

## II. Class Counsel Have Begun to Use "Feeder Sites" That Attract Investors With Information About Alleged Instances of Fraud

Recently, in one intriguing development, securities class counsel have developed and published Web sites devoted to the topic of securities fraud and securities class actions in general and urge visitors to report instances alleged instances of fraud to the owners of the site. It is not always simple to trace the ownership of such sites, but research often leads back to attorneys affiliated with well–known securities class plaintiffs' law firms.

One example of such a site is EndFraud.com. The site allows users to research "what is securities fraud", contains "frequently asked questions" about securities fraud, permits them to "Report Fraud!", provides "Resources for the Defrauded Investor" and sign up for an e–mail EndFraud newsletter referenced as "Have You Heard". Nowhere on the site is the sponsor of the site easy to determine (his name appears at the bottom of the disclaimer page and within one newsletter posted to the site).

A search of the WhoIs database of domain name registrations reveals that the sponsor, listed as the administrative contact of the site, is Michael D. Braun with the Los Angeles office of class plaintiffs' firm Stull, Stull & Brody.

## ENDFRAUD.COM HOME PAGE


## III. The Web Is Speeding Delivery of Information About Case Filings, Developments That Have an Impact on Securities Litigations and Proposed Changes in the Law of Interest to Securities Litigators

One thing has changed dramatically in the last few years. An alert Web user can learn within a matter of minutes or hours about virtually any significant development that might affect a pending securities litigation or prompt the filing of a new one – without incurring any expense other than the expense of maintaining Internet access. Occasionally, in fact, the Web offers the quickest source of information regarding developments in securities litigations.

### A. A Case Study: Daily Securities Litigation Update

One case study is the ***Daily Securities Litigation Update*** offered by Simpson Thacher & Bartlett (of which the author serves as Editor). A public version of the ***Update***, described more

fully below, is available each business day at
**http://www.simpsonthacher.com/FSL5CS/practiceareadescriptions/practiceareadescriptions884.asp**

The genesis of the ***Daily Update*** was simple: we wanted to know when any of our clients had been named as defendants in securities or shareholder derivative litigations even before our clients became aware they had been sued. Coupled with that was a desire to provide our securities litigators with links to pertinent press releases, news stories and pleadings, where available, organized by the various jurisdictions in which we maintain offices – all in a format that would allow a 30–second scan to determine if the contents contained information of use to any particular litigator. The ***Update*** has been distributed daily, without fail, for more than one year – since March 31, 2001.

The ***Update*** includes, among other things: (1) an index of companies referenced therein, color–coded to reflect whether they are Simpson Thacher clients and whether they are newly–sued; (2) summaries of, and links to, news items regarding securities litigation developments during the previous 24 hours; (3) links to newly–issued press releases announcing new securities litigations (with additional) links to associated pleadings and other material; (4) links to newly–released repeat announcements of earlier press releases about the filing of securities–related actions; (5) alerts regarding stock price declines of 20% or more on the previous trading day on any of the three major exchanges; (6) summaries of new–filings data regarding securities and shareholder derivative litigations released the previous business day by each of the Clerks of the Courts of each of the jurisdictions in which we maintain offices (S.D.N.Y., N.D. Cal., and C.D. Cal.); (7) links to new announcements regarding procedural matters in pending securities litigations (such as announcements of class periods, lead plaintiff deadlines and the like); (8) descriptions of settlements and summaries of case dismissals reported in the previous 24 hours, with links to associated news items and press releases; (9) links to other securities law news sites; and (10) links to case listing pages on securities class plaintiffs' counsel Web sites.

Over time, as the ***Daily Update*** grew ever more sophisticated and timely, we began to realize that we could rather easily project – based on such considerations as stock movement, news stories, financial message board activity and the like – which companies most likely would catch the attention of the plaintiffs' securities bar. We began a watch list identifying companies that such factors suggested would catch the attention of the Plaintiffs' bar.

Each morning, a detailed copy of the ***Daily Update*** is distributed via an automated system using Simpson Thacher's secure Intranet to securities litigators inside the Firm. The internal Update, however, contains some links to internal materials and resources that are not available to the public. In addition, the internal Update includes reprints of information that the Firm has received express written authorization to distribute electronically within the Firm, but not outside the Firm.

Due principally to client demand, later in the day, after the Firm's securities litigators have had ample time to digest and act on the information contained in the internal Update, an

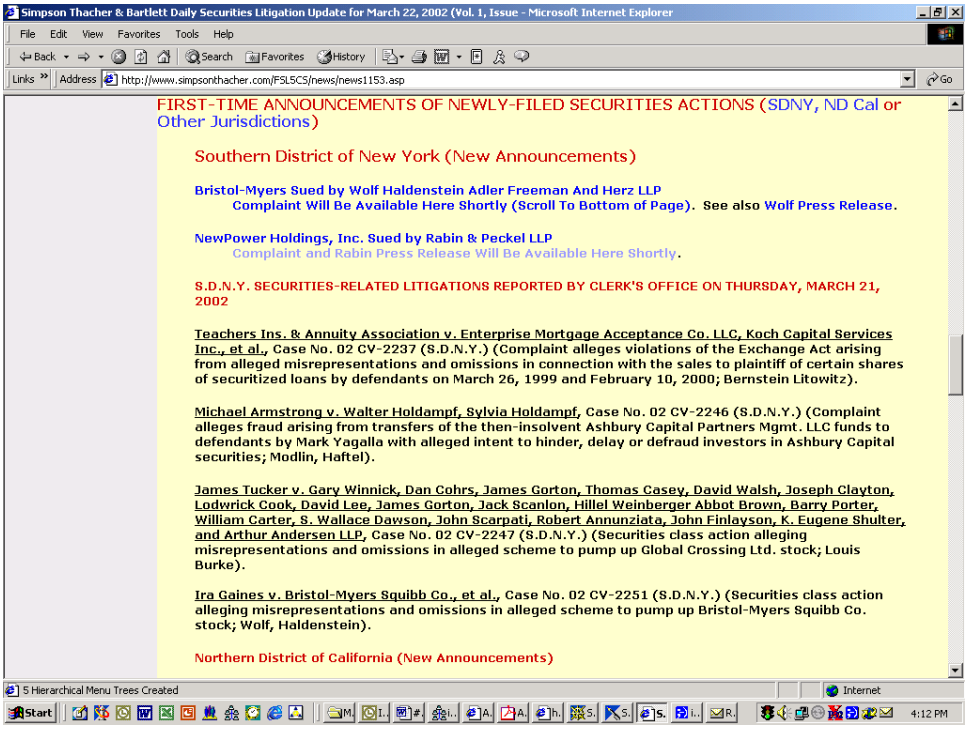
edited version is placed here on the Firm's Web site. Removed from the edited version are such things as the links to internal Simpson Thacher resources not available to the public as well as data that the Firm is permitted to reprint and distribute inside, but not outside, the Firm.

Visitors to the public version of the ***Daily Update*** on the SimpsonThacher.com Web site have the option of subscribing to an e-mail notification system that will notify them each day as the new issue is posted.

Quite frankly, nowhere else is this information collected so succinctly and made so easily available on a daily basis. Yet, the Web enables its easy preparation so that the information is in the hands of our securities litigators every day by 9:30 a.m. – and on our Web site typically by the end of the same day.

## PUBLIC VERSION OF SIMPSON THACHER & BARTLETT DAILY SECURITIES LITIGATION UPDATE – SCREEN SHOT #1

# PUBLIC VERSION OF SIMPSON THACHER & BARTLETT DAILY SECURITIES LITIGATION UPDATE – SCREEN SHOT #2 (LOWER ON SAME PAGE)




While no other Web site offers such a daily wealth of data regarding developments in securities and shareholder derivative litigations, there are a host of excellent Web sites that provide important information of interest to securities litigators. Such sites include:

***Stanford Law School Securities Class Action Clearinghouse in Cooperation With Cornerstone Research – News and Press Release Page***
**http://securities2.stanford.edu/news.html** – Provides links to news articles and press releases of interest to securities litigators and includes links to the Class Action Clearinghouse filings collection and much more.

***Cornerstone Research – Securities Page***
**http://securities.cornerstone.com/ –** Contains securities litigation data prepared by Cornerstone as well as links to collections of much of the same data available via the Stanford Law School Securities Class Action Clearing House.

***U.S. Securities and Exchange Commission Litigation Releases Page***
**http://www.sec.gov/litigation/litreleases.shtml** – This page contains links to each of the Enforcement Division's litigation releases, many of which contain links to the complaints filed in the matters.

***U.S. Securities and Exchange Commission Administrative Releases Page***

**http://www.sec.gov/litigation/admin.shtml –** This page contains links to each of the Commission's Administrative Releases describing the commencement of, or developments in, administrative proceedings commenced by the Commission Staff.

***U.S. Securities and Exchange Commission News Digest Page***

**http://www.sec.gov/news/digest.shtml –** The SEC's daily News Digest begins with a summary of the day's announcements regarding enforcement proceedings by members of the SEC's Staff.

***U.S. Securities and Exchange Commission Press Release Page (2002)***

**http://www.sec.gov/news/press.shtml –** The press release page contains links to the day's press releases, many of which contain announcements of Commission enforcement activity or developments of interest to securities litigators. There is an archive of earlier press releases available, as well, at **http://www.sec.gov/news/press/pressarchive.shtml**

***FindLaw.com Securities Law Web Sites Page***

**http://www.findlaw.com/01topics/34securities/sites.html –** This is an excellent and up to date collection of links to Web sites of interest to securities lawyers including sites of interest to securities litigators. FindLaw.com is owned by West.

***Prairie Law on Lawyers.com: Class Action Web Links***

**http://www.prairielaw.com/articles/article.asp?articleid=1536&channelId=31 –** This is also a good and current collection to Web sites of interest to class action lawyers – principally securities class action lawyers.

***SecuritiesSleuth.com***

**http://www.securitiessleuth.com/ –** This excellent Web site contains a host of original content and provides timely analyses of supposed "irregularities" of interest to securities lawyers. It provides analyses of earnings restatements and accounting questions and is closely watched by many in the plaintiffs' securities bar.

***PrimeZone Media Network Class Action Newsline***

**http://ganado.primezone.com/ca/ –** This page collects recent news releases about class actions posted to the PrimeZone Media Network online delivery system. This is NOT a complete collection of such releases. Others are posted to such online news release delivery services such as PRNewswire, Business Wire and Internet Wire, among others.

***SECLaw.com Arbitration Center***

**http://www.seclaw.com/centers/arbcent.shtml –** This wonderfully–maintained site (SECLaw.com) is full of information of interest to securities lawyers, broker–dealer compliance experts and investment adviser specialists – not just securities litigators. Securities litigators, however, may be particularly interested in the Arbitration Center which collects links of interest

to those involved in securities arbitrations and provides current news regarding securities arbitrations.

There are a host of other sites of interest to securities litigators. Those listed above, however, are some of the most widely–followed and well–maintained sites of interest to securities litigators.

## IV. With Increasing Frequency, Securities Class Counsel Are Using Public Web Sites Devoted to a Single Class Action To Communicate Data To Members of Their Reputed Classes

Although securities class action firms have created public Web sites devoted to a single class action to communicate with members of the reputed class for years, such sites are being used with increasing frequency and have grown in their sophistication.

***EnronFraud.com*** **http://www.enronfraud.com/ –** Milberg Weiss Bershad Hynes & Lerach, the lead plaintiffs' counsel in the securities class action filed against certain Enron officers and directors and its auditors in Federal District Court in Houston, Texas. Milberg Weiss has published a Web site devoted to the case located at www.enronfraud.com. The site contains PDF files of important court documents filed in the case, as well as articles thought to be of interest to Enron shareholders. Additionally, the site includes rather simple analyses of the movements of the company's stock price and insider trading information.

The site may be used to communicate with Milberg Weiss about the matter and, on its contact page, specifically asks whether the visitor is a current or former Enron employee. It also allows visitors to register for Enron Litigation mailing list, provides a question and answer area and, of course, includes links to the main Milberg Weiss Web site.

***Primedia, Inc. Class Action Resource Center*** **http://www.prmlitigation.com/ –** This Web site provides information and background about class action against Primedia, Inc. that is not technically a securities class action, but involves RICO claims, as well as claims for fraud and breach of contract brought by employees of the company who purportedly were promised, but never received stock options. The site contains a pleadings area, a news area, information for class members and contact information for the plaintiffs' law firm.

***YBM Magnex International Inc. Class Action Site*** **http://www.ybmclassaction.com/ –** A similarly slick and impressive entry from the securities class plaintiffs' bar north of the border is the YBM Magnex International Inc. Class Action Site. This site provides notice and information to shareholders and former shareholders of YBM Magnex and currently is the conduit for delivery of documents, notices and information regarding a proposed settlement of the case.

Once again, there are other, similar sites on the Web. These two, however, provide some flavor of the slick presentations and the more sophisticated look, feel and functionality of such sites as compared to their simplistic predecessors of only two years ago.

## V. The Web Has Reduced the Time It Takes for Class Plaintiffs' Lawyers To File "Copycat Lawsuits" That Regurgitate the Same Allegations Contained in the Initial Class Action Complaint – With Increased Sophistication Those Same Lawyers Are Learning New Ways To Make Such Copycat Suits More Difficult To Bring as Quickly

Class Plaintiffs' counsel, cognizant of a long–standing culture of "copycat" filings in which the first lawsuit against a set of parties quickly prompts five or six similar suits, are cognizant of the fact that the Internet has only made the problem worse. They are fighting back in interesting ways.

### A. Use of Technology To Block Printing, Copying and Pasting of Complaints and Other Court Filings.

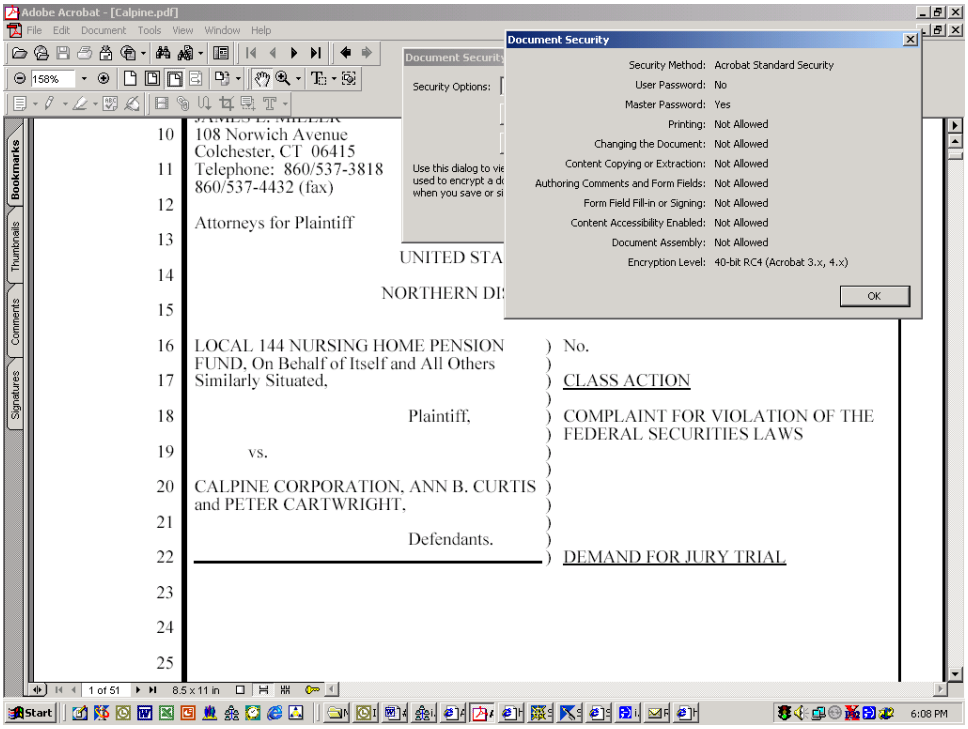
Class Plaintiffs' law firms and their employees are growing increasingly sophisticated in their use of the technologies that they employ to deliver information via the Web. With increasing – indeed, frustrating – frequency, complaints and other filings posted as PDF files on class plaintiffs' Web sites sometimes only minutes after the actual filing is made with the Court use built–in security settings that block the viewer's ability to print or copy text from the file.

Text cannot be copied, so it cannot be lifted wholesale into a "copycat" complaint in the word processing environment. The document cannot be printed which means it cannot be scanned using optical character recognition (OCR) technologies that allow the creation of a text file from the image that can be imported into a "copycat" complaint in the word processing environment. Would be plagiarists are left to type the entire document from scratch while viewing in on computer screen after computer screen. While this might be time consuming and inefficient, it does not seem to be reducing the number of copycat suits . . . . . .

By way of example – I made a random selection of a complaint available on the Milberg Weiss Web site. By chance I selected the complaint filed in *Local 144 Nursing Home Pension Fund, on behalf of itself and all others similarly situated v. Calpine Corporation, et al.* (N.D. Cal.). I downloaded a copy and then opened that downloaded version inside full Adobe Acrobat which allows me – by selecting File, then Document Security – to view the security settings set by Milberg Weiss when it created the electronic file.

The security settings are quite revealing, as the screen shot indicates below. Milberg created the file so that, unless the user has access to a Master Password set by Milberg, the user cannot – among other things – print the document, change the document, copy text from the document, or author comments within the document.

## SCREEN SHOT SHOWING SECURITY SETTINGS OF MILBERG WEISS COMPLAINT IN PDF FORMAT TAKEN FROM ITS WEB SITE




### B. Copyright Notices Included on Some Complaints

As suggested above, stringent security settings have not seemed to slow the filing of "copycat" securities class actions. Thus, in a few instances, class plaintiffs' counsel are including copyright notices on copies of complaints posted to their Web sites.

As the screen shot below indicates, Milberg Weiss Bershad Hynes & Lerach has, in certain instances, included a copyright notice on the face of a complaint posted to its Web site in an apparent effort to preclude others from misusing its work product. The notice, included at the outset of the complaint filed in *Hawaii Reinforcing Iron Workers Pension Trust Fund, Robert Morris Bell and Harriette L. Kirkpatrick, On Behalf of Themselves and All Others Similarly Situated, Plaintiffs, vs. Intel Corporation*, Defendant.(N.D. Cal.) reads as follows:

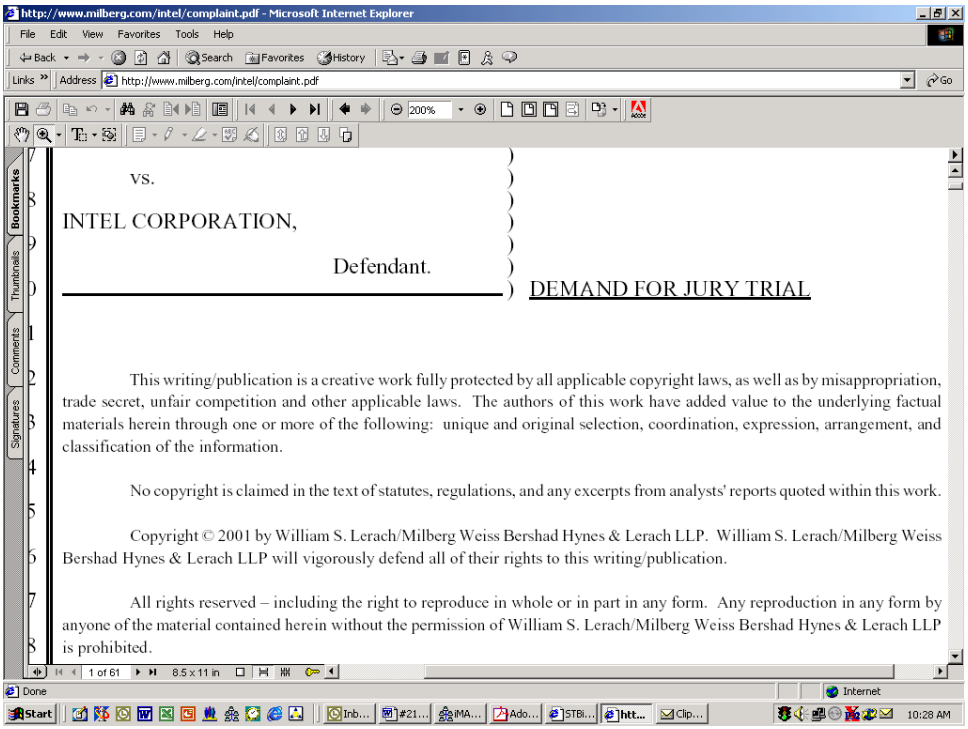
> "This writing/publication is a creative work, fully protected by all applicable copyright laws, as well as by misappropriation, trade secret, unfair competition and other applicable laws. The authors of this work have added value to the underlying factual materials herein through one or more of the following: unique and original selection, coordination, expression, arrangement, and classification of the information."

"No copyright is claimed in the text of statutes, regulations, and any excerpts from analysts' reports quoted within this work."

"Copyright © 2001 by William S. Lerach/Milberg Weiss Bershad Hynes & Lerach LLP. William S. Lerach/Milberg Weiss Bershad Hynes & Lerach LLP will vigorously defend all of their rights to this writing/publication."

"All rights reserved – including the right to reproduce in whole or in part in any form. Any reproduction in any form by anyone of the material contained herein without the permission of William S. Lerach/Milberg Weiss Bershad Hynes & Lerach LLP. is prohibited."[3]

## SCREEN SHOT OF MILBERG WEISS COPYRIGHT NOTICE ON INTEL COMPLAINT




## VI. Class Counsel Are Using the Web as a Research Tool To Identify Factual Information That Is Inconsistent With Companies' Disclosures

One interesting development in the last twelve months has involved the use of the Web by class plaintiffs' lawyers as a research tool to identify factual information that is inconsistent with disclosures made by companies. One example involves a complaint filed against ACLN, Ltd. in a securities class action brought in the United States District Court for the Southern District of New York by Milberg Weiss.

In its complaint, Milberg Weiss makes much of the fact that there is a "discrepancy" over information contained in ACLN's SEC filings which claim that it is the owner of the company's one ship named the Sea Atef and ownership information about the ship available via the Web. According to the complaint:

> "There's a problem with ACLN's claims that it owns the ship. A search of the ship registration Web site and documents provided by the Registry of Companies in Malta where the Sea Atef is based show the ship's owner is Sea Atef Shipping Co. Ltd. This company is joint–owned by someone named Herhi Ali Abou Merhi and D.C.C. Limited."[4]

In the same complaint, Milberg Weiss relies on an analysis of ACLN and its SEC filings that was first published on a Web site known as TheStreet.com.[5]

TheStreet.com, which often provides online analyses critical of companies' disclosure practices, seems to be a popular source of Web–based data relied upon by class plaintiffs' counsel in their complaints.[6]

Other Web sites that are being relied upon by class plaintiffs' counsel for purposes of developing allegations for their complaints include the CNET News.com site.[7]

## VII. Class Counsel Continue To Use Statements from Web Sites, Webcasts and Broadcast E–Mail in Their Complaints

Class counsel have found in the Internet fertile new ground in their search for evidence to support allegations of misstatements or omissions of material facts.

Company Web sites typically are a vast and easily–accessible collection of the company's public filings, press releases, marketing materials and public statements. Thus, class counsel are scrutinizing such sites and are including Web site postings in their complaints as among the misrepresentations or omissions of material fact that allegedly constitute securities fraud.[8]

One recent example of the use of company Web sites as the basis for allegations in a complaint involves a securities class action brought against Apple Computer. Among the many allegations in the complaint, which essentially asserts that Apple Computer failed to disclose that certain new products were not being well received by the marketplace, some revolve around customer complaints posted to the product support area of the Apple Computer Web site.[9]

Another interesting example involves a company Web site that does not appear to have been updated particularly frequently. In a securities class action against Apropos Technology, Inc. and many other defendants, the complaint alleges that even after the company's "Chief Technology Offer" left the company, "[t]he Company's website still falsely portrays Brady as

responsible for on–going specification, software engineering management, quality assurance and documentation."[10]

Class counsel also are scrutinizing company Webcasts – many of which are broadcast online to meet requirements imposed by the SEC's Regulation FD (Fair Disclosure). Plaintiffs' counsel are alleging, for example, that information revealed in Webcasts was inconsistent with data revealed via more traditional channels.[11]

Additionally, shareholders are making available to their counsel copies of broadcast e–mails issued by companies to their investors. Such e–mails are being quoted in securities class action complaints as alleged instances of fraudulent misrepresentations or omissions.[12]

Companies and their counsel have responded by implementing procedures recommended by securities lawyers that require Web postings and broadcast e–mails to be vetted and approved by experienced securities counsel before they are posted to issuers' Web sites.[13]

## VIII. Class Plaintiffs' Counsel Are Scrutinizing Message Boards, Including Financial Message Boards Looking for Leads and Evidence for their Cases

Plaintiffs' securities counsel are scrutinizing message board postings on company Web sites (such as messages posted to product support message boards) as well as postings on financial message boards hosted by Yahoo! Finance, SiliconInvestor, Raging Bull, Motley Fool and others looking for leads and seeking evidence for their cases.

The practice has become so prevalent that it prompted an article in *The Wall Street Journal Interactive Edition*. That article discussed a securities class action filed against 2TheMart.com, Inc. and said:

> Many of the allegations contained in the suit against 2TheMart first surfaced on the SiliconInvestor (www.siliconinvestor.com), an online forum for investors. "Message boards are a great place to gauge shareholder sentiment and maybe get a few tidbits to help develop a suit," says Mr. [Michael] Braun, whose firm [Stull, Stull & Brody] frequently files class actions on behalf of shareholders. He says visits to Silicon Investor, Raging Bull, Yahoo!, America Online and other message boards have become a vital part of his job.[14]

The message boards also have become a tool for defense counsel. As the same article notes, company lawyers who take the depositions of investors in such cases often ask investors "to disclose which online stock–discussion boards they visit because their messages could be used to refute their case. For example, if a company is being sued for allegedly failing to give adequate warnings about coming financial problems, messages on the boards might provide evidence that investors were aware of the difficulties"[15]

In at least one recent complaint, messages posted to a product support message board offered by Apple Computer on its Web site were cited in the allegations of a securities class action complaint filed against the company.[16]

## IX. The Internet Continues To Prompt A Host of Securities Lawsuits, Arbitrations and Enforcement Proceedings

The Internet is responsible for what some claim to be new classes of securities lawsuits, arbitrations and enforcement proceedings. In truth, while the medium is new, the theories used in such proceedings are not.

### A. "New" Types of Private Securities Litigations and Arbitrations

**Lawsuits Relating To Proxy Battles –** In at least two instances, closed–end management investment companies have alleged in lawsuits that dissident shareholders violated sections 13(d) and 14(a) of the Securities Exchange Act of 1934[17] by posting messages to an Internet message board devoted to discussions of closed–end funds.[18] Generally, the federal securities laws and rules cited in the suits prohibit: (1) the solicitation of more than 10 shareholders for their proxy votes unless a proposal is first filed with the SEC, (2) any proxy solicitation through false or misleading statements, and (3) certain types of concerted activity by beneficial owners of more than 5% of a company's shares without making advance filings with the SEC. Both suits were resolved without determinations on the merits. For example, one of the two suits, an action brought by The Emerging Germany Fund, reportedly was dismissed as moot once the fund became an open–end fund.[19]

Another analogous incident apparently never ripened into a lawsuit. On September 27, 1999, *The Wall Street Journal Interactive Edition* reported that a group of online investors used a message board "to solicit and collect proxies to oust an executive [of Coho Energy Inc.], possibly violating securities laws in the process." The shareholders reportedly denied any wrongdoing and at least one claimed to have received advice of counsel that their conduct was proper.[20]

**Discrepancies Between Printed Prospectus and Electronic EDGAR Filing –** Recently, the Honorable William H. Pauley III of the United States District Court for the Southern District of New York issued an interesting order dismissing a reputed securities class action brought against certain officers of iLife.com Inc. (now known as BankRate, Inc.) and underwriters of the company's initial public offering, ING Baring Furman Selz LLC and Warburg Dillon Read. In their complaint, the plaintiffs alleged that there was a discrepancy between the printed prospectus and the electronic version of the prospectus filed in the SEC's online EDGAR database.

Among the plaintiffs' many claims was one alleging that the printed version contained a bar graph that showed online publishing revenues and net losses for the company on a quarterly basis for all of 1998 and for the first quarter of 1999. Because Rule 304 under the SEC's Regulation S–T precludes the inclusion of graphic, image, audio or video data within electronic

filings submitted to the EDGAR database, the company followed the standard practice of filing an electronic version of the prospectus that contained a textual description of what was depicted in the chart found in the printed prospectus. According to the plaintiffs, the textual description in the electronic version of the prospectus erroneously identified the company's net losses as though they were online publishing revenues and failed to include any reference to net losses.

The plaintiffs alleged, among other things, that because the printed prospectus contained allegedly material information that was omitted from the electronic version of the document, the registration of the iLive shares was "defective".

Judge Pauley rejected the plaintiffs' allegations in this regard. He held that Rule 304 under the SEC's Regulation S–T makes clear that, in general, information contained in the printed prospectus of a nature that cannot be included in the electronic version will be deemed to be part of the Registration Statement deemed effective by the Commission. Thus, he rejected the plaintiffs' claim that the registration of iLife's initial public offering shares was defective. Because he also rejected plaintiffs' remaining claims, he dismissed the action.[21]

**Online Investment Newsletter Fraud** – At least one private securities lawsuit alleging fraud has involved an online investment newsletter. On April 25, 2000, the Honorable Leonard B. Sand, United States District Judge for the Southern District of New York, issued a memorandum and order denying a motion to dismiss the suit.

The plaintiff in the case alleged that he and a reputed class of similarly–situated people were defrauded in a scheme that included fraudulent statements published in an Internet newsletter known as "The Future Superstock". Plaintiff alleged that The Future Superstock recommended the purchase of stock in Electro Optical Systems Corporation and made seven allegedly false misstatements.

In his opinion, Judge Sand analyzed each of the alleged misstatements and assessed the issues of whether plaintiff adequately alleged falsity, scienter, materiality, reliance and loss causation. In perhaps the most interesting twist, lawyers for The Future Superstock argued that it was "unreasonable for Plaintiffs to rely on FSS's newsletter given that, two months earlier, the 'Stock Detective' website posted an extremely negative article on FSS." The Court ruled that "[t]his argument is also unpersuasive. FSS fails to allege that a single member of the class was aware of the Stock Detective assessment of FSS." The court rejected defendants' motion to dismiss and, as to The Future Superstock, held that "Plaintiffs have adequately alleged falsity, scienter, reliance, and causation, we conclude that Plaintiffs have adequately alleged securities fraud under Section 10(b) and Rule 10b–5."[22]

**Lawsuits Alleging an Electronic Short–Selling Conspiracy** – Civil suits that allege an electronic short–selling conspiracy apparently remain a popular Internet–related form of securities litigation.

On August 14, 2001, Michael Rapoport of Dow Jones Newswires reported that only a month after filing the lawsuit, AremisSoft Corporation dismissed an action that it filed against TheStreet.com and short sellers. In the suit, filed in the United States District Court for the Northern District of California, AremisSoft alleged that short sellers had conspired to drive down the company's stock price by distributing false information about the company, some of which allegedly was republished online by TheStreet.com. Subsequently the company disclosed that it was under investigation by the U.S. Securities and Exchange Commission for some of the same conduct for which it had been criticized by the shortsellers and TheStreet.com – apparently prompting its decision to drop the suit.[23]

In a somewhat similar dispute, on May 2, 2000, the Honorable John Conway, United States District Judge for the District of New Mexico reportedly dismissed a lawsuit brought by Solv–Ex Corp. in December 1998 against Deutsche Bank AG and nearly two dozen investors. The complaint reportedly alleged that the defendants engaged in a short–selling conspiracy to drive down the company's stock price. According to a Bloomberg report, Solv–Ex introduced evidence of e–mails exchanged among short sellers to demonstrate an alleged conspiracy. But, the report continued, the Court rejected the contention on the ground that "[t]he e–mails and discussions are merely opinions about the relative value of Solv–Ex stock . . . If such discussions were sufficient to prove a conspiracy, then every person in the securities industry would be a potential conspirator."[24]

**Civil Suits Resulting From So–Called "Web Hoaxes"** – Typically, though not always, Web hoaxes involve the creation of a bogus press release which is posted to the Web. The press release contains false information that is good or bad about the company depending on whether the perpetrator is long or short the company's stock. The perpetrator then posts hyperlinks to the bogus release to financial message boards. The perpetrator hopes that the stock price will move in a way that is favorable to his position in the stock.[25]

At least one lawsuit has resulted from such Web hoaxes. Shortly after Emulex Corp. became the target of such a Web hoax on August 25, 2000, a reputed class action was filed on behalf of investors seeking recompense for losses they allegedly suffered as a result. The suit was filed in the United States District Court for the Southern District of New York on August 31, 2000 by the law firm of Schatz & Nobel. The complaint named as defendants Internet Wire (which distributed a bogus press release created by the perpetrator of the hoax) and Bloomberg News (which issued a widely–distributed news story based on the bogus press release). The complaint reportedly alleged "that both services violated the Securities Exchange Act of 1934 by 'recklessly disseminating materially false and misleading information' about Emulex."[26]

In what should come as no surprise, on October 3, 2001, the Honorable Milton Pollack, Senior Judge of the United States District Court for the Southern District of New York, entered an order dismissing with prejudice the amended class action complaint filed against Internet Wire and Bloomberg as a result of the Emulex Web hoax. The Court earlier dismissed the complaint, but with leave to replead.

The Court dismissed the amended complaint with prejudice holding that scienter was not adequately pled, and emphasizing that the content of the release failed to provide any "meaningful hint of the falsity thereof".[27]

**Lawsuits Involving Company Webcasts** – On February 21, 2001 the law firm of Cauley Geller Bowman & Coates, LLP announced the commencement of a class action against Emulex Corporation seeking damages on behalf of shareholders. The complaint alleges a class period from January 18, 2001 through February 9, 2001 and follows a February 9 incident in which Emulex allegedly used a Webcast without a concurrently–issued press release to announce that order deferrals might reduce earnings for the quarter ending March 31 by three to five cents a share and that revenue growth could be flat. In contrast, only three weeks earlier the company reportedly forecast that it expected revenue growth of 15 to 17% over the last quarter. The announcement of the suit provides, in part, as follows:

> The complaint charges Emulex and certain of its officers and directors with violations of the Securities Exchange Act of 1934. . . . The complaint alleges that during the Class Period, defendants made positive but false statements about Emulex's results and business, while concealing material adverse information about customers pushing out orders. As a result, Emulex's stock traded at artificially inflated levels, permitting defendants to sell $40.36 million worth of their Emulex stock. On Feb. 9, 2001, Emulex issued a press release directing people to visit the Company Website. Visitors were able to listen to a recording of Emulex's CEO describing what Emulex would later disclose at a conference on Feb. 13, 2001: that it had been experiencing a push–out of orders since late January that might cause Emulex sales to fall short of previous Company guidance for Emulex's 3rdQ F01 to end on April 1, 2001. On Monday morning when the market opened again, Emulex's stock immediately dropped, falling 48% to $38–1/8 before closing at $40–3/8 on Feb. 12, 2001 on volume of 48.6 million shares.[28]

By no means is the Emulex suit the only securities class action in which the complaint contains allegations arising from a company Webcast.[29]

**Online Securities Auction Suits** – Although the only such lawsuit to date involves state law claims rather than Federal securities law allegations, some view the case as a securities law wolf in state law sheep's clothing. The suit at issue is a reputed class action brought against WR Hambrecht & Co. in connection with its online Dutch Auction system.

WR Hambrecht was named as a defendant in the reputed class action brought by Norton Capital in the spring of last year. Norton Capital used WR Hambrecht's open online Dutch auction system to bid for shares in the Andover.Net initial public offering handled by WR Hambrecht in December 1999.

Norton Capital claims to have bid $24 per share for 7500 shares. Under the Dutch auction system, anyone whose bid equals the shares' clearing price — which in this case turned out to be exactly $24 — ordinarily would expect to receive a prorated number of shares. Norton

Capital reportedly claims that it did not get any Andover.Net shares in the process although it claims that it should have. Norton Capital asserted claims for unfair business practices, negligence and breach of contract and alleged in its suit that "Hambrecht's unlawful, unfair and fraudulent business acts and practices, and its promotional and marketing materials . . . present a continuing threat to members of the general public."[30]

**E–Broker Suitability Claims –** An ongoing debate in the e–brokerage community has been whether general suitability rules such as the National Association of Securities Dealers, Inc.'s Rule 2310 apply in the online context. The NASD recently adopted a view espoused by SEC Commissioners and Staff that such rules apply to "recommendations" without regard to whether such recommendations arise in the online context or otherwise.[31]

E–Broker suitability claims already have been included in demands for arbitration and are likely to increase in frequency. In one example, in January 2000 NASD arbitrators awarded an Indiana man $40,000 in an arbitration case that included claims that e–broker Ameritrade violated suitability standards when it allegedly allowed Mr. Desmond to establish a high–risk online margin account as a novice investor. While Desmond's lawyer suggested that the victory was based, at least in part, on the suitability claim, Ameritrade Holding argued that the case was "mischaracterized as a suitability case" and that the matter essentially involved a "margin sellout case." Regardless, reports of the arbitration award sent chills up the spines of e–brokers everywhere.[32]

**E–Broker Order Execution Failures –** On August 7, 2000, a news report revealed an arbitration decision rendered against online broker E*Trade. According to the report, a panel of National Association of Securities Dealers arbitrators rendered a decision in favor of Ali Lee Khadivi, awarding him $61,203 in compensatory damages, interest and reimbursed expert and forum fees. According to the report:

> Mr. Khadivi had alleged that in early 1999, he had placed an order to buy 1,000 shares of Perot Systems Corp. at no more than $71, then shortly afterwards canceled it. In spite of receiving the cancellation request, E*Trade executed the order anyway. Mr. Khadivi said he phoned immediately and repeatedly to protest, but with no response. After the stock plunged, E*Trade liquidated his account to repay a margin loan. Mr. Khadivi said he was later called by a collection agent demanding he repay the debit balance in his account or be reported to a credit–rating agency.[33]

Another example of an analogous suit also involved E*Trade. According to news reports, in October 2000, a National Association of Securities Dealers arbitration panel ordered E*Trade Group Inc. to pay Jay Kiessling, a surgeon residing in Alabama, $203,333.15.

Kiessling reportedly submitted a buy at market order for stock in TheGlobe.com Inc. on the day the company went public (November 13, 1998). The shares were offered for $9 per share in the IPO, but a market frenzy pushed the price up to $84 per share. Kiessling alleged that his order was executed in the $84 to $86 per share range, although the price of the shares at the

close of trading that day ended at $30 per share. Kiessling alleged that although his account was limited to a maximum purchase of $144,000, his order was executed for approximately $422,000. Kiessling reportedly argued in the arbitration that "E–Trade denied Kiessling crucial market information and broke a contractual pledge to keep customers from trading beyond their means." According to one news account, E*Trade argued in response that "it wasn't at fault because of its systems lacked the capacity to stop Kiessling's order amid the fast market for Theglobe." The arbitration panel reportedly refused to award Kiessling either punitive damages or attorneys' fees and costs.[34]

In another interesting case, on January 16, 2001, the Online Investor Complaint Center reported that a San Diego woman, Tamara S. Ching, has filed a class action against Charles Schwab & Co. in San Diego Superior Court on behalf of herself and others who sold mutual funds through Schwab's automated trading services during a six–month period in 2000. The suit subsequently was removed to federal court in San Diego by Schwab's lawyers. According to the report, Ching alleges that "Schwab unilaterally and retroactively canceled . . . and then reprocessed" class members' "months–old mutual fund transactions to add previously uncharged short–term redemption fees" that apparently were not charged due to errors.

The complaint alleges that the reprocessing of the trades and the imposition of the fees "violated a Schwab account agreement and Rule 10b–10 under the Securities Exchange Act of 1934". The complaint also alleges claims for breach of fiduciary duty, and unfair, unlawful and deceptive business practices in violation of sections 17200 and 17500 of the California Business and Professions Code.[35]

No recitation of such suits would be complete without recounting one odd lawsuit filed against Charles Schwab by one hapless – and some might say clueless – online investor.

In November 1999, an online investor commenced a reputed class action against e–broker Charles Schwab Corp. in United States District Court in Sacramento, California. The suit, filed on behalf of Rudy DeBruycker and others similarly situated, alleges that in November 1998, the plaintiff tried to demonstrate to his son how to trade online using Schwab's services.

Plaintiff claims that he chose a company randomly and executed a buy order for 10,000 shares of ConnectInc.com Co. intending to cancel the order. He allegedly selected "cancel" and then checked the "order status" screen. At that time he reportedly received a "system malfunction" message and, later, a "no orders pending" message. After the long Thanksgiving holiday weekend, DeBruycker apparently learned that 10,000 shares had been purchased on his behalf at $12 per share. By January, the shares had declined to $2–5/16. The complaint reportedly alleges that Schwab should have provided better mechanisms to prevent or to lessen the risks of mistaken trades.[36]

**Broker–Dealer Web–Based Jurisdiction Disputes** – E–brokers are successfully defending efforts to hale them into distant courts based solely on "passive Internet presence". Thus, for example, on March 23, 2000, the Arizona Court of Appeals affirmed a lower court

order dismissing a class action complaint brought against broker–dealers located in New York and New Jersey.

The suit arose from the purchase of stock in a company named Discovery Zone by two Arizona residents during the summer of 1997. The men reportedly purchased their stock after a U.S. Bankruptcy Court had confirmed a bankruptcy reorganization plan that "extinguished" the stock, but before trading in the stock was suspended. The suit alleged claims for unjust enrichment and negligence and sought rescission and restitution remedies on behalf of approximately 5,500 supposed class members.

The court concluded that the plaintiffs had failed to sustain their burden to demonstrate that it had either specific or general jurisdiction over the defendants. The Court rejected arguments that it had specific jurisdiction simply because the defendants posted online stock quotes "that they knew and intended to be accessed by over 5,000 broker–dealers located . . . and representing buyers through the United States, including Arizona." Nor was it sufficient, according to the court, to allege that the defendants "electronically transmitt[ed] their asking price to and accept[ed] orders from the computer screens of the brokers located throughout the state." According to the Court, "[u]se of the Internet, without more, does not constitute purposeful availment for specific jurisdiction purposes."

Additionally, the Court held that it had no general jurisdiction over the defendants despite plaintiffs' arguments that the defendants' online contacts with broker–dealers located in Arizona were adequate to establish either substantial contacts with Arizona or systematic and continuous contacts with the State. Significantly, the Court also noted in its opinion that the plaintiffs also filed suits in New York and New Jersey and that Defendants had not contested the Courts' jurisdiction in those proceedings.[37]

**E–Broker Electronic Best Execution and Payment for Order Flow Claims –** On July 21, 2000, the Honorable Charles Schwartz Jr. of the United States District Court for the Eastern District of Louisiana entered a memorandum opinion and order approving settlement of consolidated nationwide class actions brought against Charles Schwab & Co., Inc. arising out of allegations that it purportedly failed "to provide 'best execution' of customers' stock transaction orders and [accepted] 'payments for order flow' from 'regional' and 'third markets' without disclosing the fact" to its customers. In its decision, the Court described the settlement as follows:

> Pursuant to the proposed settlement, Schwab agrees: (Part A) to review its procedures and make certain that its disclosures are provided to its customers in 'plain English;' (Part B) to employ a 'quality assurance team' to monitor the quality of the execution of customers' orders, a committee to review the work of the team, and an ombudsman to review customer complaints; (Part C) to develop and implement, within four years, a new trading system to be known as STAMP to provide flexibility for order routing and the ability to monitor execution quality; (Part D) to develop and implement, for at least a year, an investor education program for its customers regarding order handling, routing

and execution in the various markets; and (Part E) to expend no more than $20 million in connection with the foregoing activities. Schwab further agrees to pay the fees and costs of class counsel, up to the sum of $900,000.

Interestingly, the Court rejected objections to the settlement that were filed on behalf of Schwab customers who filed similar class actions against the company elsewhere in 1999. Those class actions were consolidated and became the subject of multi–district litigation in California. In addition to objecting to the settlement, the plaintiffs in that multi–district litigation moved to intervene in the case, although Judge Schwartz denied that motion.[38]

**E–Broker Systems Capacity and Operational Claims** – Though typically not presented strictly as securities claims, there have been several class actions and individual lawsuits to assert claims based on e–brokers' alleged failures to maintain adequate systems capacity. Typically these suits have been styled as breach of contract or deceptive advertising claims.

For example, on March 28, 2000, a New York State Court entered a ruling on a motion to dismiss certain claims and a motion to compel arbitration of other claims in a lawsuit brought against E*Trade Group Inc. The plaintiff in the suit alleged that "E*Trade, in its advertising and marketing materials, knowingly exaggerated the sophistication of its technology and its capacity to handle its' customers' transactions . . . E*Trade's service shutdowns in February 1999 were directly caused by E*Trade's failure to obtain the technology necessary to process the volume of trades its customers requested."

Judge Beatrice Shainswit of the Supreme Court of the State of New York for the County of New York ruled that the plaintiff agreed that all claims arising out of his E*Trade account "must be submitted to arbitration if plaintiff is a member of a class whose claims encompassed plaintiff's claims for which certification had been denied." E*Trade alleged that plaintiff was a member of classes defined in three other then–pending suits against E*Trade: (1) Cooper v. E*Trade Group Inc., Case No. CV 770328 (Cal. Superior Court, Santa Clara County); (2) Divito v. E*Trade Group Inc., Case No. CV 779810 (Cal. Superior Court, Santa Clara County); and (3) Cirignani v. E*Trade Group Inc., Case No. CV 780048 (Cal. Superior Ct., Santa Clara County). Because class certification was denied in the Cooper case (a denial that the Court noted appeared to be binding on the other two actions), the court concluded that the breach of contract claim in the case before it was subject to arbitration and dismissed the remainder of plaintiff's claims.[39]

**E–Broker False Advertising / Deceptive Trade Practices Claims** – The *Schwab* case described immediately above included a false advertising claim. Again, though not technically a securities claim, such claims are being asserted against members of the e–brokerage community. Another more recent example of such a case involved H&R Block Financial Advisors, Inc.

On October 10, 2001, the Superior Court of Arizona for Maricopa County reportedly approved a settlement agreement by H&R Block Financial Advisors, Inc. to pay $21 million to

settle a class action filed on behalf of investors who used the SmartTrade and SmartTrading Services of Olde Discount Corporation, a predecessor–in–interest to H&R Block Financial, and who purchased securities from Olde's house stocks known as "special ventures". The plaintiffs alleged claims including claims for false advertising. Plaintiffs alleged that investors were promised "full service" with "no commissions or markups of any kind" but the company allegedly steered customers to purchase only from Olde's "tiny pool of house stocks" with "exceptional markups and commissions", according to the allegations of the complaint.[40]

**So–Called "Corporate Cybersmear" Lawsuits –** A "corporate cybersmear" typically involves the posting of false and disparaging comments about a company, its management or its stock to electronic message boards or in Internet chat rooms. More than 150 lawsuits have been filed alleging such circumstances. Although the cases typically do not involve claims for securities fraud, they cannot be ignored in this context because they often involve allegations that the messages were posted with the intent to manipulate the company's stock price. New cybersmear cases come to light each week. They are far too numerous to attempt to list here.[41]

In perhaps the most interesting development in such cases, on December 17, 2001, a California Superior Court jury – after rendering a $425,000 verdict against individual defendants Michelangelo Delfino and Mary Day in a corporate cybersmear case filed by Varian Medical Systems – added an additional $350,000 punitive damage award against the pair. This brought the total awarded in what is generally believed to be the first corporate cybersmear case to go to trial to $775,000.[42]

**Other Miscellaneous Actions –** Other actions not so easy to categorize have been filed. For example, on November 13, 2001, Dow Jones & Co. reportedly filed suit in the Supreme Court of the State of New York for the County of New York against Cantor Fitzgerald Corp. and Market Data Corp. In the suit, Dow Jones reportedly seeks a declaratory judgment saying that it no longer is contractually obligated to pay the defendants for government securities data. Cantor Fitzgerald was the source of the data which was formatted by Market Data Corp. for distribution by Telerate. Telerate, which had exclusive rights to distribute the data, ceased operations on October 18, prompting Dow Jones to file suit seeking a declaration that it no longer is obligated to pay for the data.[43]

### B. "New" Types of Enforcement Proceedings

The SEC alone has now brought nearly 200 Internet–related enforcement proceedings. These cases involve a host of "new" types of enforcement proceedings relating to the Internet. Close scrutiny, however, reveals that these cases are merely "old wine in new bottles." The enforcement theories are familiar – only the medium through which the fraud is committed has changed.

Although there are many categories of such cases, some of the most common are: online "pump–and–dump" schemes, "stock–picking guru" cases, momentum trading cases involving manipulation techniques that use spam, for example; "web hoax" cases, online offering frauds,

"free–stock" offers, online ponzi schemes, online "prime bank" schemes, and Web–based scalping cases. Some of the more interesting categories of such cases are addressed below.

**Virtual Stock Exchange Case (Game vs. Transactions in Securities?) –** On September 20, 2001, the United States Court of Appeals for the First Circuit released an opinion in Securities and Exchange Commission v. SG Ltd., Nos. 01–1176 and 01–1332 (1st Cir.). The Court reversed the decision of the lower court which had dismissed the SEC's complaint for failure to state a claim. SG Ltd. operated StockGeneration.com, described as an online "game" involving virtual shares in a virtual stock market that existed only in cyberspace. According to the Opinion:

At least 800 United States domiciliaries, paying real cash, purchased virtual shares in the virtual companies listed on the defendants' virtual stock exchange. In the fall of 1999, over $4,700,000 in participants' funds was deposited into a Latvian bank account in the name of SG Trading Ltd. The following spring, more than $2,700,000 was deposited in Estonian bank accounts standing in the names of SG Ltd. and SG Perfect Ltd., respectively.

In late 1999, participants began to experience difficulties in redeeming their virtual shares. On March 20, 2000, these difficulties crested; SG unilaterally suspended all pending requests to withdraw funds and sharply reduced participants' account balances in all companies except the privileged company. Two weeks later, SG peremptorily announced a reverse stock split, which caused the share prices of all companies listed on the virtual exchange, including the privileged company, to plummet to 1/10,000th of their previous values. At about the same time, SG stopped responding to participant requests for the return of funds, yet continued to solicit new participants through its website.

The SEC filed suit alleging that SG Ltd's operations constituted a fraudulent scheme in violation of the antifraud and registration provisions of the federal securities laws. Although the District Court awarded temporary restraining and preliminary injunctive relief, it ultimately granted SG Ltd.'s motion to dismiss on the ground that the virtual shares were clearly marked as a game, lacked any business context, and did not constitute transactions in securities. The 1st Circuit reversed, holding that the operations could be found to involve transactions in securities and, thus, the SEC had alleged sufficient facts to state a triable claim.[44]

**Corporate Cybersmears –** While there have been more than 105 private corporate cybersmear lawsuits (*see supra*), there have been only a handful of corporate cybersmear enforcement actions. Federal and state enforcement proceedings as well as other interesting cybersmear developments involving the SEC are described below.

- **E–Rex, Inc.'s Complaint Filed With the SEC Alleging Minority Shareholder Group Has Engaged in Unlawful Electronic "Smear Campaign" Via the Internet –** On March 27, 2002, E–Rex, Inc. announced that it has "filed a formal complaint with the Securities and Exchange Commission against a minority group of shareholders led by Terry Shores and Chris Ford. The complaint

alleges that Ford and Shores, along with a small group of minority shareholders, have been manipulating the Company's stock price by continuously posting false and misleading information on the Internet and in press releases, and they have been attempting an illegal takeover of E–Rex since August 2001 in violation of the tender offer rules of the Securities Exchange Act."[45]

- **SEC's Settlement of Cybersmear Case Against Sean E. St. Heart** – On March 29, 2001, the SEC announced that it had filed and settled what it called a "cyber smear" lawsuit against 25–year–old Sean E. St. Heart. The SEC's complaint reportedly claimed that shortly after St. Heart received a "telephone call about an unpaid debt from someone engaged by" NCO Group, Inc., he posted a message to the Yahoo! Finance message board devoted to the company. The SEC says that the message falsely claimed that "he, as the President of St. Heart Productions, together with twelve other companies, had prepared a $20 million lawsuit against NCO for its 'business practices.'" The complaint further alleged that the posting led to a 28% drop in the price of the company's stock. According to the SEC, without admitting or denying the allegations, St. Heart "consented to entry of a judgment permanently enjoining him from violating the antifraud provisions of the federal securities laws – Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 thereunder. St. Heart further consented to the entry of a judgment that waives the imposition of a monetary penalty based on his demonstrated inability to pay."[46]

- **California Department of Corporations Cybersmear Suit** – On June 21, 2000, news reports revealed that California securities regulators prosecuted and settled a lawsuit against a man who, they claimed, allegedly posted false messages on a message board devoted to Metro–Goldwyn–Mayer in a reputed effort to manipulate the company's stock price. The case reportedly was settled after a "California Superior Court judge in Los Angeles . . . handed down an injunction [on Friday, June 16, 2000] ordering Victor Idrovo of Manhattan Beach, Calif., to issue no more 'false and misleading' statements online, pay a $4,500 fine and issue a retraction on a Yahoo! Finance message board." The man reportedly posed on the message board as the former Chairman and Chief Executive Officer of MGM, Frank G. Mancuso.[47]

**So–Called "Web Hoax" Cases** – On Friday, August 25, 2000, the shares of computer network hardware manufacturer Emulex Corporation fell more than sixty percent after a fake press release styled to look as though it came from the company was posted to Internet Wire, an online news service. The fake press release, posted at 9:30 a.m. Eastern Time just as the markets opened for trading, said that the company's President and Chief Executive Officer, Paul Folino, had resigned, that U.S. Securities and Exchange Commission was conducting a formal investigation of accounting irregularities at the company and that the company would revise its fourth quarter results to reflect losses.

Within minutes, major news services such as Bloomberg News and Dow Jones News Service became aware of the release and issued headlines reporting various elements of the bogus story. According to Bloomberg:

> The fictitious release appeared on Internet Wire at 9:30 a.m. East Coast time. At 10:13 a.m., Bloomberg News ran a headline based on the bogus release that said the company's chief executive stepped down and that the SEC would investigate Emulex's accounting. A minute later, Bloomberg published a headline, also based on the false news release, that said the company would revise its fourth–quarter results to a loss from net income.
>
> Dow Jones News Service at 10:40 a.m. sent a headline saying Emulex sees a fourth–quarter loss and two minutes later published a headline saying the company would revise its earnings for fiscal 1998 and 1999.
>
> At 10:57 a.m., Dow Jones reported that Emulex's spokesman said the news release was a hoax. Two minutes later, Bloomberg News published a headline reporting that the company told Dow Jones about the hoax. . . .[48]

Trading in the company's stock was halted on The NASDAQ Stock Market at 10:33 a.m. Trading resumed around 1:30 p.m., although upon resumption the stock reportedly was trading down 6–3/8 points.

The U.S. Securities and Exchange Commission and The NASDAQ Stock Market, Inc. immediately began Investigations. The computer fraud unit of the Federal Bureau of Investigation also investigated the hoax.[49]

On December 29, 2000, according to the SEC, 23–year–old Mark Simeon Jakob entered guilty pleas before the Honorable Dickran Tevrizian of the United States District Court for the Central District of Califorinia to two counts of securities fraud and one count of wire fraud in the scheme. In a related civil action brought by the SEC, a federal judge earlier entered a temporary restraining order, a preliminary injunction and an asset freeze against Jakob, freezing approximately $400,000 of his assets. That action, seeking a permanent injunction, disgorgement and civil penalties, reportedly is still pending.[50]

The Emulex Web hoax was not the first such hoax. There previously were six other such Web hoaxes involving Lucent Technologies Inc., International Coromandel, Aastrom Biosciences, Information Management Associates, AOL / Bid.com, and PairGain Technologies.[51] Since the Emulex Web hoax, there has been at least one other similar incident involving Go Online Networks Corp. [52]

**"Stock Guru" / "Stock–Picking" Web Sites** – Another category of Internet enforcement actions involve so–called "Stock Guru" or "Stock–Picking" Web sites. Typically, such actions involve allegations that stock–picking "gurus" have established Web sites on which they make

"recommendations" to subscribers without revealing that they have taken a position in the stock prior to making the recommendation and sell the stock while their subscribers are buying the stock, thereby driving up its price. Additionally, in a few instances, securities regulators have accused such Web site operators of failing to disclose compensation they have received from companies whose stocks they recommend on their Web site.

Although there have been many such cases to date, three have become rather infamous:

- **Jonathan Lebed, 14–Year–Old Stock "Guru" –** On September 20, the U.S. Securities and Exchange Commission brought and settled the first civil fraud charges it has ever brought against a minor. The charges were lodged against a 15–year–old New Jersey boy whom the SEC accused of making illegal profits of $272,826 based on eleven separate occasions of online securities fraud. According to the Commission's allegations, Jonathan G. Lebed of Cedar Grove, New Jersey, was fourteen years old when he used multiple aliases and "engaged in a scheme on the Internet in which he purchased, through brokerage accounts, a large block of a thinly–traded microcap stock. Within hours of making the purchase, Lebed sent numerous false and/or misleading unsolicited e–mail messages, or 'spam,' primarily to various Yahoo! Finance message boards, touting the stock he had just purchased. Lebed then sold all of these shares, usually within 24 hours, profiting from the increase in price his messages had caused. In some instances, Lebed placed a sell limit order before the market closed on the day he purchased the stock to ensure that he would not miss the price increase of the stock while he was in school the next day. Lebed's profits on each trade ranged from more than $11,000 to nearly $74,000." Lebed neither admitted nor denied the allegations, but settled the charges and agreed to entry of an administrative cease–and–desist order and to disgorge profits of $272,826, together with prejudgment interest of $12,174, for a total of $285,000.[53]

- **The Tokyo Joe Case –** On March 8, 2001, the U.S. Securities and Exchange Commission announced that it has finalized a settlement with "Tokyo Joe". The SEC filed a civil action against Yun Soo Oh Park, known in online circles as "Tokyo Joe", in January 2000 alleging that he operated a Web site through which investors paid a monthly subscription to receive recommendations and investment advice from him. According to the SEC's complaint, Park defrauded members of his Web service, known as Societe Anonyme Corp., by failing to disclose that on certain occasions he had already purchased the stock he was recommending and planned to sell those shares into the buying frenzy caused by his recommendations. Additionally, the SEC charged Park with touting the stock of one company to his subscribers without disclosing he had received shares of the stock allegedly in exchange for recommending the stock. Additionally, the SEC charged Park with misrepresenting his past performance results on the Web site. The dispute led to a widely–reported decision holding that the SEC had

adequately alleged that Park acted as an unregistered Investment Adviser within the meaning of the Investment Advisers Act and was subject to the antifraud provisions of the Federal securities laws. *See SEC v. Park*, 99 F. Supp. 2d 889 (N.D. Ill. 2000). Park and Societe Anonyme neither admitted nor denied the SEC's allegations, but consented to a permanent injunction prohibiting them from violating the antifraud provisions of the Investment Advisers Act of 1940 and the Securities Exchange Act of 1934, as well as the anti–touting provision of the Securities Act of 1933.[54]

- **Douglas Colt, Georgetown Law Student** – On March 2, 2000, the Securities and Exchange Commission filed a civil enforcement proceeding in the United States District Court for the District of Columbia, alleging that Douglas Colt, a Georgetown University law student, created a Web site known as "Fast–Trades.com." The SEC alleged that he used the Web site to manipulate the price of four stocks during February and March 1999. According to the complaint, Colt recommended stocks on the site and drove up the short–term price for each stock by as much as 700%. By trading in advance of his stock recommendations, Colt allegedly generated over $345,000 in total profits for himself, his mother Joanne Colt, three of his law school classmates, and two of his friends. Colt's mother, a Colorado Springs city councilwoman, subsequently resigned from her position after the charges were brought. Colt settled the charges, neither admitting nor denying the SEC's allegations. He subsequently received his law degree from Georgetown, was admitted to practice law in California and reportedly is now operating another stock–picking Web site on which he discloses his positions and trading practices.[55]

**So–Called "Momentum Trading" Schemes** – While "momentum trading" schemes may, at first blush, closely resemble "stock–picking guru" sites, they are recognized as a distinct enforcement category. The perpetrators of such scams typically use Web sites, online newsletters, electronic subscriber bases and massive numbers of unsolicitied e–mails simply to drum up interest – and, thus, "momentum" – in a particular stock. The perpetrators typically sell their shares as the stock price rises in a scheme that may only have a life span of a few hours.[56]

Although the examples are legion, here are a few of the more notorious instances addressed by securities regulators:

- **TnTStock.com** – On March 1, 2001, the U.S. Securities and Exchange Commission reportedly filed a civil suit in the United States District Court for the District of Oregon against two brothers named Jared Ray Leisek (age 25) and Byron John Leisek (age 22). The pair is accused of operating a so–called "momentum stock picking Web site" known as TnTStock.com. According to the SEC, the brothers used the site and an e–mail newsletter to communicate with

more than 13,000 subscribers to create momentum in the stocks which they held, but then sold upon making their recommendations.[57]

- **EquityAlert.com** – On August 25, 2000, the U.S. Securities and Exchange Commission announced that on August 8, the United States District Court for the District of Arizona issued permanent injunctions against EquityAlert.com, Inc. and Harmel S. Rayat. The defendants consented, neither admitting nor denying the Commission's allegations. According to the SEC's announcement, the Commission alleged that the defendants had violated Section 17(b) of the Securities Act of 1933 by failing to disclose the compensation they received for promoting companies' stock on their website and in more than one million daily e–mail messages disseminated worldwide. It was also alleged that in some instances the defendants disseminated daily press releases that compiled and referred to the promotional statements, claiming EquityAlert had provided its subscribers with 'proprietary coverage' of these 'top momentum' issuers.[58]

- **Thomas Carter's "Unity List"** – In *Securities and Exchange Commission v. Thomas Carter*, Civ. Action No. CV 00–09457 GHK (SHX) (C.D. Cal.), the SEC alleged that Defendant Thomas Carter created an e–mail list known as the "Unity List" which he claimed was a momentum trading list. He allegedly sent e–mail messages to "thousands" containing rumors about the stocks. The e–mails reportedly urged recipients to buy shares in the subject companies at the same time and "stated that the author planned to purchase large quantities of the stocks at the same times, implying that the author did not yet have a position in the securities." Actually, according to the SEC, Carter already had purchased shares in the companies and sold his own shares in the rising market for the securities making more than $12,000. The SEC seeks a permanent injunction against Carter for violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 thereunder. The SEC also seeks disgorgement, plus prejudgment interest, and a civil monetary penalty.[59]

**Internet Pump–and–Dump Schemes** – Once again, securities regulators have brought so many such cases that they are too numerous to list. Typically, such cases involve the use of e–mail, Websites or online newsletters to distribute false, positive information about a company with thinly–traded stock. Once the stock price reacts favorably to the false news, the perpetrators sell their stake in the company. A few such examples include:

- **NEI Webworld Pump–and–Dump Scheme** – On January 23, 2001, the U.S. Securities and Exchange Commission announced that two of the three defendants in the SEC's NEI Webworld, Inc. online stock civil suit "have agreed to settle the case by surrendering substantially all their assets and consenting to the entry of permanent injunctions." The two men, who neither admitted nor denied the SEC's allegations, are Hootan Melamed and Allen Derzakharian.

Interestingly, the Commission also announced that it has filed a new action naming a fourth individual named Arash (Danny) Molayem as a party who allegedly participated in the NEI Webworld and other online stock manipulations. Simultaneously with the announcement, Molayem reportedly consented to entry of a permanent injunction and agreed to disgorge his trading profits. The SEC's previously–filed complaint against the fourth person, Arash Azia–Golshani, remains pending. In a separate, but related criminal action brought by the United States Attorney for the Central District of California, Aziz–Golshani reportedly pled guilty to one count of securities fraud and one count of conspiracy to commit securities fraud. Melamed reportedly pled guilty to one count of conspiracy to commit securities fraud. On January 22, Azia–Golshani reportedly was sentenced to 15 months incarceration and ordered to pay restitution. Melamed reportedly was sentenced to 10 months incarceration and ordered to pay restitution in proceedings conducted on January 12. The NEI Webworld online pump–and–dump scam garnered widespread media attention in November 1999 when the price of the bankrupt company's shares soared from 13¢ to over $15 after thousands of messages were posted to online message boards by persons using a variety of aliases. When the fraud was revealed the stock price collapsed, but not before these defendants had sold shares that they had bought in the company before the messages were posted. Some of the defendants were accused of using computers at a University of California biomedical library to post messages to the effect that NEI Webworld would be taken over by LGC wireless.[60]

- **The PennyStockMan –** On March 7, 2001, the U.S. Securities and Exchange Commission settled a civil lawsuit against Lloyd Wollmershauser of Cleveland, Ohio. The SEC's complaint reportedly accused the man of using the Internet in a pump–and–dump scheme that manipulated the price of the stock of biotech firm Thermotek International. Additionally, Thermotek reportedly settled its own administrative proceeding in which it reportedly was accused of "failing to register" 2 million shares of stock in the company that reportedly were sold to Lloyd Wollmershauser for $800,000. According to the SEC's announcement: "[w]ithout admitting or denying the allegations in the complaint, Wollmershauser consented to the entry of an Order that (i) enjoins him from violating Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 thereunder, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940; (ii) orders him to pay disgorgement of $436,660; and (iii) waives disgorgement in excess of $205,000 and does not impose a civil penalty based on Wollmershauser's sworn statements demonstrating his inability to pay."[61]

**"Free Stock Offers" –** The U.S. Securities and Exchange Commission takes the position that visiting a Web site and providing personal information (like name, address and e–mail

address) in exchange for "free" shares of stock actually involves the exchange of "value" for the stock and thus subjects the stock offer to registration requirements under U.S. securities laws. When such "free stock offers" involve unregistered shares that are not subject to any available exemptions from registration, the Commission deems the offers to be in violation of the law. A number of such offerings have been the subject of enforcement activity by the Commission. A few examples are addressed below.

- **UniversalScience.com –** On August 8, 2000, the U.S. Securities and Exchange Commission announced that it filed and settled cease–and–desist proceedings against UniversalScience.com, Inc. and Rene Perez. The SEC alleged that "[b]eginning in May 1999, Universalscience and its president, Perez, offered to sell and sold 'free' shares of Universalscience stock via the Internet" to visitors who registered to use the company's "surf the Web for pay" program. According to the SEC, in addition to offering up to 100 shares of stock to visitors who agreed to surf the Web for pay, the company also allegedly made an online offer to sell up to 1,000 shares of company stock to each visitor for $1 a share. In a resounding vote of confidence for the company's prospects, not one single visitor purchased company shares in the offering, but 4,000 visitors reportedly signed up for "free" shares. While the company agreed to cease and desist from offering free stock, it neither admitted nor denied wrongdoing.[62]

- **July 1999 Free Stock Enforcement Sweep –** On July 22, 1999, the SEC announced that it settled administrative proceedings that it had brought against two companies and four individuals alleging that they had violated federal securities laws by offering "free" stock on their Web sites without registering the stock with the SEC. No fines were imposed and, without admitting or denying the SEC's findings, all parties agreed to no further violations of the registration provisions of the Securities Act of 1933. In addition, certain respondents agreed to refrain from violations of the antifraud provisions of the federal securities laws.[63]

**Unregistered Online Offerings –** Securities regulators also have used enforcement proceedings to curb unregistered online stock offerings that do not involve so–called "free stock." Once again, there have been numerous such proceedings, although only a few examples are referenced below.

- **Globus Group Online Offering –** In July 1999, the U.S. Securities and Exchange Commission announced that it filed a civil suit in Federal court in Miami, Florida against Globus Group, Inc., Bruce Gorcya (who reportedly uses the alias "Anthony DiMarco") and others. According to the SEC, Mr. DiMarco sent faxes to unsuspecting investors. The faxes were made to appear as though they were sent in error from brokers providing stock tips to some of their other customers. Additionally, the SEC alleged that the defendants purportedly offered

investments in microcap companies via a Web site that allegedly claimed, falsely, that the investments were authorized by the U.S. Government. The SEC subsequently announced that it obtained a temporary restraining order against the defendants reportedly barring them from future securities law violations and freezing their assets. Thereafter, the Commission further announced that it obtained a temporary restraining order against the defendants on July 16 and that on July 30, the Honorable Alan S. Gold entered a preliminary injunction order finding that "a securities fraud . . was effected through three means: (1) sending spam facsimile messages ostensibly issued by reputable financial firms recommending the stocks of twelve microcap companies; (2) generating false press issued by six of those companies; and (3) posting on the Internet a fraudulent offering of investment interests."[64]

- **Cellular Video Car Alarms –** On October 3, 2000, the U.S. Securities and Exchange Commission filed a complaint and obtained an *ex parte* temporary restraining order from the United States District Court for the Southern District of New York against Carl Robinson and his company, Cellular Video Car Alarms, Inc. The SEC alleges that the defendants defrauded investors of more than $400,000 by offering and selling unregistered shares of the company's stock based on false, deceptive and misleading statements made on Cellular Video's Web site and in the print media. The SEC also alleges that the defendants "engaged in a general solicitation of investors on the company's web site, in dozens of newspapers, and through the use of a roadside billboard."[65]

## X. Shareholder Activists Have Discovered the Web

### A. Attorneys Are Teaching Activists To Use the Web

Plaintiffs' securities lawyers are using the Internet to *teach* shareholders how to use the Web to enforce their shareholder rights. For example, plaintiffs' counsel are posting articles at Web sites frequented by disgruntled investors – sites such as ClassAction.com – in an effort to tutor investors on how to use the Web to enforce their rights and even to participate as lead plaintiffs in securities class actions. One such article, posted by an attorney with a securities class plaintiffs' firm, says:

> Recent federal legislation and the growth of the world wide web have greatly enhanced private enforcement of the federal securities laws. The web gives shareholders unprecedented access to information about companies and, with bulletin boards and chat rooms, an ability to communicate with each other about their investments. This communication has increased shareholder activism, and more shareholders than ever before are learning about and getting involved in securities class action lawsuits, which generally provide the only way for defrauded investors to recover their losses.[66]

The author continues by suggesting to investors that they can use the Web to determine if they have been defrauded by:

- Looking "for inconsistencies between the company's past statements and what it is now saying, or indications that adverse facts were previously known within the company";
- Checking for insider trading;
- Checking the message boards for "insights and ideas about what happened";
- Reviewing company–specific pages on Yahoo! Looking for Private Securities Litigation Reform Act notices, reviewing Stanford Law School's Securities Class Action Clearing House Web site for information on recently–filed cases and checking the Web sites of law firms that have filed securities actions against the company; and
- Contacting a "shareholder attorney" for a "free analysis of your claim".[67]

**B. Shareholder Activists Are Heeding the Lesson**

Shareholder activists are heeding the counsel of the plaintiffs' securities bar. Increasingly they are using the Internet to organize shareholder initiatives.

Recently, for example, shareholders of Xicor Corp. reportedly were organized by a stockholder who used the alias "Rip" on a Yahoo! Finance message board devoted to Xicor and who urged shareholders to collaborate to remove the Chief Executive Officer of the company. According to one news report, "within weeks" Xicor announced that the CEO was retiring and would leave the company's Board of Directors. Although the report says the former CEO has indicated that shareholders "played 'a role'" in his departure, neither he nor the company provided further details.[68]

In another interesting example, one shareholder activist Web site has received widespread media attention. The site, known as eRaider, is dedicated to online shareholder activism. It is located at http://www.eRaider.com/. It describes itself as "an Internet confederation of shareholders who believe that owning a company carries rights and responsibilities." The site was founded by Martin Stoller who teaches Crisis Management at the Kellogg School of Management at Northwestern University and Aaron Brown, who teaches Finance at Yeshiva University. On its homepage, the site currently states:

> eRaider targets companies that we think can benefit from aggressive shareholder oversight, buys a substantial position in the stock, then opens discussions with management and the board about improving equity value. In the case of target company

> Goldfield (GV), our negotiations have been unsuccessful so far. Now we want your vote in the upcoming proxy fight for the Shareholder Value Slate.[69]

Perhaps most interesting about the eRaider.com Web site is the fact that it attracts so many people who claim to be dissatisfied shareholders to the message boards that it creates for its so–called "Target Companies". The authors of the postings exchange information and ideas on the steps to be taken, including proxy solicitations, to improve shareholder value in the target companies.[70]

A recent article by Aaron Elstein and Peter Edmonston of *The Wall Street Journal Interactive Edition* highlighted the role that message boards have begun to play in securities class actions. According to the article, the Web has become important in a resurgence of shareholder class actions in defiance of the Private Securities Litigation Reform Act intended to curb such cases. The resurgence:

> Has coincided with the popularity of online–message boards. These Web forums bring disgruntled investors together and make it easier to identify a class of potentially wronged shareholders. Also, lawyers have discovered these message boards are a happy–hunting ground for leads and evidence for their cases.[71]

## XI. "Designated Internet Sites"

After passage of the Private Securities Litigation Reform Act of 1995 ("PSLRA")[72], the United States District Court for the Northern District of California became the first federal court to require the posting to the Web of certain papers filed in private securities litigations.

The Court set forth these requirements in Civil Local Rule 23–2.[73] Implementation of the rule was announced jointly by the Court and by the U.S. Securities and Exchange Commission on December 6, 1997.

In its commentary to the rule, the Court noted that the PSLRA contains provisions "designed to disseminate broadly to investors information relating to the initiation and settlement of class action securities fraud litigation in federal courts" and that the legislative history of the Act demonstrates that Congress intended litigants to "make use of 'electronic or computer services' to notify class members".[74] Thus, the Court continued in its commentary:

> Notification to class members traditionally involves a combination of mailings and newspaper advertisements that are expensive, employ small type, convey little substantive information and that may be difficult for members of the class to locate. The rapid growth of Internet technology provides a valuable means whereby extensive amounts of information can be communicated at low cost to all actual or potential members of a class, as well as to other members of the public. Consistent with Congressional intent to promote the use of 'electronic or computer services', this rule seeks to employ Internet technology to disseminate broadly information related to class

action securities fraud litigation. Civil L.R. 23–2 is designed to capitalize on the potentially substantial benefits of the Internet for class members, counsel, and the Court while imposing *de minimus* costs.[75]

Civil Local Rule 23–2 provides for the establishment of so–called "Designated Internet Sites" to which copies of court filings in appropriate cases are required to be filed on the day the document is filed with the federal court in the Northern District of California.[76] Only two such sites have been created to date.

The first Designated Internet Site, Stanford Securities Class Action Clearinghouse, was created by the Robert Crown Law Library and Stanford University and was spearheaded by Professor Joseph Grundfest of Stanford Law School, a former Commissioner of the U.S. Securities and Exchange Commission. It is located at http://securities.stanford.edu/. The site has expanded its initial mandate so that it now includes filings in shareholder suits brought in federal and state courts throughout the country.

The second Designated Internet Site was created by the nation's largest securities class plaintiffs' firm, Milberg, Weiss, Bershad, Hynes & Lerach, LLP. The site includes filings in cases filed by the firm against more than eighty companies. The site is located at http://securities.milberg.com/.

These Designated Internet Sites perform a host of important functions. They allow the U.S. Securities and Exchange Commission to monitor the progress of many private securities litigations inexpensively and efficiently. They provide investors and the general public with easily accessible information about the cases in a much shorter time frame and at far less expense than previously was possible. They enable plaintiffs' attorneys to stay abreast of the latest defense strategies and legal arguments and to evolve their own pleadings accordingly. Defendants' counsel likewise can stay abreast of plaintiffs' pleading tactics and of the latest strategies and arguments in response. Judges can quickly access and search a wealth of unpublished judicial decisions on topics they are required to decide. In short, the Designated Internet Sites have made the process of staying abreast of private securities litigation developments easier, less expensive and far more efficient.[77]

## XII. Secure Extranets

Private securities defense counsel are themselves becoming well–versed in the use of the Web to render their defense of such actions more effective and efficient. One example is a secure extranet offered by National Union Fire Insurance Company of Pittsburgh, Pa. to its so–called "Panel Counsel firms." Those firms defend National Union insureds in complex securities litigation and technology–related claims.

National Union offers a secure extranet known as BriefBase ®. The public area of the secure extranet explains as follows:

> BriefBase ® Internet resources are proprietary web–based systems created exclusively by National Union Fire Insurance Company of Pittsburgh, Pa., the nation's leading provider of management and professional liability insurance, to help give its Panel Counsel firms every advantage in developing the optimal defense for insureds facing complex securities litigation and technology–related claims. Two separate BriefBase ® databases arm D&O and Technology Panel Counsel attorneys with a vast reservoir of information on the latest pleadings, court opinions and expert testimony related to securities and technology claims – information that is not readily accessible elsewhere.
>
> BriefBase ® D&O includes information that is particularly essential in today's high–stakes securities litigation environment, as fallout from securities litigation reform has prompted unprecedented state court actions and new plaintiff attorney tactics – and made defending securities litigation more difficult than ever before. . . .
>
> Both BriefBase ® Internet resources help to promote the best possible litigation defense by enabling attorneys to, in essence, tap into the collective knowledge and experience of their Panel Counsel colleagues – which include the nation's leading defense attorneys – to help obtain the most favorable results. BriefBase ® Internet resources also help to eliminate research redundancy and reduce attorney research time.[78]

## XIII. Plaintiffs' Counsel Are Using Web Sites To Speed The Process of Identifying Prospective Plaintiffs To Retain Them and To Provide Required Named Plaintiff Certifications

Plaintiffs' counsel are using their law firm Web sites to make it easier for prospective plaintiffs to retain their services and to submit named plaintiff certifications.

Perhaps the most sophisticated implementation of this technique appears on the Web site of Milberg Weiss Bershad Hynes & Lerach LLP. At various places on the site, there are links entitled "Join a Class Action".[79] Clicking on such links takes the viewer to a page entitled "Join a Class Action" which includes a list of the Firm's current class actions.[80] Each entry in the list is itself a link to a page devoted to that case.

When a user clicks on a link to any such case page, a screen appears entitled "Notice of Pending Action".[81] Such pages typically include such information as the following, quoted from the page regarding the Visual Networks securities litigation:

> To Visual Networks, Inc. Security Purchasers:
>
> On August 11, 2000, Milberg Weiss filed a complaint alleging violations of the federal securities laws by Visual Networks, Inc. and certain of its officers and/or directors. The class action was commenced in the United States District Court, for the District of Maryland on behalf of purchasers of Visual Networks publicly traded securities during the period between February 7, 2000 and July 5, 2000.

Click here to view the complaint (please be patient while it loads into your browser)

If you purchased shares of Visual Networks publicly traded securities between February 7, 2000 and July 5, 2000 you qualify to join our clients in the securities law action as lead plaintiffs. To do so, please complete the attached electronic certification and retention forms. If you join our clients in retaining us, we will provide you with periodic reports on the progress of the case.

Click Here to Retain Milberg Weiss[82]

Clicking on "Click Here to Retain Milberg Weiss," in turn, brings up an "Email Address Verifier" that ultimately will enable the user to sign the subsequent form with an electronic signature intended to have the same validity and effect as a signature affixed to the form by hand. The "Email Address Verifier page requires the user to provide a valid e–mail address. Once provided, the user must click on a button that says "Send Unique ID to that address". The system automatically issues a unique ID in an e–mail directed to the user's listed e–mail box.[83]

The e–mail provides a unique identifier consisting of numbers and letters and states as follows:

> The inclusion of this ID number on the sign–up form is considered an electronic signature which is unique to the person using it. This electronic signature shall have the same validity as, and effect of, a signature affixed by hand. Please make every effort to exercise reasonable care to retain control of this unique ID number until the sign–up process is completed, so that the electronic signature is used only with your intent and knowledge. This electronic signature is only valid for signing your Certification on the Milberg Weiss website and is not binding for any other purposes. You may delete this message once you have completed your online sign–up.

By clicking on a link in the e–mail, the viewer is able to access a document entitled "Certification of Proposed Lead Plaintiff Pursuant to the Federal Securities Laws". That document asks for identifying information about the investor and sets forth declarations such as the following:

1. I have reviewed the Visual Networks complaint prepared by Milberg Weiss Bershad Hynes & Lerach LLP, whom I designate as my counsel in this action for all purposes.

2. I did not acquire Visual Networks stock at the direction of plaintiff's counsel or in order to participate in any private action under the federal securities laws.

3. I am willing to serve as a lead plaintiff either individually or as part of a group. A lead plaintiff is a representative party who acts on behalf of other class

members in directing the action, and whose duties may include testifying at deposition and trial.

4. I will not accept any payment for serving as a representative party beyond my pro rata share of any recovery, except reasonable costs and expenses, such as travel expenses and lost wages directly related to the class representation, as ordered or approved by the court pursuant to law.

5. I have not sought to serve or served as a representative party for a class in an action under the federal securities laws within the past three years, except [fill in the blank]

6. I understand that this is not a claim form, and that my ability to share in any recovery as a member of the class is unaffected by my decision to serve as a representative party.

The form also asks for acquisition information and sales information for the securities that were owned by the investor and requires a declaration under penalty of perjury that the information that has been entered is accurate.

One is tempted to argue that such sophisticated implementation of these basic Web technologies, at least theoretically, might allow Milberg Weiss to commence representation of allegedly aggrieved shareholders within mere moments after: (i) the firm determines what it believes to be the reason for a major decline in the price of a company's stock; and (ii) completes its investigation and the preparation of a proposed complaint.

Though Milberg Weiss is sophisticated in its use of the Web to gain certifications of named plaintiffs as required under the federal securities laws, it is not the only firm that uses the Web for this purpose. Other securities plaintiffs' firms post such certifications on their Web sites for allegedly aggrieved shareholders to download, complete and return to the firm.[84]

## XIV. Conclusion

The Internet is indeed changing the face of private securities litigation, arbitrations and regulatory enforcement activity. What the future holds is anybody's guess. In all likelihood, though, in the not too distant years, we will see universal electronic filing and service of all litigation papers, including those filed in securities cases. We will see the use of online oral arguments in limited circumstances where a Judge already has a good grasp of the basic issues but would like additional issues addressed and is unwilling to require the time and travel it would take for full–blown arguments. We will see increased use of secure extranets to support both plaintiffs and defendants in their securities cases. We will see increased use of online document repositories to reduce the inefficiencies of the discovery process in securities litigations and arbitrations. We may even see increased uses of technology that allows online depositions, once again to reduce the inefficiencies of the discovery process.

In short, securities litigation will never be the same. The Internet is largely responsible.

## ENDNOTES

1 Office of Administration of the U.S. Courts, Questions and Answers on Rules Authorizing Electronic Service (visited Mar. 21, 2002) <http://www.uscourts.gov/Press_Releases/elecattach.pdf>.

2 To learn more about the secure extranet, see Carlyn Kolker, Securities Litigation, Web–Style, *AmLaw Tech: A Supplement to the American Lawyer* (Mar. 2002) at pp. 13–14.

3 *See also Hawaii Structural Iron Workers Pension Trust Fund v. Apple Computer, Inc. and Steven P. Jobs*, Complaint for Violation of the Securities Exchange Act of 1934 (N.D. Cal., filed Sept. 27, 2001) p. 1 <http://securities2.stanford.edu/1020/AAPL01/20010927_f01c_HAWAIII.pdf>.

4 *Keith Mautner v. ACLN, Ltd., et al.*, Class Action Complaint for Violations of Federal Securities Laws ¶ 39, p. 17 (S.D.N.Y., complaint filed Dec. 27, 2001) <http://securities2.stanford.edu/1023/ASW01–01/20011227_f01c_Mautner.pdf>.

5 *Id.* ¶ 39, p. 16 & ¶ 42, pp. 21–23.

6 *See, e.g.*, Harvey Raskind v. Amylin Pharmaceuticals, Inc. and Joseph C. Cook, Jr., Complaint for Violation of the Federal Securities Laws (S.D. Cal., filed Aug. 17, 2001) ¶ 36, p. 19 <http://securities2.stanford.edu/1020/AMLN01/20010817_o01c_RASKIND.pdf>.

7 *Hawaii Structural Iron Workers Pension Trust Fund v. Apple Computer, Inc. and Steven P. Jobs*, Complaint for Violation of the Securities Exchange Act of 1934 (N.D. Cal., filed Sept. 27, 2001) ¶ 24, p. 21 & ¶ 127, p. 91 <http://securities2.stanford.edu/1020/AAPL01/20010927_f01c_HAWAIII.pdf>.

8 *See, e.g., Lui v. Cybermedia, Inc., et al.*, Case No. 98–2617 MMM (CWx), Complaint for Violation of Federal Securities Laws ¶ 110 (C.D. Cal., Apr. 8, 1998) <http://securities.stanford.edu/complaints /cybr/98cv02617/001.html> (Web site allegedly contained "false and misleading representations about the Company and the strengths of its products"); *Ong v. Cybermedia, Inc., et al.*, Case No. 98 CV 01811, Complaint for Violation of Federal Securities Laws ¶ 102 (C.D. Cal., Mar. 12, 1999) <http://securities. stanford.edu/complaints/cybr/98cv01811/001.html> (same); *Ellison v. American Image Motor Co.,* Civ. Action No. 97 Civ. 3608, Class Action Complaint for Violations of Federal Securities Law and Common Law ¶¶ 54–57 (S.D.N.Y., complaint dated May 16, 1997) <http://securities.stanford.edu/complaints/usmc/97cv03608/001.html> (alleging statements on Web site to be false); *Howard Gunty Profit Sharing v. Quantum Corp.*, No.

C–96–20711–SW (EAI), First Amended Complaint for Violation of the Securities Exchange Act of 1934 ¶¶ 28–29 (N.D. Cal., San Jose Div., complaint filed Sept. 12, 1997) <http://securities.Stanford.EDU/complaints/quantum/96cv20711/038.html> (alleging "corporate backgrounder" posted to Web site to be false); *Great Neck Capital Appreciation Investment Partnership, L.P. v. Jeffrey T. Grade, et al.*, C.A. No. 98–CV–524, Class Action Complaint for Violation of the Federal Securities Laws ¶¶ 43–45 (E.D. Wis., complaint filed Jun. 5, 1998) <http://securities.Stanford.EDU/complaints/hph/98cv00524/001.html> (speech posted to Web site allegedly contained false and misleading misstatements of material fact); *Paul Berger, et al. v. Andrew K. Ludwick, et al.*, Case No. C–97–0728–CAL, Third Amended Class Action Complaint ¶ 172 (N.D. Cal., filed Dec. 15, 1999) <http://securities.Stanford.EDU/complaints/bay/97cv00728/119.html> (statements on Web site allegedly contradicted public disclosures); Timothy Burton v. Informix Corp., et al., Case No. C–97–2976, Class Action Complaint for Violations of the Securities Exchange Act of 1934 ¶ 68 (N.D. Cal., complaint filed Aug. 13, 1997) <http://securities.Stanford.EDU/complaints/informix/97cv02976/001.html> (letter to shareholders published on Web site allegedly omitted to state true reasons for "poor financial performance").

9 *Hawaii Structural Iron Workers Pension Trust Fund v. Apple Computer, Inc. and Steven P. Jobs*, Complaint for Violation of the Securities Exchange Act of 1934 (N.D. Cal., filed Sept. 27, 2001) ¶ 24, pp. 20–21 & ¶ 126, pp. 90–91 <http://securities2.stanford.edu/1020/AAPL01/20010927_f01c_HAWAIII.pdf>.

10 *Martin L. Mayo v. Apropos Technology, Inc.*, et al., Class Action Complaint (N.D. Ill., complaint filed Nov. 2, 2001) ¶ 8, p. 4 & ¶ 64, p. 15 <http://securities2.stanford.edu/1021/APRS01/20011102_f01c_Mayo.pdf>.

11 *See, e.g., Hawaii Structural Iron Workers Pension Trust Fund v. Apple Computer, Inc. and Steven P. Jobs*, Complaint for Violation of the Securities Exchange Act of 1934 (N.D. Cal., filed Sept. 27, 2001) ¶ 5, pp. 3–4 http://securities2.stanford.edu/1020/AAPL01/20010927_f01c_HAWAIII.pdf; Cauley Geller Bowman & Coates, LLP, *CORRECTION – Cauley Geller Bowman & Coates, LLP Announces Class Action Lawsuit Against Emulex Corporation Seeking Damages on Behalf of Shareholders*, Primezone special to Yahoo! Finance (Feb. 21, 2001) <http://biz.yahoo.com/pz/010221/14606.html>.

12 *See, e.g., Harrington v. 2TheMart.com, Inc., et al.*, Case No. 99cv01127, Class Action Complaint for the Violation of Federal Securities Laws ¶ 38 (C.D. Cal., So. Div., Sept. 13, 1999) (citing broadcast e–mail to shareholders as allegedly misrepresenting that deployment of Web site was on schedule when it was not).

[13] Such procedures have long been advocated by securities counsel who have argued that Web postings should be treated no differently than company press releases and should receive the same care and attention to accuracy. *See, e.g.*, Blake A. Bell, *Dealing With False Internet Rumors: A Corporate Primer*, 2(7)Wallstreetlawyer.com 1 (Glasser LegalWorks Dec. 1998) ("it is critical that [the company] treat all such communications just as carefully as it would a formal press release issued in a more traditional context. Such communications should be vetted with counsel and should be scrupulously accurate and complete.") <http://www.simpsonthacher.com/memos/art006.htm >.

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[15] *Id.*

[16] *Hawaii Structural Iron Workers Pension Trust Fund v. Apple Computer, Inc. and Steven P. Jobs*, Complaint for Violation of the Securities Exchange Act of 1934 (N.D. Cal., filed Sept. 27, 2001) ¶ 24, pp. 20–21 & ¶ 126, pp. 90–91 <http://securities2.stanford.edu/1020/AAPL01/20010927_f01c_HAWAIII.pdf>.

[17] 15 U.S.C.A § 78m(d) and 15 U.S.C.A. § 78n(a).

[18] *See The Emerging Germany Fund, Inc. v. Phillip Goldstein, Opportunity Partners L.P., Kimball & Winthrop, Inc., Ronald Olin and Deep Discount Advisors, Inc.*, 98 Civ. 2508 (S.D.N.Y., complaint filed April 8, 1998) and *Opportunity Partners L.P., and Great Neck Capital Appreciation Investment Partnership, L.P. v. The Emerging Mexico Fund, Inc., Gonzalo De Las Heras, Philip L. Bullen, Rodney B. Wagner, Edgar R. Fiedler and Richard S. Weiner*, No. 98 Civ. 4218 (WK) (S.D.N.Y., complaint filed June 16, 1998).

[19] For more about use of the Internet by shareholder activists to solicit proxies, see Blake A. Bell, *Do Shareholder Activists Violate Federal Proxy Solicitation Laws Through Internet Message Boards?,* 2(4) wallstreetlawyer.com 8 (Glasser LegalWorks Sept. 1998) <http://www.simpsonthacher.com/memos/art012.htm>. For a bibliography of articles relating to use of the Internet for proxy solicitation, *see* CyberSecuritiesLaw.com *Proxy Solicitation* <http://www.cybersecuritieslaw.com/biblio/proxy_solicitations.htm>.

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[21] *See DeMaria, et al. v. Andersen, et al.*, Case No. 00 Civ. 2337 (S.D.N.Y.). See also Bruce Balestier, Class Action Dismissed: Company's Print Prospectus Trumps E–Version, N.Y.L.J. (Mar. 30, 2001)

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22 *Alan Fellman, On Behalf of Himself and All Others Similarly Situated, Plaintiffs v. Electro Optical Systems Corp., Charles Weaver, George C. Chachas, U.S. Milestone, Thomas Edward Cavanagh, William Levy, Donald & Co., Cosimo Tacopino, the Future Superstock, and Barrow Street Research, Defendants,* No. 98 Civ. 6403 LBS, 2000 WL 489713 (S.D.N.Y., Memorandum and Order filed Apr. 25, 2000); *Securities Fraud: S.D.N.Y. Allows Fraud Suit Against Internet Newsletter To Proceed*, 1(1) e–Trading Legal Alert 8–9 (Andrews Publications June 9, 2000).

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<http://www.siliconinvestor.com/stocktalk/msg.gsp?msgid=13552730 >.

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<http://www.techlawjournal.com/courts/emulex/20000831.asp>. *See also Class Action Suit Filed Against Internet Wire and and Bloomberg Over Emulex Hoax*, TechLawJournal.com (Sept. 5, 2000)
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28 Cauley Geller Bowman & Coates, LLP, *CORRECTION – Cauley Geller Bowman & Coates, LLP Announces Class Action Lawsuit Against Emulex Corporation Seeking Damages on Behalf of Shareholders*, Primezone special to Yahoo! Finance (Feb. 21, 2001) <http://biz.yahoo.com/pz/010221/14606.html>.

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