THE IMPACT OF THE INTERNET ON SECURITIES LITIGATION: CHANGING THE WAY PLAINTIFFS SUE BUSINESS

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JUNE 1, 2001

The Internet is changing the face of securities litigation.

- Class counsel routinely 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.

- Plaintiffs' counsel are using their law firm Web sites to make it easier to retain them to represent allegedly aggrieved shareholders.

- Class counsel are complaining that because their complaints, occasionally based on weeks of hard work and investigation, are immediately available via the Web, their allegations are being filched by other plaintiffs' firms which quickly file copycat lawsuits.

The list of changes wrought by the Internet in the securities litigation context goes on and on. This article explores some of the most significant recent developments in this area.

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I. Class Counsel Are Using 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.[1]

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.[2]

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.[3]

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.[4]

II. Class Plaintiffs' Counsel Are Scrutinizing Financial Message Boards Looking for Leads and Evidence for their Cases

Plaintiffs' securities counsel are scrutinizing 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 recently prompted an article in *The Wall Street Journal Interactive Edition*. That article discussed a securities class action recently 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.[5]

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"[6]

III. The Internet Is Breeding "New" Types of Securities Lawsuits, Arbitrations and Enforcement Proceedings

The Internet is responsible for 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[7] by posting messages to an Internet message board devoted to discussions of closed-end funds.[8] 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.[9]

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.[10]

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.[11]

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."[12]

Lawsuit Alleging an Electronic Short-Selling Conspiracy - 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."[13]

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.[14]

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."[15]

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.[16]

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."[17]

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.[18]

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.[19]

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.[20]

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.[21]

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.[22]

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.[23]

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.[24]

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.[25]

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.[26]

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 120 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.[27]

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.

Corporate Cybersmears – While there have been well over 100 private corporate cybersmear lawsuits (*see supra*), there have been only a handful of corporate cybersmear enforcement actions. Federal and state enforcement proceedings are described below.

- **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."[28]

- **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.[29]

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. . . .[30]

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.[31]

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 California 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.[32]

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.[33] Since the Emulex Web hoax, there has been at least one other similar incident involving Go Online Networks Corp. [34]

"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.[35]

- **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.[36]

- **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.[37]

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.[38]

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.[39]

- **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.[40]

- **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.[41]

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.[42]

- **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."[43]

"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.[44]

- **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.[45]

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."[46]

- **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."[47]

IV. 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.[48]

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".[49]

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.[50]

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.[51]

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.[52]

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.[53]

V. "Designated Internet Sites"

After passage of the Private Securities Litigation Reform Act of 1995 ("PSLRA")[54], 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.[55] 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".[56] 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.[57]

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.[58] 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.[59]

VI. 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.[60]

VII. 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".[61] 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.[62] 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".[63] 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[64]

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.[65]

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.[66]

VIII. So-Called "Paint-By-Numbers Lawsuits" and Electronic "Litigation Machines"

In its January 29, 2001 issue, the cover story of *BusinessWeek* addressed what the financial news magazine called "The Litigation Machine". In that story, Mike France and other BusinessWeek reporters detailed how the Internet has begun to transform the practice of plaintiffs' lawyers in mass tort cases. Many of the same techniques being used by tort lawyers in such cases likely are making their way – in slightly different guises -- into the private securities litigation context. Thus, this article will conclude with a brief discussion of the techniques addressed in the *Business Week* cover story.[67]

BusinessWeek describes "Paint-By-Numbers Lawsuits" in which tort lawyers use the Internet in a five-step process: (1) find a victim using such national referral systems as USInjuryLawyer.com; (2) obtain a "how to sue" litigation packet, sometimes available online; (3) find an expert using Web sites such as DepoConnect.com; (4) obtain financing to avert cash flow crises during the course of the litigation by using services such as ExpertFunding.com; and (5) obtain so-called "smoking gun" documents by contacting organizations that collect internal corporate materials from publicly-available sources and make them available to their members.

There are online counterparts to virtually all of these steps in the private securities litigation context.

Find a Victim - This article already has described how class plaintiffs' counsel are using their Web sites to allow aggrieved shareholders to communicate with them regarding investment losses and to complete required certifications online to allow the investors to serve as named plaintiffs under applicable federal securities laws.

In addition, some defense counsel complain that provisions of the Private Securities Litigation Reform Act that require plaintiffs' firms to issue press releases notifying the public of the commencement of reputed class actions have merely become an excuse to promote such lawsuits via the Internet.[68]

Obtain a "How To Sue" Litigation Packet – Some class counsel have begun to complain that once they file a securities class action complaint on which they have worked for weeks, the allegations are quickly filched by other plaintiffs' lawyers who have easy online access to such online resources as Designated Internet Sites and Court Web sites where the complaints can be readily located and downloaded. In short, according to some plaintiffs' lawyers, diligently-prepared complaints which may become immediately available nationwide the same day the lawsuit is filed are serving in some instances as a "how-to guide" for other plaintiffs' lawyers suing the same company.

Find an Expert Online - The Web is littered with Web site directories of supposed experts who seek retention in private securities litigation.

One such site is ExpertPages.com, which describes itself as "The Original and Leading Directory of Expert Witnesses and Consultants". ExpertPages.com's "Securities" page states that the firm makes available "Experts in securities litigation and financial and statistical analysis" and provides "Assistance with discovery of financial information and quantitative analysis, as well as conformance to standards of practice and adherence to codes." Users of the site, which provides its information for free, can click on the jurisdiction in which they have a need for an expert and will see a list of all such expert firms registered with the database.[69] ExpertPages.com is not the only such site. There are a multitude of others.[70]

Obtain Advance Financing To Support the Securities Case While It Is Pending – Perhaps because the securities class plaintiffs' bar is dominated by experienced and well-established class counsel, there does not appear to be as advanced a service industry to allow advance financing for securities cases as is often seen in the tort world. Firms such as ExpertFunding.com and Litigation Funding Internationale apparently do not target the plaintiffs' securities bar in their appeals to allow them to provide so-called "pre-settlement funding" as an advance to enable the pursuit of a securities class action.

Obtain "Smoking Gun Documents" To Support the Lawsuit – As already detailed in this article, class counsel are scrutinizing issuers' Web sites, reviewing their Webcasts and broadcast e-mails to investors and are monitoring financial message boards looking for evidence for their cases. In many instances, they are finding such evidence and are using it in the complaints that they file with the Court. While such evidence technically would not be an internal corporate "smoking gun" (except, perhaps, in the instance of broadcast e-mails to investors), it certainly can play an important role in the nature of the allegations contained in plaintiffs' complaints.

IX. 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 *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").

2 *See*, *e.g.*, 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>.

3 *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).

[4] 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>.

[5] Aaron Elstein & Peter Edmonston, *Investor Suit Against 2TheMart Underscores Power of the Web*, Wall St. J. Interactive Ed. (Jan. 19, 2001) (paid subscription required) <http://interactive.wsj.com/articles/SB979765860930928639.htm>.

[6] *Id.*

[7] 15 U.S.C.A § 78m(d) and 15 U.S.C.A. § 78n(a).

[8] *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).

[9] 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>.

[10] Alexei Barrionuevo, *Heard on the Net: Coho Energy Holders Stage Revolt, Collect Proxies*, Wall St. J. Interactive Ed., Sept. 27, 1999 (available via search at http://interactive.wsj.com/ - paid subscription required).

[11] *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) <http://www.law.com/cgi-bin/gx.cgi/AppLogic+FTContentServer?pagename=law/View&c=Article&cid=ZZZOQK38XKC&live=true&cst=1&pc=1&pa=0&s=News&ExpIgnore=true&showsummary=0&useoverridetemplate=ZZZHCC0Q95C>.

12 *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).

13 *Solv-Ex Corp. v. Deutsche Bank [Morgan Grenfell unit], et al.,* (D.N.M., complaint filed Dec. 1998)(Hon. John Conway, D.J.); *Solv-Ex Suit Against Investment Firms, Short Sellers Dismissed*, Bloomberg (May 2, 2000) (pasted copy available via SiliconInvestor.com Message Board StockTalk> Coffee Shop> Investment Chat Board Lawsuits Message #234 (May 3, 2000)) <http://www.siliconinvestor.com/stocktalk/msg.gsp?msgid=13552730>.

14 There have been at least seven such Web hoaxes, most of which have resulted in prosecutions of the perpetrators. *See infra* at Part IV.B. "'New' Types of Enforcement Proceedings".

15 *See Ronald Hart v. Internet Wire, Inc. and Bloomberg, L.P.*, Case No. _____, Class Action Complaint (S.D.N.Y., complaint filed Aug. 31, 2000) <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) <http://www.techlawjournal.com/seclaw/20000905.asp>; Jeffrey Goldfarb, *Federal News - Stock Markets: Investor Sues Over Press Release Hoax; Information Distributors Rethink Policies*, 32(36) Sec. Reg. & Law Rep. (BNA) 1231 (Sept. 18, 2000); Jeffrey Goldfarb, *Lead Report - Stock Market: Investor Sues Over Press Release Hoax; Information Distributors Rethink Policies*, Sec. Law Daily (BNA) (Sept. 8, 2000) (available via LEXIS-NEXIS); Craig Bicknell, *Emulex Victims: Who Can We Sue? [Part 1]*, Wired News (Sept. 1, 2000) <http://www.wired.com/news/business/0,1367,38581,00.html>; *Emulex Victims: Who Can We Sue? [Part 2]*, Wired News (Sept. 1, 2000) <http://www.wired.com/news/business/0,1367,38581-2,00.html>; *Emulex Suit Targets Media - Shareholder Class Action Targets Messengers: Bloomberg, Internet Wire*, CNNfn.com (Sept. 1, 2000) <http://cnnfn.cnn.com/2000/09/01/companies/emulex/>; Sandeep Junnarkar, *Emulex Hoax Suspect Bond Set at $100,000*, CNET News.com (Sept. 1, 2000) <http://news.cnet.com/news/0-1004-200-2667995.html?tag=st.ne.ron.lthd.ni>; Nicole Volpe, *Bloomberg, Internet Wire Hit by Emulex Suit*, Reuters special to Excite News (Sept. 1, 2000) <http://news.excite.com/news/r/000901/15/tech-emulex-lawsuit>.

16 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>.

17 *See* Jonathan Rabinovitz, *The New New Hambrecht*, TheStandard.com (Mar. 6, 2000) <http://www.thestandard.com:80/article/display/0,1151,12475,00.html?nl=int>.

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19 *See* Jason Anders, *Ameritrade Case Shines Light on Online 'Suitability Claims'*, Wall St. J. Interactive Ed. (Jan. 24, 2000) <http://interactive.wsj.com/articles/SB948381812900663168.htm>; *Ameritrade Denies Arbitration Loss Involves Online Suitability Claim*, 1(12) CyberSecuritiesLaw Tribune (Week of Jan. 24, 2000) http://www.cybersecuritieslaw.com/oldsite/csltribune_1_24_00.htm>.

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25 *Gordon DuMont v. Charles Schwab & Co., Inc.*, No. CIV.A. 99-2840, CIV.A. 99-2841, Memorandum Opinion and Orders, 2000 WL 1023231 (E.D. La., Jul. 21, 2000); *Federal News - Broker-Dealers: Court Approves $20M Settlement In Schwab Suit Over Best Execution*, 32(30) Sec. Reg. & law Rep. (BNA) 1018 (Jul. 31, 2000); *Lead Report - Broker-Dealers: Court Approves $20M Settlement in Schwab Suit Over Best Execution*, Sec. Law Daily (BNA) (Jul. 28, 2000) (available via LEXIS-NEXIS).

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46 *See SEC v. The Globus Group, Inc., Bruce Gorcyca (a.k.a. Anthony DiMarco), China Food, James C. Tilton, Trans-Global and Jacques Verhaak*, Civ. No. 99-1968 (S.D. Fla.); Richard A. Oppel Jr., *S.E.C. Civil Suit Says Faxes About 12 Stocks Were False*, N.Y. Times, July 17, 1999, at C3, col. 3 <http://search.nytimes.com/search/daily/bin/fastweb?getdoc+site+iib-site+80+0+wAAA+S.E.C.>; *Restraining Order Halts Securities Scam Involving Spam Fax Messages, Fraudulent Internet Offerings, and False Press Release*, SEC News Digest Issue 99-137 (July 19, 1999) <http://www.sec.gov/news/digests/07-19.txt>; *SEC Litigation Release No. 16212* (July 16, 1999) <http://www.sec.gov/enforce/litigrel/lr16212.htm>; *Federal News - Microcap Fraud: SEC Notes TRO Against Alleged Scam Involving 'Spam' Faxes, Internet Offering*, 31(29) Sec. Reg. & Law Rep. (BNA) 972 (July 23, 1999); *SEC News Digest No. 99-150* (Aug. 5, 1999) <http://www.sec.gov/news/digests/08-05.txt> (scroll down to "District Court Preliminary [sic] Enjoins Fax Spammer").

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[62] Join a Class Action (visited Mar. 21, 2001) <http://www.milberg.com/current_cases.html>.

[63] *See* Notice of Pending Action: Visual Networks Securities Litigation (visited Mar. 21, 2001) <http://www.milberg.com/visual/>.

[64] *Id.*

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