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Stanley Keller – Chair
John H. Sturc – Editor
Consuelo J. Hitchcock - Associate Editor
Gavin A. Beske - Assistant Editor

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FROM THE CHAIR

by
Stanley Keller
skeller@palmerdodge.com

This is my first "From the Chair" message in our Committee's newsletter. I would like to use this opportunity to share with you a few of my thoughts regarding the Committee going forward. Before doing so, let me express on behalf of all of us, as I did in Atlanta, our appreciation to John Liftin for his four years of dedicated, effective and wise leadership as Chair of our Committee. The Committee has accomplished a great deal under John's stewardship, including establishing this newsletter. We have a strong legacy to carry forward.

An important priority of the American Bar Association this coming year, which is strongly supported by the Business Law Section and to which I subscribe, is the promotion of diversity. This requires making the extra effort to seek out and foster the participation of women and minority lawyers.

Diversity goes hand-in-hand with openness in our activities and a willingness to get new faces involved. This extends to making younger lawyers feel welcome and to involving more government lawyers. My request of each of you is:

- If you have been active in the Committee, please sustain that activity but try to get someone, such as a younger lawyer, who has not been active to become involved. Bring them to a meeting and introduce them. We will take it from there.

- If you have not been active, now is the time to become more involved. You will be welcomed and you will come away feeling rewarded.

If we accomplish the goals of promoting diversity, involving new faces and expanding member participation, we will assure the ongoing renewal of our Committee's extraordinary professional contribution.

On the professional side, my objective is to expand the quality and relevance of our activities. This includes the following elements:

- Continue our interesting and informative programs. We need to hear from you about what interests you.

CONTENTS — **Page**

THE SECURITIES REPORTER can be accessed on-line at ***http://www.abanet.org/buslaw/secrep***. The ID is "secrep" and the password is "pyramid." If you have any questions, please send an E-mail to ***businesslaw@abanet.org***.

- Make our subcommittee and task force meetings more effective vehicles for professional interaction and education through workshops and mini-programs publicized to all.

- Create professional work product, such as reports, forms and practice guides, that will be useful resources for our members.

- Continue our involvement with the SEC through comment letters and expanded informal interaction with the staff.

- Expand our relationship with other relevant regulatory and self-regulatory bodies, as well as with other ABA committees and other comparable professional organizations.

- Enhance communication by taking advantage of the electronic communications revolution surrounding us. This communication needs to be two way – from the Committee leadership to its members and, more importantly, from the members to the leadership. My e-mail address is at the beginning of this message; please feel free to use it. The e-mail address of other Committee leaders is on our Committee's website *(www.abanet.org/buslaw /fedsec/ home.html)*.

We are the largest committee in the Business Law Section and have a unique relationship with the SEC and other key regulators. As a result, we have an important responsibility to work for the benefit of our members and for the sound development and effective administration of the federal securities laws. This presents both a challenge and an opportunity for each of us. I look forward to working with you over the next several years to meet the challenge and seize the opportunity.

Hopefully, you will receive this edition of *The Securities Reporter* before our Fall Meeting on November 12 and 13 in Washington. I look forward to seeing you there.

THE SEC's STATUTORY WEAPONRY TO COMBAT INTERNET FRAUD

by
Stephen M. Cutler and John Reed Stark[1]

It's become fashionable of late to question the ability of federal regulators to enforce securities statutes and regulations in the fast-paced new medium of the Internet. Some have even gone as far as to give the SEC's enforcement effort its last rites. But reports of our death have been greatly exaggerated. With over 100 Internet-related securities fraud actions brought since 1995, the Enforcement Division has demonstrated that the statutory weapons in its arsenal are as effective when combating unconventional securities frauds in cyberspace as when battling conventional backstreet boiler rooms.

The Commission's Internet program has applied an array of enforcement provisions in several nontraditional ways. Some actions have revitalized statutory provisions that had only infrequently been the basis of enforcement actions during the past few decades. Other actions have signaled a strategic shift for the overall enforcement program, creating a more proactive slant to the Division's fraud counteroffensive.

The Commission's effectiveness in fighting Internet-related securities fraud should come as no surprise to those following trends in cyberfraud. After all, the securities swindles taking place online -- sham offerings, pump-and-dump schemes,[2] false and misleading promotions of securities, pyramid schemes, Ponzi schemes and other venerable cons – are the same basic scams that have plagued our markets for almost a century. What is surprising is the ease with which the Division has applied the very same statutes and regulations used to combat the boiler rooms, tipster sheets and traditional securities thievery of yesteryear to the cyberscams of today.

The four sections that follow chronicle the Commission's application of certain provisions of the federal securities laws in the context of Internet-related enforcement actions. Although the Internet continues to shape and reshape the playing field for regulators and law enforcement, the analysis below demonstrates that the Division's basic arsenal of statutory provisions remains remarkably potent in cyberspace.

I. Section 10(b), Rule 10b-5 and Section 17(a) -- The Antifraud Provisions

Section 10(b) of the Securities Exchange Act of 1934[3] and Rule 10b-5 thereunder, and Section 17(a) of the Securities Act of 1933[4] - the powerful federal antifraud provisions that have served the Commission so well since their adoption - are the linchpins of the Division's enforcement program. These sections prohibit the employment of a fraudulent scheme or the making of material misrepresentations and omissions in the offer or sale, and in connection with the purchase and sale, of any security. In order to prove a violation under these provisions, it must be shown that the alleged misrepresentations or omitted facts were material.[5] The "in connection with" requirement of the Exchange Act is satisfied "whenever it may reasonably be expected that a publicly disseminated document will cause reasonable investors to buy or sell securities in reliance thereon[.]"[6] Establishing violations of Securities Act Section 17(a)(1) and Exchange Act Section 10(b) requires a showing of scienter.[7] However, actions pursuant to Securities Act Sections 17(a)(2) and (3) do not require a showing of scienter.[8]

The majority of the Commission's Internet-related enforcement actions contain violations of one or both of the antifraud provisions. When the Commission charges violations of both 17(a) and 10(b), the case typically involves securities offered through fraudulent solicitations. Some companies whose securities are so offered have claimed to be involved in fields familiar to fraud investigators, fields such as high-tech,[9] oil and gas exploration,[10] multimedia publishing,[11] communications,[12] gold mining,[13] and affinity operations.[14] Other companies have claimed involvement in more esoteric lines of business such as eel farms,[15] coconut plantations,[16] online casino gaming,[17] elaborate pyramid[18] schemes, an international telephone lottery,[19] prime bank instruments,[20] prefabricated hospitals in Turkey,[21] and even the raising of an underwater island nation.[22]

While Section 17(a) claims are limited to those cases involving fraud in an offer or sale of securities, Section 10(b)'s "in connection with the purchase or sale language" provides more flexibility, serving as the basis for cases involving market manipulations, unlawful touting and other related schemes. Indeed, Section 10(b) can be employed even where the malfeasor does not buy or sell securities to generate personal profits. One such recent action involved the alleged fraudulent manipulation of the stock of PairGain Technologies. This action, captioned SEC v. Hoke,[23] demonstrates how SEC Internet-related cases handily take advantage of Section 10(b)'s dexterity.

In Hoke, the defendant posted a message on an Internet message board falsely reporting that an Israeli company planned to acquire PairGain, a Tustin, California-based telecommunications equipment manufacturer traded on the National Association of Securities Dealers National Market System. The message board posting contained a link to a website designed by Hoke to mimic a Bloomberg News Service online news report announcing the impending acquisition. The publication of the false information created significant buying activity, which boosted the market price for PairGain common stock.

Hoke clearly targeted a virtual audience of potential PairGain shareholders and falsely inflated expectations about PairGain's prospects. Hoke's scheme shows how, in cyberspace, a single individual using just a single web page and message board posting can affect thousands (or, perhaps, even millions) of individuals who choose to trade based on the false information. Hoke, apparently spooked by the publicity surrounding his hoax, opted not to add fuel to the fire and sell any of the PairGain stock he owned – despite the opportunity for a quick and easy profit.

The Commission charged Hoke with violating Section 10(b), alleging that "Hoke knew or was reckless in not knowing that his statements . . . were materially false and misleading and, in addition, that posting those statements on a counterfeit Bloomberg page would materially mislead investors as to the reliability of that information . . . and would result in an increase in both the price and the volume of trading in PairGain securities."[24]

Notably absent from the Commission's complaint was any mention of trading by Hoke. The Commission does not have to allege that a defendant bought or sold securities when charging violations of the antifraud provisions, in the context of an Internet-related charge or otherwise. The Rule 10b-5 prohibition applies to false statements that are reasonably calculated to affect the market, whether or not the makers of the false statements participated in securities transactions[25] -- and in a case like Hoke, statements made over the Internet, in a financial message board thread, clearly meet this test.

Section 10(b) also has figured prominently in many of the Internet "touting" actions brought by the Commission. A Section 10(b) charge may lie where a promoter makes misrepresentations about (i) the promoted company (or companies),[26] (ii) the promoter's own track record,[27] or (iii) the promoter's independence.[28] The Commission may also charge a violation of Section 10(b) when a touter engages in scalping, the deceptive practice in which touters sell their stock or options into a rising market after disseminating their own buy recommendations.[29]

Unfortunately, the Internet (together with the greatest bull market in history) has attracted an eager population of cyber-promoters well-schooled in the art of scalping. Equipped only with a home computer and an Internet connection, touters take advantage of the Net's speed and sheer simplicity to generate scalping profits with a keystroke. The threat posed by scalping becomes particularly acute when fraudsters employ an Internet touting operation; in cyberspace, one person can orchestrate a scam from the comfort of his own living room, and potentially pocket hundreds of thousands of dollars in illicit profits.[30]

The Internet cases involving scalping provide another example of how important Section 10(b) is to the Commission's arsenal; that provision has been instrumental in protecting investors and slowing down what is a most disturbing trend. Indeed, in one recently-published opinion in a Commission scalping case, a federal judge attacked the practice of scalping head-on, branding it not only "deceptive" but also determinative evidence of scienter for purposes of the federal antifraud provisions.[31]

II. Section 17(b) of the Securities Act – Unlawful Touting of Securities

Section 17(b) of the Securities Act prohibits the publication of paid-for descriptions of securities without full disclosure of the compensation arrangement. This prophylactic measure was "particularly designed to meet the evils of the 'tipster sheet,' as articles in newspapers or periodicals that purport to give an unbiased opinion but which opinions in reality are bought and paid for."[32] Prior to the Internet era, Section 17(b), unchanged from its enactment in 1933, served the Commission as the legal basis to combat touting fraud in a variety of mediums, including brochures,[33] investment newsletters,[34] and radio talk shows[35] – wherever touters attempted to disguise their paid promotions as independent journalism.

As the Internet began to evolve into an important tool for investors, unlawful touting spread to every corner of cyberspace, including websites, online newsletters, "spams" (electronic junk mail), and even online message boards and discussion forums. The Commission first acted to slow this growing trend with several enforcement actions brought between 1996 and early 1998, including one action in which the Commission's sole charge against the defendant was for violating Securities Act Section 17(b).[36] Despite the Division's efforts, the practice continued to proliferate, prompting the Commission to take even stronger action in two Internet "sweeps" one in October 1998 and also then in February 1999. These coordinated roundups consisted of more than 25 separate enforcement actions against more than 50 individuals and companies.[37]

Never in the history of the Commission has Section 17(b) enjoyed as much popularity as an enforcement weapon. In short, the Commission will not tolerate ostensibly independent opinions that are in reality "bought and paid for," regardless of whether they are disseminated by print, by airwaves, by megaphone or by modem.

Section 17(b) clearly requires that promoters paid to tout stocks fully disclose the receipt of compensation, the source of compensation received, and the amount of such compensation. Many Internet touters attempt to comply with the law by simply making a blanket statement that compensation was received, or that they may trade in shares of the touted stock. The Internet-related 17(b) cases highlight the Commission's aggressive posture regarding such "partial disclosure" of a touter's compensatory arrangement, a particularly prevalent practice in Internet newsletters, websites and spam.

Indeed, one court opined pointedly that partial disclosure was not merely inadequate, but might even exacerbate the deception. In that recent case, the Commission alleged a 17(b) violation when the Internet newsletter contained the following disclosure:

> "Personnel associated with [the publisher] may own shares in the companies mentioned or may act as consultants thereto for compensation."[38]

The court found the statement not only ambiguous but also affirmatively misleading, since subscribers to the newsletter "simply could not tell from the disclaimer that [the defendant] was paid to promote the stocks about which he wrote."[39] And although some still assert that a decision finding an Internet 17(b) violation will not withstand a First Amendment challenge, one court has already responded to this argument:

> The government has a substantial interest in the investing public 'knowing

whether an apparently objective statement . . . is motivated by the promise of payment' . . . [and] [r]egulations which turn solely on whether consideration was paid for publication of an article, and not the content of the article, are constitutionally permissible.[40]

Section 17(b) mandates disclosure and does not censor content. Thus, courts should continue to uphold Section 17(b)'s critical disclosure requirements.

III. Section 5 of the Securities Act – Failure to Register Securities

Section 5 of the Securities Act generally makes it unlawful for an issuer to offer or sell securities without filing a registration statement with the Commission, unless the offering qualifies for one of certain exemptions.[41] Historically, most SEC actions that alleged a violation of Section 5 involved at least one actual sale of the underlying security to an investor. But the securities laws do not require an actual sale in order for the Commission to charge an issuer with a section 5 violation; most of the Commission's actions have traditionally involved sales because the Commission usually does not become aware of unregistered securities offerings until an investor purchases the security, and then complains after experiencing losses or some form of duplicity.

However, the Commission recently has, in appropriate instances, brought actions based on offers of securities, without waiting until an investor actually buys, most prominently in the context of Internet-related charges. Why so in Internet-related cases in particular? Because the World Wide Web offers the Commission's staff an important window through which to observe developing frauds, and, in certain cases, to halt them before they reach investors' pockets. Before the Internet, the Commission typically learned of offering frauds when a victim came forward with a complaint. Unlike criminal authorities, the Commission does not operate undercover stings and does not sit as a fly on the wall during the perpetration of a boiler-room scheme.

Although the staff can't be everywhere online, or pursue every lead, by encouraging netizens to self-police cyberspace and by building an active Internet surveillance program, the Enforcement Division can, in many cases, detect securities fraud before anyone falls prey to it. The Enforcement Complaint Center, the Commission's online mail station, is on the receiving end of from 200-300 e-mails every day reporting suspicious conduct on the Internet, while Division staff scour the Internet in targeted surveillance operations – sometimes enabling staff to sometimes get a glimpse of a fraud during its early phases of operation.[42] Consider the May 1998 Internet fraud sweep targeting bogus Internet-related offerings and the July 1998 coordinated filing of four so-called "free stock" actions.

A. The May 1999 Internet Offering Fraud Sweep

The Commission's recent efforts towards so-called "preemptive strikes" in Internet-related matters bore fruit in the May 1998 Internet fraud offering sweep. In several of the sweep actions, the Commission stopped sophisticated and potentially dangerous securities frauds *before* investors lost a penny.[43] In one instance, the Division of Enforcement alleged that a group of conmen used the Internet to conduct a fraudulent offering of $15 million of notes, the proceeds of which were to be used to construct prefabricated hospitals in Turkey.[44] In another action, the Division alleged that a respondent used three different websites to sell so-called "prime bank" instruments promising returns of 50% to 1600% in from approximately three to 120 days, and promising that the instruments would be "100% insured" and "guaranteed in writing."[45]

One regulatory change that has also aided these preemptive strikes is the amendment of Rule 504 of Regulation D. The Rule 504 exemption from Section 5's registration requirements, amended as part of the SEC's small business initiatives of the early 1990s, allowed a company to offer and sell up to $1 million in securities to the public without any required disclosure documents. Since the early 90s revision of Rule 504, issuers offering securities through the Internet without registration could claim that the face amount of such offerings did not exceed $1 million and assert the Rule 504 exemption in defense of such offerings.

However, after April 7, 1999, Rule 504 exempts only offerings registered with a state that requires preparation and filing of disclosure documents for Rule 504 offerings,[46] or if the offering was limited to sophisticated, or "accredited" investors. Since the use of the Internet implies that an offering will be made to all Internet users regardless of sophistication, the practical import of this rule revision is to require issuers to register with states and circulate disclosure documents to prospective purchasers. These new requirements now clearly require an issuer to register a "direct public offerings", either federally or with a state – otherwise, an issuer risks an enforcement action.

B. The July 1999 Coordinated Filing of Actions Against Promoters of so-called "Free Stock"

The recent Commission actions against the purveyors of so-called "free stock" demonstrate the importance with which the staff views Section 5's registration requirement. Within the past year, issuers peddling free stock have promoted their offerings through spam, websites and message boards.[47] Despite several regulatory pronouncements pertaining to the illegality of free stock offerings,[48] such offerings continued to proliferate online. The newly effective amendments to Rule 504 described above provided an even more effective basis as well as a final impetus for enforcement action.

The designation "free stock" was really a misnomer in these offerings. While cash does not typically change hands in free stock offerings, the companies that issue the stock usually receive valuable benefits.[49] In an online environment where merchants and retailers struggle for market share, information about, and access to, potential customers are valuable commodities. Free stock giveaways are typically employed to help generate these valuable customer databases, or to stimulate other forms of commercial activity.

For example, in each of the four actions brought in July 1999, investors were required to sign up with the issuers' web sites and disclose valuable personal information in order to obtain their "free" shares. Free stock recipients were also offered extra shares, in some cases, for soliciting additional investors or, in other cases, for linking their own websites to those of an issuer or purchasing services offered through an issuer. Through these techniques, issuers received value by spawning a fledgling public market for their shares, increasing their business, creating publicity, increasing traffic to their websites, and, in two cases, generating possible interest in projected public offerings.[50]

By offering an investment opportunity that on its face appears to involve no risk with seemingly no payment of money for the stock itself, issuers and promoters can lull Internet users into believing that they "are getting something for nothing." The issuers promote an expectation of financial gain for the holders of the "free stock" that is dangerous for the investor and could be easily exploited by an issuer or promoter at a later date, for example, in a manipulation scheme. Though investors might not envision an immediate threat from these free stock offerings, the potential future hazard prompted the need for preemptive enforcement action, stopping the violations before investors experienced more serious economic harm.

IV. Section 15 of the Exchange Act – Failure to Register as a Broker-Dealer

Section 15(a) of the Exchange Act contains the general registration requirements for anyone acting as a broker-dealer. The Commission's Division of Market Regulation has stated that persons who receive transaction-based compensation and negotiate the terms of securities transactions are generally required to register as broker-dealers.[51]

The May 1999 Internet offering sweep demonstrates that the Commission will pursue even non-traditional broker-dealers, especially when such parties conduct their activities on the Internet. Issuers selling bogus securities on the Internet need a cadre of salespersons to peddle the goods just as badly as yesterday's boiler-room operators needed telephone solicitors. Online fraudsters now can recruit a technologically sophisticated sales force of Internet users to sell their phony offerings. Given the ease with which the Internet can be used to sell securities, a cottage industry has sprung up among wired "broker-dealers" who employ new technology to sell not-so- traditional securities, like prime bank programs and other more esoteric frauds.

Once again, however, the Internet program need only draw upon the standard broker-dealer registration provisions. In addition to charging violations of Securities Act Section 5 and Exchange Act Section 10(b), the Division also may charge violations of Section 15's broker-dealer registration requirements under appropriate circumstances. Of the 16 actions announced as part of the May 1999 Internet offering sweep, five involved alleged violations of the broker-dealer registration provisions, including several involving attempts to promote prime bank schemes[52] and one involving securities in an entity purportedly formed to purchase and operate commercial website software franchises.[53]

V. Conclusion

As investors become more and more dependent upon the Internet as a source of information and guidance, and as they continue to surf in search of investment opportunities, they undoubtedly also will encounter the Net's dark side. Unfortunately, as opportunities expand for investors to access market information and opinion, so do opportunities for con artists and securities cheats to exploit unsuspecting investors.

Historically, the federal securities laws have provided a flexible statutory basis for prosecuting a wide spectrum of offenses ranging from unlawful insider trading to fraud in the sale of certain derivatives to pay-to-play municipal bond schemes. So it really comes as no surprise that these same laws have served such a prominent role in addressing Internet-related securities activities. What is surprising, however, is that the Internet program has shifted certain less-frequently-charged securities violations to the forefront.

Will the Commission need new laws to combat effectively the Internet fraud of the future? Yes and no. Of course, the Commission will always consider legislative efforts that improve its overall arsenal for battling securities fraud, on the Internet or elsewhere, but the Commission has also demonstrated its readiness to leverage the laws already on the books to maximum effect right now.

By fully availing itself of a well-stocked statutory armory, the Commission has not only launched a counter-offensive against Internet fraud, but has also shifted the enforcement paradigm from reaction to prevention. The World Wide Web often gives enforcement staff a glimpse into fraudulent schemes as they unfold, enabling, in many cases, the Enforcement Division to arrest frauds before investors' savings are lost. This may yet prove to be the most profound change wrought by the Internet on the field of securities regulation. Far from tying regulators' hands, the Internet may be the virtual rope that many cyber-thieves use to hang themselves.

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[1] Mr. Cutler serves as Deputy Director of the Division of Enforcement of the United States Securities and Exchange Commission. Mr. Stark serves as Chief of the Office of Internet Enforcement of the Division of Enforcement of the United States Securities and Exchange Commission and Adjunct Professor of Law at the Georgetown University Law Center where he teaches a course entitled "Securities Law and the Internet." The Securities and Exchange Commission as a matter of policy disclaims any responsibility for any private publication or speech by any of its members or staff. The views expressed herein are those of the authors and do not necessarily reflect the views of the Commission or the author's colleagues on the staff of the Commission. The authors would like to thank David P. Gionfriddo, Senior Counsel of the Office of Internet Enforcement, for his editorial assistance in the preparation of this article.

[2] In the typical pump-and-dump scheme, fraudsters widely circulate false and misleading information to drive up a stock's price, then sell their shares at the inflated price. Often, orchestrated trading or bribes to brokers help artificially increase stock prices. When the scheme is complete, the share price normally collapses. These scams routinely involve "microcap" stocks -- low-priced, thinly-traded securities. The Internet has served as the modern day "boiler room" for these scams replacing the traditional army of salespersons working the phones with scripts in hand. John Reed Stark, *Tombstones: The Internet's Impact upon SEC Rules of Engagement*, 12 Insights 10, 13 (1998), reprinted in Securities Law & The Internet: Doing Business in a Rapidly Changing Marketplace 407 (PLI Corporate Law and Practice Course Handbook Series No. B-1046, 1998).

[3] 15 U.S.C. §78j(b), 17 C.F.R. § 240.10b-5 (1996).

[4] 15 U.S.C. § 77q(a) (1994).

[5] Basic v. Levinson, 485 U.S. 224 (1989).

[6] SEC v. Savoy Industries, Inc., 587 F.2d 1149, 1171 (D.C. Cir. 1978), cert denied, sub nom. Zimmerman v. SEC, 440 U.S. 913 (1979).

[7] Aaron v. SEC, 446 U.S. 680 (1980).

[8] Id.

[9] SEC v. Interactive Products and Services, Inc., and Matthew P. Bowin, Litigation Release No. 15700, 1998 SEC LEXIS 630 (N.D. Ca. April 8, 1998); SEC v. Rosenthal, Litigation Release No. 16133, 1999 SEC LEXIS 950 (D. Mass. May 11, 1999).

[10] SEC v. Capital Acquisitions, Inc., The Somerset Group, Inc., Wayne Notwell and Clealon Mann, Litigation Release No. 15601, 1997 SEC LEXIS 2654 (D. Utah December 23, 1997).

[11] SEC v. P. Joseph Vertucci, Bruce E. Straughn, Robert V. Petry, Roland R Baughman, Richard M. Johnson, Edward Meyer, Jr, and Hazlet Investors, Inc., Litigation Release No. 16069, 1999 SEC LEXIS 391 (N.D. Ohio February 24, 1999).

[12] SEC v. International Automated Systems, Inc. et al., Litigation Release No. 15898, 1998 SEC LEXIS 2040 (D. Utah September 24, 1998).

[13] SEC v. David Abramson d/b/a American Brightstar Gold, Litigation Release No. 16137, 1999 SEC LEXIS 954 (S.D.N.Y. May 11, 1999).

[14] SEC v. First Zurich National USA, LLC, Compunomics 139, Inc. and Paul Douglas Catchings, Litigation Release No. 15645, 1998 SEC LEXIS 268 (D. Wy. February 18, 1998); In the Matter of Gary J. Pierce and C.S.I. Ag, SEC Release No. 7697, 1999 SEC LEXIS 1331, (July 7, 1999). Affinity frauds typically target a particular racial, religious or ethnic group.

[15] SEC v. Daniel Odulo, Individually and d/b/a Golden Waters Productions, Litigation Release No. 14616, 1995 SEC LEXIS 2186, (U.S.D.C. R.I. August 24, 1995).

[16] SEC v. Scott A. Frye, Litigation Release No. 15139, 1996 SEC LEXIS 3016, (S.D.N.Y. October 29, 1996).

[17] SEC v. Internet Casino Sports Gaming, LLC, Internet Casino Sports Gaming, Inc., Robert Matias A/K/A Robert Duvall, And Alan Lenchner A/K/A Alan Lane, Litigation Release No. 16025, 1999 SEC LEXIS 112, (C.D. Cal. January 13, 1999).

[18] SEC v. International Heritage, Inc., 4 F. Supp. 2d 1378 (N.D.Ga. April 22, 1998); SEC v. Future Strategies Srl a/k/a Future Strategies International, Litigation Release No. 16213, 1999 SEC LEXIS 1387, (N.D.Ga. July 16, 1999).

[19] SEC v. Pleasure Time, Inc. d/b/a Telephone Information Systems, et al, Litigation Release No. 15178, 1996 SEC LEXIS 3334, (S.D. Ohio November 26, 1996).

[20] SEC v. Theodore O. Pollard, Litigation Release No. 16140, 1999 SEC LEXIS 957, (N.D. Cal. May 11, 1999). Prime bank instruments are fictional securities purporting to represent a secondary market for stand-by letters of credit.

[21] In The Matter Of Lawrence M. Artz, Neurotech Corp., Enhance Resources, Inc. And Bruce W. Lynch, SEC Release No. 7681, 1999 SEC LEXIS 970 (May 11, 1999).

[22] SEC v. Lazarus R. Long (a/k/a Howard Turney), individually and doing business as New Utopia, Litigation Release No. 16110, 1999 SEC LEXIS 714 (N.D. Ok. April 9, 1999).

[23] SEC v. Gary D. Hoke, Jr., Litigation Release No.16266, 1999 SEC LEXIS 1735, (C.D. Cal. August 30, 1999).

[24] Hoke consented to the entry of a final judgment against him by the United States District Court for the Central District of California. Under the terms of his consent, Hoke, without admitting or denying the allegations in the Commission's complaint, agreed to be permanently enjoined from future violations of the antifraud provisions of the Securities Exchange Act of 1934, Section 10(b) and Rule 10b-5 thereunder. Based upon Hoke's sworn statement of financial condition, which demonstrates an inability to pay, the proposed final judgment does not provide for the imposition of a monetary penalty. Id.

[25] See generally McGann v. Ernst & Young, 102 F.3d 390 (9th Cir. 1996), *cert. denied*, Ernst & Young LLP v. McGann, 520 U.S. 1181 (1997). The Commission filed an *amicus* brief in the McGann case that argued for the position adopted by the Ninth Circuit.

[26] SEC v. John Wesley Savage and Princeton Research, Inc., Litigation Release No. 15954, 1998 SEC LEXIS 2341, (S. D. Florida October 27, 1998).

[27] SEC. v. The Future Superstock, Inc. and Jeffrey C. Bruss, Litigation Release No. 15958, 1998 SEC LEXIS 2345, (N.D.Ill. October 27, 1998).

[28] Id.

[29] SEC v. Stockstowatch.Com Inc., et al, Litigation Release No. 15956 1998 SEC LEXIS 2343, (M.D. Fla. October 27, 1998).

[30] For a discussion of the new *cyberboiler-rooms,* see, John Reed Stark, *Tombstones: The Internet's Impact upon SEC Rules of Engagement*, 12 Insights 10, 13 (1998), reprinted in Securities Law & The Internet: Doing Business in a Rapidly Changing Marketplace 407 (PLI Corporate Law and Practice Course Handbook Series No. B-1046, 1998).

[31] See SEC v. Huttoe, Civil Action No. 96-2543 (D.D.C. Sept. 14, 1998) (Slip op. Kessler, J.)

[32] Committee on Interstate and Foreign Commerce, H.R. Rep. No. 85, 73d Cong. 1st Sess. (1933) 24. See also SEC v. Wall Street Publishing, 851 F.2d at 369 n.6 (D.C. Cir. 1988) (quoting House Report).

[33] In the Matter of Sky Scientific, Inc., W.A. Dorow, Jr., Jerry L. Foster, Gilbert Marshall & Co., Inc., Michael A. Usher, Strategic Resource Management, Inc., William A. Moler, Daniel R. Lehl, Thomas Patrick Meehan, Douglas A. Glaser, Smith, Benton & Hughes, Inc., Michael Zaman, George T. Hellen, Robert Schlien, American Capital Network, Inc., Philip M. Georgeson, Melvin L. Levine, William David Jones, SEC Release No. 7372, 1996 SEC LEXIS 3421 (December 16, 1996).

[34] SEC v. Wall Street Publishing, 851 F.2d at 369 n.6 (D.C. Cir. 1988) (quoting House Report).

[35] SEC v. Jerome M. Wenger, Litigation Release No. 15707, 1998 SEC LEXIS 678, (S.D.N.Y. April 15, 1998).

[36] SEC v. Charles O. Huttoe, et al, Litigation Release No. 15906, 1998 SEC LEXIS 2044, (D.D.C. September 24, 1998) (first filed November 7, 1996) ; SEC v. George Chelekis, KGC, Inc., and Hot Stocks Review, Litigation Release No. 15264, 1997 SEC LEXIS 423 (D.D.C. February 25, 1997); SEC v. Steven Samblis et al, Litigation Release No. 15609, 1998 SEC LEXIS 7 (M.D. Fla. January 6, 1998). In the Samblis action, the Commission charged the defendants with violations of 17(b) only.

[37] See SEC Internet Sweep Announcements at <http://www.sec.gov/news/netfraud.htm> and <http://www.sec.gov/news/spamcase.htm>.

[38] See SEC v. Huttoe, Civil Action No. 96-2543 (D.D.C. Sept. 14, 1998 (Slip op. Kessler, J.) at 13-14 and 29.

[39] See SEC v. Huttoe, Civil Action No. 96-2543 (D.D.C. Sept. 14, 1998 (Slip op. Kessler, J.) at

13-14 and 29. See also SEC v. Blavin, 760 F.2d 706 (6th Cir. 1985).

[40] See SEC v. Huttoe, Civil Action No. 96-2543 (D.D.C. Sept. 14, 1998 (Slip op. Kessler, J.) at 27-28).

[41] See 15 U.S.C. § 77e(c). The Securities Act defines "offer" as "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." 15 U.S.C. § 77b(3).

[42] Of course, given the Internet's vast scope, no amount of surveillance or self-policing can cover every nook and cranny of cyberspace. Unlike traditional thieves, however, Internet grifters face a double-edged sword: they want investors to find them easily, but they also want to fly under the radar of law enforcement authorities. They want to be accessible to potential investors, yet they also want to preserve their anonymity. When they surface, which they must do sooner rather than later, law enforcement surveillance can detect them, often before anyone suffers any loss – allowing regulators to conduct preemptive strikes against scam artists.

[43] See SEC Announcement, SEC Steps Up Nationwide Crackdown Against Internet Fraud, Charging 26 Companies and individuals for Bogus Securities Offering http://www.sec.gov/ news/ nets0599.htm.

[44] In The Matter Of Lawrence M. Artz, Neurotech Corp., Enhance Resources, Inc. And Bruce W. Lynch, SEC Release No. 7681, 1999 SEC LEXIS 970 (May 11, 1999). The Division also alleged that the respondents claimed that three well-known Turkish banks had agreed to guarantee the notes, so that there would be no risk to investors. The complaint claims that the entire investment was a sham – no Turkish banks had ever made any such guarantees and the projections used in the offering were baseless. The Division believes it filed its action against the respondents before any investor lost money. This matter is still pending.

[45] In the Matter of Derrick C. Johnson, SEC Release No. 7677, 1999 SEC LEXIS 949 (May 11, 1999). As set forth in the complaint, the purported investments, like all "prime bank" securities, never even existed.

[46] Revision of Rule 504 of regulation D, the Seed Capital Exemption, SEC. Act Rel. No. 7644 (Feb. 25, 1999), SEC LEXIS 408.

[47] By placing the free stock offering on a website, an Internet Portal, an online message board, online classified listing, or by using spam to direct the recipient to the Web page containing the online offering, issuers and promoters can reach millions of potential victims throughout the world.

[48] The Division of Corporation Finance has issued several no-action letters advising that the distribution of "free stock" to individuals who visit or register on an Internet web site constitutes an event of sale within the meaning of Section 2(a)(3) of the Securities Act of 1933. Simplystocks.com, SEC No-Action Letter, 1999 WL 51836 (February 4, 1999); Vanderkam & Sanders, SEC No-Action Letter, 1999 WL 38281 (January 27, 1999). See also In the Matter of Capital General Corporation, SEC. Act Rel. 7008, 54 SEC Dock. 1332 (1993) ("Capital General's distributions of securities [which were purportedly for free] constituted a 'sale' within the meaning of the Securities Act since the distributions were dispositions for value . . . [which] accrued to Capital General and Yeaman by virtue of the creation of a public market for the issuer's securities . . . ")

[49] Issuers of these offerings offer "free" shares to individuals under a variety of circumstances such as: i) requiring an Internet user to register with or visit the issuer's website, typically offering more "free" shares if identified as a "reference" by future visitors to the issuer's website who similarly register for "free" shares; ii) requiring cash payments for the "free" shares (as much as $10 per share) to "defray the printing costs of the stock certificates;" and iii) requiring the purchase of a product, such as a phone card, or a service, such as an Internet service provider account, in order to receive one or more "free" shares.

[50] For a discussion of all four SEC actions, see SEC Announcement, SEC Brings First Actions To Halt Unregistered Online Offerings of So-Called "Free Stock" at <http://www.sec.gov/news/ webstock.htm>. Two of these free stock issuers offered stock through websites that featured false claims. In one action, investors were told that the free shares they received would give them interests in an aerospace company that would revive lunar exploration. In fact, the company was never incorporated and its promoter had no space exploration or aerospace engineering experience. In another action involving an Internet telecommunications marketing firm, the website informed free stock recipients that their shares could eventually exceed $200 each in value, even though the firm had realized less than $30 in gross operating revenues. In the Matter of Joe Loofbourrow, SEC Release Nos. 7700 and 41631, 1999 SEC LEXIS 1419 (July 21, 1999); In the Matter of Web Works Marketing.Com, Inc. and Trace D. Cornell, SEC Release Nos. 7703 and 41632, 1999 SEC LEXIS 1424 (July 21, 1999).

[51] John M. McGiveny Securities, Inc., SEC No-Action Letter LEXIS 2159, May 20, 1985.

[52] SEC v. Richard J. Briden, Empowerment Funding Group, Llc And Infopro Group, Litigation Release No. 16134, 1999 SEC LEXIS 951 (U.S.D.C. Mass. May 11, 1999); In the Matter of Lila Keith, SEC Release Nos.7699 and 41624, 1999 SEC

LEXIS 1600 (July 19, 1999); SEC v. Theodore O. Pollard, Litigation Release No. 16140, 1999 SEC LEXIS 957, (N.D. Cal. May 11, 1999).

53 SEC v. Rosenthal, Litigation Release No. 16133, 1999 SEC LEXIS 950 (D. Mass. May 11, 1999).