

Shareholder Communications in Cyberspace

By Robert Seberger

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The increase in the use of the Internet and other forms of electronic communication over the past several years has led to many changes in the methods used by investors to obtain information regarding public companies and in the methods that public companies use to communicate with investors.

The use of electronic communications is attractive to public companies because it enables them to disseminate information to more people at a faster and more cost effective rate than traditional paper-based methods. Investors like to use the Internet and other electronic communications to quickly obtain current information about the companies that they are interested in and because it gives them access to information that previously may have only been available to larger investors.

Obtaining information in electronic format also makes it easier to search it and put it into spreadsheets or databases for further analysis and comparison.

One of the most popular locations for investors to obtain information about public companies is the SEC's website (www.sec.gov) which, among other things, contains all of the electronic filings made by public companies as part of the SEC's EDGAR (Electronic Data Gathering, Analysis and Retrieval) system.

All public companies whose securities are registered under the Securities Exchange Act of 1934 (which includes almost all companies with significant investor interest) are required to file in electronic format with the EDGAR system all of the periodic reports (e.g. annual reports and quarterly reports) and proxy statements that are required to be filed in accordance with the Securities Act of 1934 (the "1934 Act").

The EDGAR system also includes registration statements filed under the Securities Act of 1933 (the "1933 Act") and the exhibits to those periodic reports and registration statements.

The SEC's website enables anyone with access to the Internet to easily and inexpensively view and download all of the documents that are filed in the EDGAR system, an obvious benefit to investors and a great aid to the free flow of market information.

The SEC's website is currently receiving in excess of 500,000 "hits" per day with more than 2.5 million pages being downloaded daily.

The SEC is aware of the benefits of the increasing use of new forms of electronic communication for investors and the securities markets and has sought to encourage the use of that new

technology while also protecting investors and the integrity of the markets.

In October 1995, the SEC issued an interpretative release that sets forth procedural guidelines for companies who want to use electronic media such as Internet websites, e-mail, facsimiles, videotapes, audiotapes and CD-ROM's to deliver information that they are required to deliver to investors in accordance with the 1933 Act, the 1934 Act, and the Investment Company Act of 1940.

Among the documents that those Acts require to be delivered to investors (the "Required Delivery Documents") are prospectuses, annual reports, and proxy statements.

Other documents, such as quarterly financial information, are not required to be delivered to investors even though they are required to be filed with the SEC and are available on the SEC's website.

That October 1995 release was followed by additional interpretative releases in May 1996. Those releases explain how electronic communications can be used to comply with the existing information delivery requirements but they do not change the existing disclosure and delivery requirements.

Although the SEC believes that the use of electronic media should be at least an equal alternative to paper-based media, it recognizes that not all investors have access to computers or desire to receive their information in that manner.

Therefore, in general, companies who want to use electronic media to deliver Required Delivery Documents must also provide paper copies to those investors who want them.

In the long run, as the use of computers becomes more prevalent and investors get accustomed to receiving information in an electronic format, the SEC may change its views.

The SEC releases set forth the three following basic requirements for using electronic media as a substitute for paper-based delivery of Required Delivery Documents.

Notice. Under traditional delivery methods, the investor becomes aware that the new information exists when it arrives in his mailbox. However, merely posting new information on a website will not, in and of itself, provide notice of that new information.

Accordingly, for websites and other passive delivery systems, separate notice (e.g. by e-mail or regular mail) is required to be provided, unless the company can otherwise show that the information was actually delivered.

Access. The electronic media should not use a confusing system of menus or otherwise be so burdensome to use that the intended recipients cannot effectively access the information. In addition, the recipient should have the opportunity to retain the information or have ongoing access equivalent to personal retention.

Evidence of delivery. Companies that provide electronic delivery of Required Disclosure Documents should have reasonable assurance that the investor received the information. This requirement is to ensure that the Company is not relying on electronic delivery to an investor who is unable or unwilling to take advantage of it.

The release lists the following five non-exclusive examples of procedures that would evidence satisfaction of the delivery requirement:

- (1) obtaining an informed consent from an investor to receive the information through a particular

electronic medium, coupled with assuring appropriate notice and access as described above;

(2) obtaining evidence that an investor actually received the information, for example, by electronic mail with return receipt or confirmation of accessing, downloading or printing;

(3) disseminating information through certain facsimile methods;

(4) having investors access a document that contains a "hyperlink" to a Required Delivery Document (e.g. sales material for a public offering that contains a hyperlink that the viewer can click to view the related final prospectus); and

(5) using forms or other material that are available only by accessing the required information.

The need to obtain shareholder consent to electronic receipt of Required Delivery Documents is an impediment to using electronic delivery as the primary method of delivery.

Another impediment is the need to redesign paper-based documents to make them more visually appealing and usable with a web browser. As a result, most Required Delivery Documents are currently being delivered in the traditional paper-based format.

However, many companies have established Internet websites in which a variety of information is available and placing a company's website address in advertisements is now commonplace.

According to a survey done by the National Investor Relations Institute in August 1996, over 95% of companies with over 1.5 billion dollars in market capitalization and over 75 % of companies with under 1.5 billion dollars in market capitalization either already had or soon planned to establish a website.

In the sixteen months since that survey, those numbers have surely grown. According to that survey, over 75 % of corporate websites posted financial information including annual reports, 10-K's and 10-Q's.

These sites either hyperlinked to the company's filings in the SEC's EDGAR Internet database or directly posted the reports on the company's website.

Many companies also place their annual reports on their website, some of which include enhanced features such as video presentations by senior management, interactive applications to enable investor feedback, and spreadsheets that permit the viewer to analyze the company's financial data.

Although a website can be a valuable communication device, a company that wants to provide investor related materials on its website must be aware that there are some potential dangers that make it necessary to take some basic precautions in establishing and maintaining its website.

It must be kept in mind that not all of the persons who view a company's website will be happy investors.

The information on the website will also be available to the company's competitors, the SEC and other government regulators, as well as unhappy investors and their attorneys. In addition, the company will also need to protect its website from attacks by "hackers" who might want to change the information on it.

Before placing any material on its website, the company should subject that material to the same screening process that it uses when it issues press releases or other material.

When deciding what material to be reviewed, it must be kept in mind that securities fraud cases can be based not only on such obvious things as incorrect financial statements or estimates of future performance that in hindsight turn out to be overly optimistic, but also on things such as product announcements that initially might not be considered to be investor related.

It is common practice for materials that are filed with the SEC to contain cautionary language such as those regarding the use of forward looking statements and disclaiming any duty to update the information contained therein.

All corporate websites should contain similar disclaimers. Although the disclaimer could be contained on a separate page that is accessible by clicking on a button or hyperlink on the page being viewed, companies should also consider having the disclaimer contained in a location where the viewer must click a button to acknowledge having viewed the disclaimer before being given access to the information.

Once information is placed on a website, it must be continually reviewed to make sure that it is current.

A good practice is to place dates on all press releases and other information placed on the website so that viewers are made aware that some of the information is dated and to enable the company more easily to remove the older "stale" information.

Many companies also include "archive" sections where older press releases and other information is stored. Even though a disclaimer may say that the information on the website is current only as of the date posted, many viewers may assume that the information is current unless it is contained in an archive section.

That would certainly be problematic if, for example, older earnings projections are still contained on the website after it becomes clear that they were overly optimistic when issued.

Special problems in the use of a website occur when a corporation is conducting a securities offering. The Securities Act places limits on the types of communication that can be provided to investors during a securities offering.

Violations of those restrictions can have serious consequences, including giving the purchasers the right to rescind their purchase.

If a company is conducting a private offering of its securities pursuant to an exemption from registration under the 1933 Act, it must take care to ensure that the information on its website would not constitute general advertising or solicitation that is prohibited in most of the private placement exemptions.

For public offerings that are registered under the Securities Act, the content of the disclosures that are permitted to be made depends on whether the offering is in the "pre-filing period," the "waiting period," or the "post effective period."

Pre-filing Period. During the pre-filing period, when the issuer is preparing for a public offering but has not yet filed a registration statement with the SEC, the 1933 Act imposes restrictions on activity that could condition the market for the securities.

Placing information on a website during the pre-filing period should not be done without first obtaining advice from the company's securities counsel because it could be deemed to constitute

prohibited "gun jumping."

Waiting period. The waiting period is the period from the time the registration statement is filed with the SEC until it is declared effective. During the waiting period, only oral communications and distributions of the preliminary prospectus are permitted.

No other written material generally may be distributed. In its October 1995 interpretive release, the SEC gave an example of a company that placed a preliminary prospectus on its website and provided direct access by hyperlink to an analyst's research report.

The SEC said that was not permissible because, during the waiting period, the company could make offers of those securities only through the preliminary prospectus and not through the use of the research report.

Having the link to the research report was deemed to be the same as placing it in the same envelope as the preliminary prospectus. Other information contained on a website during the waiting period might cause similar problems if that information is deemed to be incorporated into the registration statement.

The SEC has issued two "no-action" letters in which it advised issuers that including a reference in their preliminary prospectus that the issuer's SEC filings are also available on its website would not, "by itself, include or incorporate by reference any information into the registration statement which is included or hot linked to the company's website but is not otherwise incorporated by reference into the registration statement." Although those no-action letters are beneficial, they still leave many unanswered questions to be resolved by the SEC and the courts.

Post-Effective Period. During the post-effective period after the SEC declares the registration statement effective, issuers may complete their offerings using written sales literature in addition to the prospectus as long as the final prospectus is sent before or with the sales literature.

Determining when or whether a final prospectus placed on a website has been "delivered" would be analyzed under the principles set forth in the SEC interpretative releases discussed above.

Companies with websites must also decide if they want the website to include a link to independent analysts' reports or include a list of analysts who issue reports about the company.

As previously discussed, the inclusion of links to analysts' reports would be prohibited during the waiting period of a public offering. Even if a company is not conducting a public offering, there are still risks in including links to analysts' reports because plaintiff's counsel may argue that the company adopted those reports that were linked to its site, even if those reports are not entirely accurate and are based on information that the company did not provide.

The risk would be greater if a company only provided links to favorable reports. One recommended approach is to provide only a complete alphabetized list of all analysts who report on the company, along with a disclaimer stating that the company does not endorse or incorporate by reference into its website any statements made by those independent analysts.

The use of the Internet and other electronic media to communicate with investors is an evolving area that promises many exciting changes. This article only touches upon some of the many issues in this area.

Our company, Investor Relations Marketing offers a variety of highly specialized services to quickly and cost effectively attract the long term, high net-worth retail and institutional investors that your

company needs as shareholders.

By utilizing our services to get your company information out to the masses of stock investors, your company will receive the notice that it deserves.

Investor Relations Marketing's services are an easy and cost effective way to get your corporate communication out to the masses of stock investors.

We only utilize marketing strategies that have proven to be the most successful and resulted in achieving the highest gain in a company's stock price.

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