709 Employee-Shareholders: Applying Securities Laws to the Workplace

Marian S. Block
Vice President and Associate General Counsel
Lockheed Martin Corporation

Elizabeth A. Goodman
Pension Law Specialist
Office of Regulations and Interpretations
Pension and Welfare Benefits Administration
United States Department of Labor

Carol Crofoot Hayes
Chief Counsel, Transactions and Securities and Assistant Secretary
Coca-Cola Company

Broc Romanek
Director of Strategic Planning
RR Donnelley Financial

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).
Materials may not be reproduced without the consent of ACCA.
Reprint permission requests should be directed to James Merklinger at ACCA: 202/293-4103, ext. 326; merklinger@acca.com

Faculty Biographies

Marian S. Block

Marian S. Block is vice president and associate general counsel for Lockheed Martin Corporation in Bethesda, MD. She is responsible for providing and overseeing legal advice on employee benefits, executive compensation, federal securities laws, general corporate matters, corporate transactions, corporate finance, and election campaign law.

Prior to joining Lockheed Martin, she was an associate at the Washington, DC law firms of Arnold & Porter and Reed, Smith, Shaw & McClay and served as a trial attorney at the U.S. Department of Labor.

She is currently a director of ACCA's Washington Metropolitan Area Chapter and she is a member of the Employee Benefits Committee and Business Law section of the ABA. She was chairman of the Employee Benefits Committee of the District of Columbia Bar and is currently on the Board of Trustees of the Employees Benefits Journal.

Ms. Block received her BA from Kenyon College and law degree from the University of Virginia. She also has a Masters degree in history from Brown University.

Elizabeth A. Goodman

Elizabeth A. Goodman is currently a senior pension law specialist with the Office of Regulations and Interpretations, Pension Welfare Benefits Administration, United States Department of Labor.

Prior to working with the Department of Labor, Ms. Goodman was an associate in the Washington, DC office of Drinker Biddle & Reath. She served as a judicial clerk to the Honorable Richard A. Levie, Superior Court for the District of Columbia.

Ms. Goodman received her BA from Bryn Mawr College and her JD from the National Law Center, George Washington University.

Carol Crofoot Hayes

Carol Crofoot Hayes is chief counsel, transactions and securities, of The Coca-Cola Company. She has been with the company for over 15 years and her legal responsibilities include mergers and acquisitions, securities, executive compensation, financings, Board of Directors matters, issues involving the Securities and Exchange Commission and New York Stock Exchange, the proxy process, financial reporting, and disclosure matters. Recently she served as the lead lawyer in the purchase of the majority of the international soft drink business of Cadbury Schweppes.

Previously, Ms. Hayes served as law clerk to the Honorable B. Avant Edenfield, U.S. District Court for Southern District of Georgia. She joined the law firm of King & Spalding and practiced in the mergers and acquisition area. While at King & Spalding, her work included acquisitions for The Coca-Cola Company.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Ms. Hayes has served as president of the Southeastern Chapter of the American Society of Corporate Secretaries and serves on the Society's Securities Law Committee. She also served on the Society's Board of Directors.

Ms. Hayes graduated first in her class, magna cum laude, from Hood College and received her law degree from The University of Chicago Law School.

Broc Romanek

Broc Romanek is director of strategic planning and editor-in-chief of RR Donnelley Financial's RealCorporateLawyer.com.

Before his time at RR Donnelley Financial, Mr. Romanek served as assistant general counsel at a Fortune 50 company, was in the Office of Chief Counsel of the SEC's Division of Corporation Finance, acted as counselor to former SEC Commissioner Unger, and was in private practice.

In addition, Mr. Romanek is editor of the *Corporate Governance Advisor* and managing editor for the *M&A Lawyer*. He is coauthor of the "Shareholder Proposal Handbook" and "Mergers and Acquisitions".

Mr. Romanek is vice chair of ACCA's Securities Law Committee and on the Securities and Education Committees of the American Society of Corporate Secretaries (as well as a member of the Advisory Board for the Mid-Atlantic Chapter).

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Communicating With Employee Shareholders

Marian S. Block
Vice President and Associate General Counsel
Lockheed Martin Corporation

Employees become shareholders through participation in employee benefit plans such as stock option plans, employee stock purchase plans, 401(k) plans, ESOPS or through direct market purchases. In most large public companies today, employees represent a significant portion of the shareholder population. According to a special report prepared by the Employee Benefit Research Institute, 73 percent of large 401(k) plans (5000 or more employees) have a company stock investment feature.[1]

Employee shareholders raise two distinct issues for employers who are also public companies:

1. Employee access to, and use of, non-public information; and
2. Communications to employees concerning stock, financial prospects, employee benefit plans becoming viewed as communications regarding investment in the employer's securities.

This outline discusses some of the current issues regarding communicating to employees concerning stock, financial prospects and employee benefit plans.

1. Benefit Plan Communications

The Employee Retirement Income Security Act of 1974, as amended ("ERISA"), the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act") have extensive disclosure requirements for employee benefit plans.

A. Title I of ERISA (29 U.S.C. 1000-1031) and related Department of Labor Regulations encompasses the ERISA requirements. As a general rule, ERISA mandates that certain minimum disclosures be provided to plan participants.

i. Summary plan description ("SPD") must be provided to each participant and beneficiary and must contain the information set forth in Section 102(b) of ERISA (29 U.S.C. 1022(b)) and 29 C.F.R. 2520.102-3. The required disclosures are the basic information about the plan such as:

(1) Identifying information (name of plan, name and address of employer etc.);

(2) Type of plan;

[1] EBRI Special Report "Company Stock in 401(k) Plans: Results of Survey of ISCEBS Members" (Jan. 31, 2002).

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

(3) Names of contributing sponsors;

(4) Employer identification number;

(5) Type of administration, plan administrator and trustee information;

(6) Information about benefits, eligibility and participation rules vesting, counting years of service, normal retirement age, requirements for benefits, circumstances under which benefits may be forfeited or a participant becomes ineligible or when benefits are subject to offset;

(7) Authority to termination plan; and

(8) Legal rights of employees.

The summary plan description can be updated through a "summary of material modifications." ERISA 104(b); 29 U.S.C. 1024(b); 29 C.F.R. 2520.104b-3.

ii. Annual Report: Plans must also file with the Department of Labor an annual report (ERISA 103, (29 U.S.C. 1023; 29 C.F.R.2520.103-1) which contains financial and actuarial information about the plan.

iii. Summary Annual Report: Participants are provided with a summary annual report (ERISA 104(b)(3); 29 U.S.C. 1024(b); 29 C.F.R. 2520.104b-10).

iv. Section 404(c) Plans

Under ERISA, the plan fiduciaries generally are responsible for the management or disposition of the plan's assets. If a plan that provides for individual accounts permits a participant or beneficiary to exercise control over the assets in that account and the participant or beneficiary actually exercises that control, the regular plan fiduciaries are not liable for any loss which results from the participant or beneficiary's exercise of control. ERISA 404(c), 29 U.S.C. 1104(c); 29 C.F.R. 2550.404c-1(a)(1). A plan that satisfies those requirements is known as a "404(c) Plan."

(1) Whether a participant or benefit can be considered to have an opportunity to exercise control is, in part, determined by whether "the participant or beneficiary is provided or has the opportunity to obtain sufficient information to make informed decisions with regard to investment alternatives available under the plan, and the incidents of ownership appurtenant to such investments." 29 C.F.R. 2550.404c-1(b)(2)(B). The regulations list the types of information that must be provided to participants and beneficiaries or the participant will not be considered to have sufficient information, including

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

(a) An explanation that the plan is intended to constitute a plan described in section 404(c);

(b) A description of the investment alternatives available under the plan and, a general description of the investment objectives and risk and return characteristics of each such alternative;

(c) Identification of any designated investment managers;

(d) An explanation of the circumstances under which participants and beneficiaries may give investment directions;

(e) A description of any transaction fees and expenses;

(f) the name, address, and phone number of the plan fiduciaries;

(g) Description of confidentiality procedures for the purchase, holding, sale, voting and tendering of employer securities; and

(h) The participant or beneficiary is provided either directly or upon request, the following information, which shall be based on the latest information available to the plan:

(I) A description of the annual operating expenses of each investment alternative and the aggregate amount of such expenses expressed as a percentage of average net assets;

(II) Copies of any prospectuses, financial statements and reports, and of any other materials, to the extent such information is provided to the plan;

(III) A list and value of the assets comprising the portfolio of each designated investment alternative which constitute plan assets;

(IV) Information concerning the value of shares or units in designated investment alternatives available to participants and beneficiaries under the plan, as well as she past and current investment performance of such alternatives, determined, net of expenses, on a reasonable and consistent basis; and

(V) Information concerning the value of shares or units in designated investment alternatives held in the account of the participant or beneficiary.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

(2) The regulations also state that the limitation on the fiduciary's liability only applies with a respect to a transaction where a participant or beneficiary has exercised independent control in fact. (29 C.F.R. 2550-404c-1(c)). A participant or beneficiary's exercise of control is not considered independent in fact if

(a) The participant or beneficiary is subjected to improper influence by a plan fiduciary or plan sponsor;

(b) A plan fiduciary has concealed material non-public facts regarding the investment from the participant or beneficiary, unless the disclosure of such information by the plan fiduciary to the participant or beneficiary would violate any provision of federal aw or any provision of state law which is not preempted by ERISA; or

(c) The participant or beneficiary is incompetent.

(29 C.F.R. 2550.404c-1(c)(2)). Finally the DOL regulations indicate that the limitation on the fiduciary's liability for a 404(c) Plan will not apply to employer securities that are publicly traded unless information provided to shareholders is provided to participants and beneficiaries with accounts holding such securities. (29 C.F.R. 2550.404c-1(d)(4)(v)).

v. The emphasis in ERISA disclosure is on categories of information required to be disclosed rather than on a standard of disclosure although ERISA 102(a) (29 U.S.C. 1022(a)) notes that the information in a summary plan description "shall be written in a manner calculated to be understood by the average plan participant, and shall be sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of their rights and obligations under the plan."

vi. Over the past few years, there has been an emerging case law that considers the disclosure obligations of plan fiduciaries beyond the categories of items contained in the ERISA statute itself. Not surprisingly the case law has found an obligation for fiduciaries to speak truthfully (Varity Corp. v. Howe, 516 U.S. 489, 506 (1996) "To participate knowingly and significantly in deceiving a plan's beneficiaries in order to save the employer money at the beneficiaries' expense is not to act solely in the interest of the participants and beneficiaries.' As other courts have held, '[l]ying is inconsistent with the duty of loyalty owed by all fiduciaries and codified in section 404(a)(1) of ERISA.'"). Other courts have concluded that ERISA fiduciaries must provide complete and accurate information in response to questions about plan terms although the question of whether there is an affirmative obligation to disclose when no inquiry has been made or where no statutory obligation exists remains unsettled. (See, for example, Bins v. Exxon Co. U.S., 220 F.3d 1042 (9th Circ. 2000); Estate of Carol Becker v.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Eastman Kodak Co. 120 F.3rd 5 (2d Cir. 1996); Pochia v. NYNEX Corp. 81 F.3d 275 (2d Cir. 1996) cert. denied 117 S.Ct. 302).

B. The Securities Act sets forth registration obligations and antifraud provisions for the offer and sale of securities. The Exchange Act describes the ongoing disclosure obligations of public companies.

i. Interests in plans holding employer securities that are "contributory and voluntary" on the part of the employee are generally viewed as securities. International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979); SEC Release No. 33-6281 (January 15, 1981); SEC Release No. 33-6188 (February 1, 1980). Absent an exemption, under the Securities Act, it is illegal to sell a security unless a registration statement is in effect as to the security and unless a prospectus meeting the requirements meeting specified requirements accompanies the security. Section 5 and 10 of the Securities Act (15 U.S.C. 77e, 77j).

(1) Company stock offered under employee benefit plans as well as interests in an employee benefit plan generally can be registered using a short-form registration statement known as a Form S-8.

(2) In addition, the SEC has adopted special rules as to what information must be included in a prospectus for an employee benefit plan. In general, the prospectus requirement is fulfilled by providing plan participants with a document containing the plan information required by Form S-8, updated as necessary, and a written statement advising participants of the availability, upon written or oral request, of the documents incorporated by reference in the registration statement and stating that those documents are incorporated by reference in the prospectus. The plan's summary plan description may be used as the prospectus so long as

(a) It contains the information required by Form S-8;

(b) It contains a legend noting that the materials constitute a prospectus covering securities that have been registered under the '33 Act;

(c) Is dated; and

(d) It is delivered early enough to ensure timely delivery of current plan information to participants under the federal securities laws, which generally would be earlier than the ERISA deadlines for delivery of the summary plan description.

(3) Summaries of material modification can also serve as updates to the prospectus so long as they are dated and contain a legend stating that the information constitutes part of the prospectus.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

(SEC Securities Act Release No. 6867 (Jun. 20 1989); Exchange Act Release No. 28094 (Jun. 20, 1989); SEC Rule 428 (17 C.F.R. 230.428)).

(4) The information required to contained in the prospectus for an employee benefit plan includes

(a) Information about the plan;

(b) Information about the plan administrator;

(c) The title and amount of securities to be offered;

(d) Class eligible to participate;

(e) Amount of contributions;

(f) Amount to be paid for securities;

(g) Nature and frequency of reports to be made;

(h) Resale restrictions;

(i) Tax effects on plan participants;

(j) Forfeiture provisions;

(k) Withdrawal provisions, fees, liens; and

(l) Tabular or other meaningful presentation of financial data for each of the past three fiscal years that in the opinion of the registrant, will apprise employees of material trends and significant changes in the performance of alternative investment media and enable them to make informed investment decisions in plans where the participating employees may direct all or any part of the assets under the plan to two or more investment media.

ii. Plans with securities registered under the Securities Act are required to file an annual report containing financial information. The report may be filed on a Form 11-K or as part of the plan sponsor's annual report on Form 10-K. SEC Rule 15d-21 (17 C.F.R. 240.15d-21).

iii. Both the Securities Act and the Exchange Act contain statutory provisions setting forth disclosure standards. Under both laws, it is unlawful to make any disclosure, which includes an untrue statement of material fact or omits to state a

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading. (See e.g., Sections 11, 12 and 17 of the Securities Act (15 U.S.C. 77k, 77l, 77q) and Section 10(b) of the Exchange Act (15 U.S.C. 78j)).

2. Current litigation involving communications and plans with employer securities

A. Most people are familiar with class action lawsuits that are filed after a public company experiences a significant decline in its stock price or discloses that it is restating its financial statements. Historically, these lawsuits have been based on various provisions of the federal securities laws and allege, among other things, that the company's disclosures omitted material facts or made material misrepresentations. In the past two years, a new series of class action complaints have been filed claiming that the company's inaccurate or incomplete disclosures are breaches of fiduciary duty to employee benefit plans holding employer securities and constitute ERISA violations. These complaints include the following companies:

CMS Energy	Potter v. CMS Energy (E.D. Mich.)
Duke Energy	Matthews v. Duke Energy Corp. (W.D.N.C.)
Enron	Tittle v. Enron Corporation (S.D.Tex) (consolidated case)
Global Crossing	Ramkissoon v. Winnick (E.D. Cal.) McAllister v. Winnick (E.D. Cal.) Johnson v. Winnick (E.D.Cal.)
Lucent	Reinart v. Lucent Technologies Inc. (D.N.J.)
Nortel Networks	Zafarano v. Nortel Networks (M.D.Tenn.) Kauffman v. Nortel Networks (M.D.Tenn.)
Providian Financial Corporation	In Re Providian Financial Corporation ERISA Litigation (N.D. Cal.)
Qwest Communications	Brooks v. Quest Communications Inc. (D.Col.)
Tyco	Jepson v. Tyco International Inc. (S.D.N.Y.)
Williams Cos.	VanNess v. Williams Companies Inc. (N.D.Ok)
WorldCom	Rambo v. WorldCom Inc. (S.D.Miss.)
Xerox	Patti v. Xerox Corp. (D.Conn.)

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

B. The cases follow a common pattern (many of them have been filed by the same law firm):

i. Class action covering a class of participants and beneficiaries who invested in employer securities through a benefit plan during a specified time period prior to the drop in stock price.

ii. Defendants include internal plan administrators, officers and members of the board of directors with oversight responsibilities over benefit plans.

iii. The allegations contain a lengthy recitation of the history of the stock price, stock transactions by insiders and various SEC disclosures and press releases about the financial condition of the company in question.

iv. General theories of liability

(a) Failure to provide complete and accurate information to plan participants and beneficiary about the financial condition of the company. "A plan fiduciary's duties of loyalty and prudence include a duty to disclose and inform. This duty entails: (1) a negative duty not to misinform; (2) an affirmative duty to inform when the fiduciary knows or should know that silence might be harmful; and (3) a duty to convey complete and accurate information material to the circumstances of participants and beneficiaries. This duty to disclose and inform recognizes the disparity that may exist, and in this case did exist, between the training and knowledge of the fiduciaries, on the one hand, and the participants and beneficiaries, on the other. . In a plan with various funds available for investment, this duty to inform and disclose also includes: (1) the duty to impart to plan participants material information of which the fiduciary has or should have knowledge that is sufficient to apprise the average plan participant of the risks associated with investing in any particular fund; and (2) the duty not to make material misrepresentations. " (Complaint in <u>Ramkissoon v. Winnick,</u> paragraph 109).

(b) Failure to ensure plan assets were invested prudently by allowing the investment by participants (or the match by the company) to be made in company stock at a time when the financial problems made stock an inappropriate retirement investment for plans' participants and beneficiaries.

(c) Failure to monitor investments or conduct an independent investigation.

(d) Failure to diversify the stock investment and override plans documents (in particular the requirement that the match be made in stock) when

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

fiduciary knew or should have known that employer security was not an appropriate investment option for an employee benefit plan.

v. Some issues raised by the litigation:

(a) Does possession of material non-public information create a conflict of interest for an officer or director who serves as a plan fiduciary of an employee benefit plan holding employer securities that constitutes a breach of fiduciary duty under Section 404(a)(1)(A) (29 U.S.C. 1104(a)(1)(A)) and if so, what does the officer do to remedy the conflict?

(b) When an employee benefit plan holds employer securities, do communications by officers and directors about the plan sponsor (including filings with the SEC) constitute communications concerning plan benefits such that an omission or misstatement could be remedied as a breach of fiduciary duty? If so, what communications by an employer are not subject to ERISA?

(c) Is the contribution by a sponsor of its securities as the matching contribution to an employee benefit plan subject to review by the plan fiduciary as an appropriate plan investment under Section 401(a)(1)(D) of ERISA (29 U.S.C. 1104(a)(1)(D)) and if so, can a fiduciary require that the matching contribution be made in a different form?

(d) Is the continued investment of a sponsor's matching contribution in employer securities consistent with the plan document subject to review by the plan fiduciary as an appropriate plan investment under Section 401(a)(1)(D) of ERISA (29 U.S.C. 1104(a)(1)(D) and if so, can a fiduciary override the plan document and invest the matching contribution in another investment vehicle?

(e) Are plan restrictions on diversification, consistent with the Internal Revenue Code rules regarding limitations on diversification for holdings in employer securities, subject to review and override by the plan fiduciary under Section 401(a)(1)(D) of ERISA (29 U.S.C. 1104(a)(1)(D))?

(f) If the plaintiffs prevail in these cases are there any circumstances under which a fiduciary of an employee benefit plan holding employer securities can ever wear "two hats" (officer/director and fiduciary) in a financially troubled company?

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Suggestions On Avoiding Liability

1. Whether to offer employer securities as an investment option in a defined contribution plan or as a matching contribution should not be a fiduciary decision. The plan document should state explicitly that stock will be an investment option or the match.

2. The plan and related employee communications should state that the plan is a 404(c) Plan under ERISA and therefore employees are responsible for investment decisions.

3. The employer securities fund should be managed by an independent investment manager within the meaning of ERISA 3(38) who does not have access to material nonpublic information about the company. There should be a signed investment management agreement for the employer securities fund which gives the investment manager discretionary authority over the fund.

4. All material information about the plan should be contained in a prospectus and updates should be legended to note that the materials are part of a prospectus.

5. Management should not comment to employees on the benefits of buying the employer's stock.

6. Informal communications about the plan (i.e. newspaper articles, newsletters, CEO communications, all-hands meetings) should be reviewed by counsel and should not include any material information not contained in the plan prospectus. Informal communications about the financial condition of the company should be reviewed by counsel and should be limited to publicly disclosed information.

7. Confirm that your fiduciary liability policy covers everyone who could conceivably be considered a fiduciary (or who are alleged to be serving as fiduciaries).

8. Confirm that the plan indemnification clauses are binding on the company (and not just the plan) or alternatively that your bylaw indemnification provisions cover employees and directors serving as benefit plan fiduciaries (or who are alleged to be serving as fiduciaries).[2]

9. Make sure that employees are sent any communication sent to shareholders (e.g. proxy, annual report, quarterly reports).

10. Time your plan blackouts carefully: (i) avoid periods immediately preceding or following public disclosure of material information; (ii) consider asking your directors and officers to refrain from trading during any blackout, even when not required to do so under Section 306 of the Sarbanes Oxley Act. (H.R. 3763/P.L. 107-204); and (iii) consider complying with all the requirements of Section 306 of the Sarbanes Oxley Act, even if the blackout occurs prior to the effective date of the provision.

---

[2] See Rosina Barker and Kevin Obrien, "Double Indemnity: Does Your Plan's Fiduciary Indemnification Clause Protect Your Plan Administrator?" Benefits Law Journal (Autumn 2002).

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Setting up an Insider Trading Compliance Program

Carol Hayes – 8/15/02

In my view it is wise to set up an insider trading program for the following reasons:

1. A good program will prevent inadvertent violations of the law. The SEC presumes that a trade made while in possession of material unannounced information is made on the basis of such information. You can prevent trades which, while made innocently, are quite difficult to defend.

2. A good program protects the company from embarrassment. Particularly in today's environment, the reputation of the company as well as an individual, can be seriously damaged by the appearance of improper trading.

3. A good program will provide some protection under the Insider Trading Sanctions Act. This law provides for a fine of up to $1,000,000 against a company or a supervisory person who fails to provide reasonable safeguards against insider trading

There are three major components to the program:

1. Who should be included?

2. What restrictions should apply to these people?

3. How will these people be educated?

At a minimum, the officers and directors should be included. Then, in order to determine who else should be included, you must first think through what kinds of

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

information could be considered material, i.e., significant to a reasonable investor in deciding whether to buy, sell or hold. Unannounced earnings would clearly qualify as material. However, different industries have different material events, e.g., drug approvals, material contracts, significant merger and acquisition activity, etc. You must then think through who in the company has access to this information before it is announced. For example, who in the finance organization sees earnings before they are announced?

After some analysis, speak to the heads of the business units and the function heads. Talk about what kinds of material unannounced information might be known by people they supervise and get a list of names from each business unit or function head.

How you will structure the restrictions depends on what types of undisclosed material information is likely to be available to the people on your list and when that information is likely to be available. At the very least, you should restrict trading when earnings are known but not released. You should also restrict trading after the release to give the market a chance to digest the news. The third trading day after the release is safe.

You may have other types of material non-public information. The safest method is to require preclearance. You may wish to have a preclearance system for directors and officers who file Form 4's in any event since you will want to check for any possible violation of the six-month profit recovery rules and to prepare the Form 4 which shortly will have a 2-day filing timeframe. A preclearance system for a large group of employees below this level may be burdensome.

Depending on your situation, a blackout period before earnings may work or an announced trading period, with preclearance at other times. You may wish to restrict only some persons at certain times. For example, you may wish to restrict trading for a deal team which has knowledge of a material transaction during a time when trading would otherwise be allowed. How the restrictions are handled is an individual decision

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

based on particular facts. You may want to consider the use of a 10b-5(1) plan. Remember, the goal is to prevent insider trading and to protect the reputation of the company.

With regard to transactions in employee benefit plans, I advise as follows:

1. A stock option issued under the company's stock option plan can be exercised at any time. However, sales must take place during a permitted period.

2. Changes into or out of the company stock account in a 401(k) should take place only during a permitted period.

3. Changing forward elections affecting company stock in a 401(k) plan should only be done when the participant has no material unannounced information.

After your program is thought through, education must be a big part of implementation. I suggest a letter be sent to the people whose trading is restricted, explaining the program. If you use blackout periods or trading periods, memos should be sent alerting those people. I also hold quarterly training and education programs on insider trading, which are open to employees whose trading is not restricted, as well as to restricted employees. Points to be emphasized include:

1. Explain clearly what insider trading is and that the SEC presumes liability when trading occurs while in possession of material, inside information. Stress that criminal liability could be involved.

2. Explain tipping and the fact that a tipper can be liable for three times the profit of the tippee, even if the tipper did not make a cent on the

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

transaction. Caution against sharing material inside information with other employees who have no need to know.

3. Remind the employees that there is no de minimus exception to the rules.

4. Familiarize them with the Insider Trading Sanctions Act with its potential $1,000,000 fine against supervisors and companies that do not take proper precautions to prevent insider trading.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

May 2002

Volume 5 • Number 12

Web Watch

XBRL: The Latest Developments
by Broc Romanek

Over a year ago, I wrote about eXtensible Business Mark-up Language (known as "XBRL"), a new software programming code that many expect will revolutionize how financial statements "look and feel."1 Among other benefits, XBRL enables public companies to create their financial statements so that investors can easily manipulate and retrieve financial data from the Web. XBRL can also be used to enhance the integrity and expediency of a company's audit by making data collection and consolidation quick and efficient.

What is XBRL?

XBRL is derived from eXtensible Mark-up Language, known as "XML." XML is an Internet industry framework for languages that describes data and establishes individual "tags" for specific elements in structured documents. With XBRL, each item in a financial statement is individually tagged based on a "taxonomy," or system of classification. With the tags working "behind the scenes," individual users can call up and manipulate numbers with a click of a button to analyze the data for their own specific purposes.

XBRL was created in 1998 following a concerted effort by the XBRL.org consortium. This group has grown from approximately 70 members at the beginning of 2001 to more than 140 members today, including each Big Five accounting firm, the AICPA, the Australian Stock Exchange, the Deutsch Börse, and the Hong Kong Exchange. Each member has committed to integrate XBRL into its products and eventually encourage its clients to use it.

Recent Developments in the Use of XBRL

The movement towards using XBRL has accelerated in the global market and is gradually picking up steam in the United States. At the end of 2001, the XBRL.org consortium released the second version of the programming code for financial statements and a taxonomy for financial reporting of commercial and industrial

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

companies that reflect U.S. generally accepted accounting principles. This version promises to usher in new user growth.

Global Developments

In February 2002, the International Accounting Standards Committee Foundation (IASCF) released an “alpha” version of taxonomy for XBRL, including a system of classification for a balance sheet, income statement, statement of cash flows and statement of changes in net equity.2 Proper and consistent classification is critical because universal agreement about terminology is the linchpin of XBRL. Indeed, the IASCF widely released an alpha (or preliminary) version to encourage input from the accounting community to improve the quality of the end product and increase the odds that market participants will accept the final version. The IASCF taxonomy likely will change before it is released in a beta or final version.

The efforts of the IASCF could fulfill the predictions of some commentators who believe XBRL will increase pressure on companies to provide financial information based on international accounting standards.3 This dovetails with the European Commission’s campaign to have its International Auditing Standards adopted on a worldwide basis. With XBRL’s ability to create more standardized financial statements, arguments about obstacles related to collecting and reporting information may be overcome.

U.S. Progress

In the United States, Microsoft Corporation recently has emerged as a big XBRL booster. Microsoft released its second-quarter 2002 earnings results in XBRL, and also converted its last two Form 10-Qs and its 2001 annual report to XBRL. These documents are available on Microsoft’s investor relation’s Web page. Last December, Reuters Group PLC posted its financial statements in XBRL and Morgan Stanley Dean Witter filed its Form 10-K with its financial statements in XBRL as an exhibit a year ago.

In a white paper, Microsoft’s Chief Financial Officer, John Connors, out-lined how the company collects its internal data and transforms it into XBRL.4 Using a tool called the “XBRL Builder,” Microsoft uses four processes to obtain the end product:

1. Mapping the financial report line items with the appropriate XBRL tag;
2. Building and maintaining taxonomies (dictionaries of XBRL terms);
3. Creating XBRL Instance Documents (marrying the XBRL tag with the actual financial result); and
4. Transforming Instance Documents into publishable format (create once, report in many formats).

XBRL has also attracted interest on Capitol Hill. It was discussed at a Senate Banking Committee hearing regarding technology’s role in facilitating more rapid corporate disclosure. The Brookings Institution Economic Studies Program Director, Robert Litan,

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

testified that the Securities and Exchange Commission should consider ways to encourage companies to use XBRL as soon as possible.5

What is Holding XBRL Back?

Despite its apparent benefits, few companies have adopted XBRL. Although academic interest is high, accounting software vendors only recently have begun integrating XBRL into their products and services. It remains to be seen whether clients will embrace these products. However, with the recent release of the latest XBRL standards, many commentators predict an explosion in the adoption and use of XBRL during the next two years.

Some commentators argue that XBRL is impractical today since the stability of the new standards is uncertain and practical applications for XBRL are still unavailable. In comparison, standards such as HTML are widely and easily used in many ways on the Web.

Along the same lines, these commentators believe that requiring companies to file XBRL documents with the SEC is premature. Since the case has not yet been made that XBRL documents are simple to create, they would prefer to have market forces drive the widespread acceptance of XBRL rather than permit the SEC to impose what may be undue compliance burdens.

To follow recent precedent, the SEC could allow for voluntary filings of XBRL documents. This is the current accommodation for HTML documents. Once critical mass has been reached and most companies show they are capable and willing to file in HTML, it is expected that the SEC will mandate the use of HTML (perhaps sometime later this year). However, the SEC probably would need to expend significant resources to upgrade EDGAR to accept XBRL documents; this may be the bottleneck to eventual SEC acceptance.

Aside from upgrading EDGAR, the SEC can take actions to facilitate the XBRL movement. The SEC could insist that the line items in financial statements and tables filed with it be drawn from a specific taxonomy. Right now, there is a high level of “creativity” in line item labels from company to company. If companies were required to file financial statements with standardized line item names, it would be relatively easy for third parties to mechanically convert the filings into XBRL and create a complete XBRL database. This capability is already available at PricewaterhouseCoopers (http://edgarscan.pwcglobal.com/servlets/edgarscan) and Downside (www.downside.com). For this to work, the SEC must stand ready to penalize companies that do not use the specified labels.6

Could XBRL have prevented “Enron”?

It is interesting to mull over the question of whether the implementation of XBRL could have helped investors spot the developments at Enron at an earlier stage. If information

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

was automatically consolidated among Enron partnerships and made publicly available in some form, it arguably would have been more difficult to sweep the partnership debt problems under the rug. However, this assumes that the partnership data would have been automatically consolidated—a dubious proposition given the company's view that the partnership data was distinct from the corporation's. Still, XBRL does lead to more transparent financial information and may help to prevent future "Enrons."

Notes

1 Broc Romanek, "XBRL: Financial Statements May Never Be the Same Again," WALLSTREETLAWYER.COM, January 2001 at 20.

2 *See* "Core Financial Statements XBRL Specification V2" and its accompanying documents, *available at* www.xbrl.org.

3 At a March 12, 2002, XBRL.org conference, Michael Sanderson, CEO of NASDAQ Europe, urged global adoption of XBRL for better business information. See press release at www.xbrl.org/News.htm.

4 "The Road to Better Business Information: Making a Case for XBRL—A Conversation With Nasdaq, Microsoft and Pricewaterhouse Coopers," *available at* www.xbrl.org.

5 See the related white paper, Robert E. Litan and Peter J. Wallison, "The GAAP Gap:Corporate Disclosure in the Internet Age," *available at* www.aei.brookings.org/publications/books/gap.pdf.

6 The failure of the SEC to penalize companies that filed incorrect information in their financial data schedules resulted in poor data quality that ultimately led the SEC to abandon the requirement to file these schedules.

About the Author
Broc Romanek

* ©2002 Broc Romanek. Broc Romanek (broc.romanek@rrd.com) is Editor-in-Chief of RR Donnelley Financial RealCorporateLawyer.com. The views expressed in this article are the author's alone and do not necessarily represent the views of RR Donnelley Financial.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

WALL Street LAWYER
SECURITIES IN THE ELECTRONIC AGE

April 2002

Volume 5 • Number 11

Web Watch

After Enron: More IR on the Web
by Broc Romanek

Veteran securities law practitioners universally agree that the Enron collapse is the single most galvanizing change agent that has arisen in several decades. Dozens of reform bills have been introduced on Capitol Hill, collectively addressing a myriad of practice areas. Some large institutional investors have become quite aggressive and are demanding dramatic changes, particularly in the area of corporate governance. It is likely that few aspects of the securities market will emerge unchanged, including the accounting industry, the analyst community, and even the SEC itself.

One area that will evolve considerably is corporate disclosure. In February, the SEC announced plans to issue proposals to overhaul the timing and transparency of corporate disclosure. In President Bush's 10-point plan for corporate reform, one emphasis is on improving disclosure practices. The same is true for a number of the bills introduced by Congress.

In their comments about how disclosure practices should be improved, it appears that many lawmakers are now ready to recognize the Web as an efficient mechanism for communicating with investors. This will be a relief for those that have argued that the use of the Web has grown to proportions sufficient to sustain a presumption that most investors have online access.1 Without fanfare, the debate regarding the "digital divide," at least among investors, may be over.

Proposals that Mandate Use of the Web

Although they differ in their approach, both the SEC and some members of Congress have indicated that they expect companies to post disclosure documents on their own Web sites. This obligation would be in addition to the obligation to file the same documents with the SEC.

As outlined in a February 11 press release, the SEC intends to conduct rulemaking that would require companies to post their Form 10-Ks and 10-Qs (and potentially Form 8-Ks and other disclosure documents) at the same time those documents are filed with the SEC.2 In Congress, a pending bill sponsored by House Financial Services Chairman Michael G. Oxley would require insiders to post their Forms 3, 4 and 5 on

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

corporate Web sites the day after they are filed.3 Currently, these forms are not even required to be filed electronically.

The National Investor Relations Institute recently released results of a survey commissioned in response to the SEC's proposed disclosure reforms. Although the survey may not reflect the views of many issuers (only 406 companies participated), the findings are telling. Only 11% of the survey respondents indicated that they would have trouble simultaneously posting their 10-Ks on their Web sites when they file with the SEC. Indeed, 41% of the respondents already do so.4

Analysis of How the Web is Used Today

Nearly every public company already has a Web page devoted to investor relations. Not only can investors expect to find press releases and SEC filings on a company's IR Web page, but information about a company's analyst conference calls, investor conferences, and stockholder meetings is increasingly standard. It is expected that reforms wrought by the fall of Enron will cause companies to devote more resources to communicating through these IR Web pages.

SEC filings

As could be expected, most companies provide their periodic filings (*i.e.,* Form 10-Ks and 10-Qs)—or at least access to them—on their IR Web pages, although how they do so varies to some degree. Based on an informal poll of the IR Web pages of the Fortune 100, approximately 90% provide these filings or access to them. (In the NIRI survey, 13% of the respondents said they do not post their 10-Ks.) Perhaps what is surprising is to find a large company that does not provide such an IR staple.

Approximately three-quarters of the Fortune 100 provide access to their SEC filings for more than two years. A little over 10% provide them for just one year, and fewer than 10%provide them for two years. From an IR perspective, the longer the better, as some investors like to do comparative research beyond a company's immediate past.

Approximately 80% of the Fortune 100 provide access to their SEC periodic reports in an HTML format. Another 15% provide them only in a PDF format. Only 5% provide reports in both PDF and HTML formats. The PDF format is ideal for printing a document to read offline; HTML is optimal for creating an investor-friendly, navigable, online document.

One critical element for investors is how companies label the links to their SEC filings. Without a self-explanatory title, investors cannot easily find these documents on crowded IR Web pages, and are likely to give up before attaining their goal. The most popular title, used by nearly 60% of the Fortune 100, is the self-explanatory "SEC Filings." Less obvious are titles like "Current Financial Reports" (5%), "Regulatory Filings" (1%), and "Financial Highlights" (1%). Numerous companies use their own unique labels.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

As I reported a year ago, quite a few companies rely on third party service providers to maintain their IR Web pages, or at least portions of them.5 One area where service providers appear to be busy is hosting SEC filings. Frequently, when an investor clicks on “SEC Filings” on an IR Web page, the investor is taken to a Web page hosted on a third party’s server where the company’s SEC filings are housed. The majority of the Fortune 100 appears to utilize this type of outside service, offered by companies like CCBN, Shareholder.com, and Edgar-Online. Most companies do not have sufficient staff—either investor relations personnel or Webmasters—to efficiently maintain their SEC filings on their Web site for public access.

Earnings releases

Compared to SEC filings, an even greater number (nearly 95%) of the Fortune 100 make their earnings releases available from their IR Web pages. Still, 6% do not (although this number includes a few non-public companies).

Just over half of the Fortune 100 permit investors to access earnings releases that are more than one year old; 17% go as far as providing access to releases more than five years old. Approximately 20% allow access to earning releases just for the past year, and 3% are quite conservative and allow access to just the last quarterly earnings release. Although a vague “duty to update” standard presents some legal risk to offering “aged” earnings releases, it seems like the benefit of providing investors with historical references outweighs such conservatism.

More than 80% of the Fortune 100 provide access to earnings releases in an HTML format. Another 2% provide them only in a PDF format. Almost 10% provide reports in both PDF and HTML formats.

Unlike for their SEC filings, companies use a wide variety of labels to indicate where their earnings releases can be found, partially because they lump earnings releases together with a variety of other news information. The four most popular captions are: “Press Releases” (17%); “News” (17%); “Earnings Releases” (16%); and “Financial Releases” (14%). Less popular captions include: “Company Releases” (7%); “Quarterly Earnings” (6%); and “Financial Results” (4%).

The more popular “Press Releases” and “News” captions may be too generic for investors seeking quick access to earnings releases. It might make sense for companies to offer earnings releases under a separate caption that is specific, while also maintaining those releases in a broader group of news bulletins.

Analyst conference calls and other types of presentations

Since the adoption of Regulation FD, the use of Webcasts clearly has skyrocketed, with well over half of the Fortune 500 conducting Webcasts. The manner in which companies make Webcasts available has evolved somewhat in the past year.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Of the Fortune 100, nearly 70% make Webcasts available from their IR Web pages. Approximately 25% of these companies make them available for just the last quarter, and 35% make them available for more than one year. Only one-third of these companies use the caption "Audio Archives" to clearly label older Webcasts as archival content. The use of an archive caption can be important if a company is faced with a claim that relates to the duty to update.6

Nearly 15% of the Fortune 100 use the Web to broadcast more than just analyst conference calls. These companies make items like officer presentations and speeches available, often with PowerPoint slides available.

Notes

1 A number of comment letters submitted to the SEC regarding the 1998 "aircraft carrier" proposal made this observation. For example, see the June 30, 1999 comment letter from the Corporate and Securities Law Committee of the American Corporate Counsel Association at wwww.sec.gov/rules/proposed/s73098/starr1.htm.

2 "SEC to Propose New Corporate Disclosure Rules," Press Release 2002-22, *available at* www.sec.gov/news/headlines/corpdiscrules.htm.

3 On February 14, Rep. Oxley and Capital Markets Subcommittee Chairman Richard H. Baker introduced the "Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002." A copy of this bill is at www.realcorporatelawyer.com/HR3763.pdf.

4 The complete survey results are available through a link at .

5 *See* Broc Romanek, "Developing Investor Relations Web Pages: The Team Approach," WALLSTREETLAWYER.COM, March 2001, at 21.

6 *See* Steven Dolmatch and Amy Goodman, "Investor Relations on the Web," ACCA Docket (July/August 2000).

About the Author
Broc Romanek

* ©2002 Broc Romanek. Broc Romanek (broc.romanek@rrd.com) is Editor-in-Chief of RR Donnelley Financial RealCorporateLawyer.com. The views expressed in this article are the author's alone and do not necessarily represent the views of RR Donnelley Financial.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

March 2002
Volume 5 • Number 10

Web Watch

Annual Reports on the Web

by Broc Romanek

Now more than ever, the Web is changing the “look and feel” of annual reports. Although the disclosure itself has not changed, the presentation of these reports is evolving at a rapid pace. As could be expected, some companies are innovating more than others: consider Motorola’s annual report, which can be accessed by wireless communications. The recent development of “off-the-shelf ” interactive annual report templates should hasten changes in this area.

Perhaps the most surprising aspect of online annual reports is the disparity in the ways companies are creating and posting them-from differing formats and layouts to a wide range of archival practices and navigation structures. Clearly, there are no “standard practices” right now, and no such practices are likely to emerge soon unless they are imposed by the SEC or arise by default (for example, if a particular service provider corners the market in providing online annual report templates).

At this point, the lack of standard practices can be viewed as ideal, since it encourages companies to dabble and find out what works best for them and their investors. The science of Web usability is in its infancy and has not been explored in the financial arena. However, the usability studies conducted to date provide some guidance for companies interested in creating disclosure documents that are effective on the Web.1 In fact, as investors get a taste of “usable” writing, they may demand online disclosure that is easily navigable and scannable.2

Marketing Tone

Those portions of an annual report that are not incorporated by reference into formal filings, such as the ubiquitous “Shareholder Letter from the Chairman/CEO,” bear a lower standard of liability than filed portions.3 As a result, these portions historically have been more marketing oriented. In recent years, however, some companies have been cutting back on this marketing content in an effort to reduce the page count (and hence, the printing and mailing costs) of their reports.

The Web alters this equation entirely. Beefing up the marketing features of an online annual report comes at virtually no additional cost. Some companies appear to have recognized this dramatic change and have created online annual reports that are replete with graphically rich pages that show off the company’s business. For example,

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Harley Davidson's online annual report has many photographs of customers using its products, much like the company's regular investor relations Web site.

Choice of Format

The biggest decision is whether a company should post its annual report in HTML (hypertext mark-up language) or PDF (portable document format, pioneered and provided solely by Adobe Corp.) or both.4 Documents formatted as a PDF are ideal for printing because they accurately capture what the creator intends the investor to read. In contrast, HTML documents can be viewed slightly differently depending on the type of browser used, and settings selected, by the reader. However, HTML documents can be more interactive, navigable and accessible than their PDF counterparts.

A recent informal survey of the investor relations' Web pages for the Fortune 100 reveals that most (approximately 80%) offer the PDF format for their online annual reports. But HTML use is increasing; approximately 65% of the Fortune 100 host an HTML version of their online annual reports. Perhaps the overriding trend is for companies to provide both formats: an HTML version for investors to peruse online and a PDF version for investors who want a printed document. Approximately 45% of the Fortune 100 make both types available.5

Nearly all companies offering a PDF version also link to Adobe's Web site so that investors can download a free Acrobat Reader (which allows investors to read PDF documents). This comports with the SEC's guidance in the electronic delivery context that companies can provide disclosure that cannot be accessed without special software so long as obtaining the software is not so burden-some as to effectively prevent access.6

Quite a few companies use the term "Printable Version" when referring to their PDF documents. This practice is user-friendly, as it does not presume that investors know that PDF documents are more printer-ready than HTML documents.

Archival Practices

For quite some time, there has been disagreement in the courts over whether companies have a duty to update their statements that were true when made. This uncertainty extends to Web site content, and in fact is compounded on the Web because some commentators have argued that continuously available Web site content is continuously "published" and "alive." In other words, the line between information that was misleading when "made" or was rendered misleading by "subsequent events" is blurred.

The SEC has noted that this is a gray area and has requested comments on how companies can responsibly offer historical information on the Web. In offline contexts, the SEC and the courts have indicated that a duty to update may exist when investors still are relying on material prior statements that are now misleading. The SEC has not

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

yet expressed a view as to whether disclosure is considered constantly republished if posted on a Web site.

Although this may be mere speculation, the ambiguous duty to update may cause a number of companies to forego archiving older versions of their annual reports. Approximately 40% of the Fortune 100 only post the last available annual report on their Web sites. (Since annual reports are not filed with the SEC, older versions become quite difficult to obtain if they are not archived.) The remaining 60% post annual reports for a number of years—typically two or three, although a significant number (approximately 10%) of the Fortune 100 post annual reports for at least five years. Two companies go the extra mile: MCI-Worldcom has 15 years worth of annual reports online, and Wal-Mart Stores' online annual reports go back to 1981! These companies understand that some investors want access to older reports to assist them in analyzing trends.7

Navigation Within Annual Reports and Financials

Navigation is critical for online documents, particularly HTML ones, and ergonomically sound navigation is a key functional component of a successful electronic annual report.

Compared to print, investors can more easily—and are more likely to—control where they go to seek information online. With a hard copy, investors rely almost exclusively on the "Table of Contents," as well as their historical experience with similar documents, to find information. The Web, with its searching and tracking features, enables investors to more easily find what they need. This probably is the most fundamental difference between an online and offline document.

In an ideal world, navigational tools would tell investors:

- Where they are within a document, making it easier to decide where to go next;
- Where they have been, so they do not waste time inadvertently revisiting pages; and
- Where they can go, which is the primary purpose of a navigation system.

Some companies show investors where they can go; very few indicate where they are or where they have been.

Of the Fortune 100 that offer annual reports in an HTML format, nearly half provide a table of contents along the top of each page. About 10% provide a table of contents on the left or right side of the page. Another 10% offer a "drop down" box as the table of contents. Nearly one third do not provide any navigational tools at all, so investors are forced to either sequentially read the documents or click on the "Back" button to access a table of contents from the annual report's "cover" page. Nearly one quarter impose the annoying obstacle of a "flash" page with fluffy graphics that investors can elect to skip by clicking to get to the real content.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Interestingly, the navigational framework within the financial and MD&A sections of an annual report often differs from the framework used for the annual report itself. The Fortune 100 offer a table of contents for these sections on the left side nearly one quarter of the time. Very rarely is it offered at the top of the page—probably to distinguish it from the navigational framework used for the remainder the annual report. Drop down boxes are offered by 15% of the Fortune 100. Over half of the time, investors have no ability to navigate within these sections at all. Indeed, 25% of the time, the so-called HTML version links to these sections in a PDF format; no HTML version is offered in these instances.

Navigation within PDF documents is straightforward and plentiful due to the navigational tools provided by the Acrobat Reader. However, the format type makes it difficult for companies to tailor additional navigational tools. In 80% of annual reports offered in PDF, there are no navigational tools. The other 20% of the time, a table of contents is constantly visible on the left side.

Language Translation

Reflecting the fact that posted documents can—and are—easily read from anywhere in the world, some companies offer their annual reports in a variety of languages. Of the Fortune 100, approximately 10% make them available in two or more languages. Spanish appears to be the most popular language (after English, of course), but some companies are quite global in their approach. For example, General Electric posts its annual report in French, German, Italian, Spanish and English, and its “Shareholders Letter” in 11 languages. Compaq offers its “Letter to Investors” in eight languages.

Going the Extra Mile

Some companies have created spectacular annual reports. Intel has produced a prime example of an “investor-friendly” document. The table of contents is always visible on the left side, and each line item in the table displays additional sub-contents when it is “rolled over.” Intel uses different colors to denote headings and subheadings, and even arrows from the headings to the main text. Together with about 10% of the Fortune 100, Intel permits investors to drop its financial statements into an Excel spread sheet. It has even experimented with its disclosure, using links from each director to denote the board committees on which he or she serves. Among the Fortune 100, exemplary reports are also provided by Lucent Technologies and JC Penney.

Sid Cato (www.sidcato.com) has rated annual reports for nearly two decades, and he posts an annual review of the best online annual reports on his site. Currently, he likes the online reports of Tellabs, IBM, RLI Corp., Chevron and Wells Fargo.

The Future

Further experimentation can be expected. The Investor Relations Information Network (www.irin.com) has begun compiling online annual reports in a directory, and already

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

has over 3000. This service offers a “template” that is a unique online utility that permits IR professionals to manage content about their company on the IRIN site in real time. In addition, the “template” can be private-labeled to serve as a navigational hub for the IR section of a company’s Web site. Specifically related to annual reports, IRIN permits companies to post up to nine links, which can include historical reports and other documents.

OnlineProxy.com (www.onlineproxy.com) has developed an HTML annual report template that is quite investor-friendly. It recently released a survey indicating which pages within online annual reports receive the most attention, with summary financials and the letter to shareholders leading the way.

CCBN (www.ccbn.com) recently released its “Interactive Annual Report”—an HTML template with a scoped search functionality. This interactive annual report (built on the Mobular Technologies platform) combines the best of PDF and HTML formats, and it can deliver speed and navigation within a print-friendly environment.

These service providers should help companies reach to make online annual reports become more “usable” for investors.

Notes

1 Numerous studies are mentioned throughout the best book on Web usability, Jakob Nielsen’s *Designing Web Usability* (2000). For an article applying usability principles to disclosure, see Broc Romanek, “Drafting Disclosure for the Web,” INSIGHTS (July 2001).

2 Sun Microsystems has an excellent tutorial on how to write for the Web at www.sun.com/980713/webwriting/.

3 Non-filed portions only have Rule 10b-5 liability (and possibly Section 12(a)(2) under the Securities Act of 1933 if used in a transaction); filed portions also have liability under Section 18 of the Securities Exchange Act of 1934 and, more significantly, Section 11 of the Securities Act of 1933 if they are incorporated by reference into a prospectus.

4 For a few years, the SEC has allowed companies to file their disclosure documents in HTML and quite a few companies have done so. *See* Release No. 33-7855 (April 24, 2000). However, the HTML required for EDGAR is outdated and documents need further conversion before being posted on corporate Web sites.

5 Only one of the public companies in the Fortune 100 did not have any annual report on its Web site at the time of the survey (conducted at the end of January 2002).

6 Companies can deliver PDF documents so long as they inform investors how to download PDF documents at the time they obtain consent to electronic delivery and provide investors with free software and technical assistance to access the PDF documents. *See* Release 33-7856 (May 4, 2000), footnotes 32-34 and accompanying text, and Example 5.

7 Perhaps for this reason, Verízon Communications maintains four years of annual reports for two predecessor companies, GTE and Bell Atlantic.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

JANUARY 2002

Volume 5 • Number 8

Web Watch

Technology Trends for 2002
by Broc Romanek

As could be expected with a market downturn, the acceleration of technological change has slowed from its breathtaking pace of the past five years. A number of promising technologies have fizzled out, as many entrepreneurs have been unable to secure financing. However, there still are a healthy number of new tech trends, as well as enhancements to some old ones.

Below is a brief description of eight trends that may have lasting effects for the business community, or may be fleeting fads. Only time will tell which ones have the requisite staying power.

Online Proxy Fights

During 2001, an increasing number of shareholder activists used Internet-based solicitation strategies as part of their proxy contests. The success of these strategies should ensure that these techniques will remain popular. For example, Travis Street Partners LLC used the Internet almost exclusively to elect three members to the board of directors of ICO, Inc. Similar results occurred at Pioneer Group, ICN Pharmaceuticals, Luby's, and Goldfield Corporation.

In most of these cases, the dissidents posted proxy contest developments on their Web sites and on message boards. Interactive discussions on message boards were used to allay any fears of would-be supporters. By encouraging Web site visitors or message board participants to provide e-mail addresses, dissidents were able to compile a comprehensive list of potential supporters with whom they could easily and directly communicate. This enabled them to avoid the cumbersome process of demanding a stockholders list from management—a list that only shows record holders, not "street name" or beneficial holders, anyway.

Electronic Stockholders' Meetings

In April 2001, the first company took advantage of Delaware's year-old laws permitting all-electronic stockholders' meetings. Inforte became a groundbreaker when it allowed 5500 registered and beneficial holders to attend its e-annual meeting. Granted, the

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

electronic aspects of this meeting were somewhat limited: no votes were cast electronically during the meeting, nor were any questions e-mailed to management. Still, Inforte was pleased with the event and likely will continue to hold its annual meeting electronically.1

Now states other than Delaware, such as Massachusetts, are reported to be considering changing their laws to allow e-meetings. Many practitioners had predicted that companies would not attempt pure e-meetings because of the concerns raised by various groups, including the Council of Institutional Investors and the AFL-CIO. These groups seek to preserve their already limited opportunities to directly confront management, arguing that there is no substitute for in-person contact. It will be interesting to see if more established Delaware companies take their meetings online, particularly in view of the security precautions necessary in today's terrorist environment.

Notably, no one seems to object when companies offer supplemental Webcasts of their annual meetings. During the past year, over 125 companies provided supplemental electronic access in real time to their physical annual meetings, and others offer replays for a limited period of time. Since more stockholders likely would "attend" an electronic meeting than a physical meeting, supplemental Webcasts arguably make meetings more relevant. Indeed, Webcasting arguably is required under Regulation FD if material nonpublic information is provided during the meeting.

"True" Electronic Offerings

Perhaps front running changes to be implemented by the SEC over the next year, on October 25, the Commission approved the first completely all-electronic offering: a variable annuity offering by The American Life Insurance Company of New York. Contrary to the SEC's existing interpretive guidance, American Life did not make paper copies of its disclosure documents available;nor did American Life intend to provide separate notice to investors when a prospectus was posted on the Web.

Since several features of the offering were inconsistent with prior SEC positions regarding electronic delivery, the Commission issued its own order to declare the registration statement effective rather than rely on delegated authority—a novel action without recent precedent. In addition, the Commission issued a statement that briefly explained its actions. Commissioner Hunt dissented, focusing on the lack of notice.2

In its statement, the Commission took pains to note that the situation was unique, but it also signaled that its existing interpretive guidance on electronic delivery would be reconsidered to determine if it should be modified. It appears that one factor weighed by the Commission was that the novel aspects of the all-electronic offering were fully disclosed in the prospectus.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Electronic Delivery and Voting

During 2001, the high growth rate of electronic voting continued and online voting remarkably caught up to telephonic voting. Electronic delivery also grew, but disappointed some as the number of companies soliciting consents actually decreased compared to 2000. This trend may reverse as more companies implement householding in the 2002 proxy season, allowing ample opportunity to solicit e-delivery consents. In addition, ADP-ICS recently began scanning disclosure documents to effect e-delivery for larger companies, even if the companies take no action themselves.3

Not So "FreeEdgar"

As is the case for most free online ventures, free EDGAR services and other educational legal Web sites needed to find new ways to generate revenue. Popular Web sites such as FreeEdgar.com and 10Kwizard.com now charge subscription fees for access to their main databases. Other promising sites, such as Section16.net and TheCorporateCounsel.net, are also subscription based, but (to be fair) these sites continue to improve and provide more content. And there still are sites with complimentary resources, such as Glasser LegalWorks' CyberSecuritiesLaw.com, RR Donnelley Financial's RealCorporateLawyer.com, and TheCorporateLibrary.com.

Regulatory Changes and Communications

Under new Chairman Harvey Pitt, it appears that big changes in the regulatory framework may be forthcoming. Based on some of the Chairman's initial actions, it can be expected that new technologies will receive greater recognition in proposed rulemakings, and that the Chairman may look "outside the box" as he undertakes to have each single regulation reconsidered during his tenure.

In addition, the new Chairman likely will use the SEC's own Web site to communicate more directly with the SEC's constituency. For example, since late October, the Web site has featured a new page on which the Corp Fin staff seeks input regarding its comment process for filings. Input can be offered on an anonymous basis and sent via e-mail to cfcommentprocess@sec.gov.

Director Communications

As cost, legal and security considerations are resolved, more companies are considering building or licensing extranets for their boards and board committees to communicate with management and with each other. These extranets can be custom built or taken off the shelf from vendors such as Corporation Service Company's Virtual BoardRoom (at www.RecordsCenter.com) and Board Vantage (www.boardvantage.com).

Extranets enable directors to have more resources available at their fingertips and to better manage the increasing volumes of information in board packages. Companies

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

are coming to grips with legal issues, such as a breach of the duty of care if it can be proven that a director did not bother to download and review the information provided in an online board book, or excessive casual language in online communications that could be used against the company in subsequent litigation.4

Online Education

As the continuing legal education bodies of the state bars have caught up to the Web, online CLE has begun to take off. Some state bar associations claim that over 10% of their members have earned CLE credit online or through a CD-ROM. The ample convenience and low costs of online CLE are unparalleled, so these programs are likely to place considerable pressure on the traditional live programs that many lawyers have grudgingly sat through over the years. According to the ABA Journal, of the 41 states that require CLE, 25 allow for some form of online CLE.

Since Institutional Share-holder Services' new numerical corporate governance rating system—the "Corporate Governance Quotient" or "CGQ"—takes into account director education, it will be interesting to see if continuing director education programs will emerge online. If they do, directors that become more accustomed to the Internet are likely to ask for the convenience and wealth of board extranets.

Notes

1 *See* Tami Kamarauskas, "Inforte Corp. Hosts Virtual Shareholder Meeting," WALLSTREETLAWYER.COM, Oct. 2001 at 20.
2 *See* Michael Berenson, "The Door to Paperless Offerings Opens," WALLSTREETLAWYER.COM, Nov. 2001 at 15.
3 *See* Broc Romanek, "Electronic Voting and Electronic Delivery in the 2001 Proxy Season," WALLSTREETLAWYER.COM, Aug. 2001 at 15; Broc Romanek, "More than Meets the Eye for Householding: The First Proxy Season," WALLSTREETLAWYER.COM, June 2001 at 23.
4 *See* Broc Romanek, "The Promise of Board Extranets," WALLSTREETLAWYER.COM, Nov. 2001 at 24.

About the Author
Broc Romanek

* Broc Romanek (broc.romanek@rrd.com) is Director of Marketing for RR Donnelley Financial, and Editor-in-Chief of RealCorporateLawyer.com. The views expressed in this article are the author's alone and do not necessarily represent the views of RR Donnelley Financial.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

DECEMBER 2001

Volume 5 • Number 7

Web Watch

What is a Section 13(d) "Group"? Murky Waters Get Even Murkier Online
by Broc Romanek and James Moloney

Many investors are learning how to leverage the communications abilities of the Internet—including message boards, chat rooms, Web sites, and e-mail—to find and communicate with other investors that share similar interests. The most savvy have even learned how to conduct a proxy contest entirely online.1 During the past several years, the Internet has played a significant role in a number of contested board elections, such as The Pioneer Group, ICN Pharmaceuticals, Luby's, ICO, and Goldfield.

The use of new electronic tools to pressure management raises issues about how to apply existing federal securities laws to online investor activities. One issue that is far from clear is how to apply the definition of "group" from Section 13(d) to online correspondents.

The definition of "group" is one of the most challenging to apply in an offline context, and applying it online has not proven to be any easier. In fact, it is probably more difficult due to the informal nature of most online communications. Moreover, the vast majority of online investors are not aware that their communications could trigger an obligation to file with the SEC. If these investors knew better, they would worry about inadvertently forming a Section 13(d) group when they communicated online.

What is a "Group"?

Under SEC rules, investors generally are permitted to communicate freely without incurring any filing obligations.2 One exception appears in Rule 13d-1, which requires any shareholder (or group of shareholders) that acquires over 5% of a company's stock to file a Schedule 13D with the SEC. A Schedule 13D calls for beneficial ownership information and a discussion regarding the purpose of, and method of financing, any proposed acquisition.

To trigger a Schedule 13D filing obligation, securities must be purchased or held with a control-related intent, i.e., "for the purpose of acquiring, holding, voting or disposing of" a public company's stock. A Schedule 13D filing is intended to have a "signal effect" so

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

that the market, as well as the target company, is aware that there may be a battle for control for the company.3

Because few investors own more than 5% of a company's stock, the Schedule 13D filing requirement appears irrelevant for most investors on the surface. However, the filing obligation is triggered by the formation of a group that, in the aggregate, beneficially owns at least the threshold 5% amount and possesses the requisite control-related intent.4 SEC rules define the term "group" to include "two or more persons that agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities."5 If a "group" exists, it is deemed to beneficially own the aggregate number of shares owned by the individual members.6

Finding a "Group"

The "group" determination involves an analysis of whether the actions and words of the alleged members demonstrate a control-related intent.7 In most cases, electronic communications create an easily discoverable "paper" trail to aid in this analysis of whether a "group" has been formed.

Agreement to act in concert

The linchpin of a group filing obligation is an "agreement" to act in concert.8 One way to demonstrate an agreement among members is to offer evidence of a common purpose.9 This can be difficult, particularly in the online world, because the communications tend to be somewhat informal. However, court cases indicate that an "agreement" may be informal or may be inferred from circumstantial evidence.10 Circumstantial evidence can include a pattern of similar action among members in a relatively short period of time.

Group members need not have pre-existing relationships to be deemed members of a group. Nor do they need to know who the other group members are. Since many online communications are made under pseudonyms, it is likely that groups will contain one or more anonymous members. The biggest obstacle anonymity presents is that it is nearly impossible to determine how many shares are beneficially owned by a "group" that includes anonymous members.

A saving grace for online investors is that courts have been reluctant to find a group if there is no clear evidence of an agreement or action in furtherance of a common purpose. Until there is a relatively clear agreement, discussions among shareholders may be properly characterized as "preliminary." Again, since most online communications are informal, it is quite rare to find investors that take steps beyond this "preliminary" stage. Mere venting of anger at management generally does not do the trick.11

"Preliminary" activities will support the inference of an agreement if there is other evidence of actions taken to further the cause. For example, a number of shareholders

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

of the United Companies Financial Corporation organized on a Yahoo! message board and banded together to petition a bankruptcy court to assert the rights of common stockholders. After being contacted by the SEC staff, these shareholders filed a Schedule 13D because they had formed a group online and had taken action beyond merely posting messages about the company's demise.12

Control-related intent

As recently as last year, the SEC confirmed that the mere passive receipt of information about shareholder initiatives does not necessarily reflect control-related intent.13 Thus, investors that receive e-mails or read Web sites that urge a change of control are not likely to be deemed group members unless they become actively involved in the effort. In addition, courts have long recognized that investors may discuss the merits of investing in companies without creating a Section 13(d) agreement.14 In other words, Section 13(d) does not presume control-related intent simply because investors communicate regarding the management or the business affairs of a company.

Of course, online interactive discussions regarding investment opportunities could potentially offer sufficient proof of intent if, during the course of such communications, some investors advance an agenda that relates to the control of the company. It is not hard to imagine a scenario that goes beyond the posture urged by many practitioners of "listen, but don't agree."15 In some circumstances, online communications with a company representative can provide evidence that one or more group members seeks to exert influence over the company.

The topics, as well as specific words and phrases, of an online discussion likely would bear heavily on whether a group will be found. Some topics are considered more control-related than others. For example, the SEC has intimated that pure corporate governance issues are likely to be outside the ambit of Section 13(d).16 Online discourse that falls within the parameters of normal business or personal relationships also is unlikely to implicate the formation of a group.17

Possible Application to Online Activities

Because the SEC staff has provided sparse guidance and the courts have not considered the application of the "group" definition to online communications, it is difficult to predict how the definition will be applied in cyberspace. We offer some possible solutions below, but, in all cases, the content of the communications is likely to weigh more heavily in a court's reasoning than the medium used to communicate.

"Ad hoc" web sites

Unhappy investors may decide to jointly launch "ad hoc" Web sites to pressure management. This action alone may serve to form a group. The primary issue in these instances is whether the group has the requisite control-related intent.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

If a Web site advocates a change in control, a Schedule 13D should be filed. For example, until relatively recently, when shareholder activist site eRaider.com named a new target company, it filed a precautionary Schedule 13D because visitors to its message boards may have happened to own 5% or more of the target's equity in the aggregate.18 eRaider has discontinued this practice since an unaffiliated fund recently discontinued direct investments in the target companies.

An example of an ad hoc Web site that did not seek control but instead placed pressure on management to change its business strategy is ATTinsider.com (www.attinsider.com). This site was launched by a union to oppose AT&T's plan to break-up into four distinct companies. Even though the site sought interactive discussion about management's break-up plan, and sponsored an online shareholders' meeting that did not include management, participants did not seek to oust management. As a result, the union did not file a Schedule 13D to reflect the Web site's activities.19

Message boards

Thousands of investors use Yahoo! and other message boards to communicate with other investors. Dissidents frequently use message board postings to make instantaneous announcements of proxy contest developments. On more than one occasion, investors (like those affected by the United Companies Financial Corporation bankruptcy) have banded together to conduct a proxy contest or take other contested action after "meeting" on message boards, but mere participation on a message board should not support the finding of a group (although the nature of the communications and the ownership stake of the participants could change this analysis).

E-mails

Encouraging Web site visitors or message board participants to provide their e-mail addresses facilitates formation of groups. Still, the key is whether the alleged group has the requisite control-related intent, as well as the aggregate holdings, to trigger a Schedule 13D filing requirement. Since e-mail communications tend to be quite informal, a court may consider any messages that demand the ouster of management with a grain of salt unless the group takes more concrete action.

Instant messaging and chat relay

The use of instant messaging and chat relay is unlikely to generate Section 13(d) groups. From the user's perspective, these technologies tend to be one-on-one in real-time, and thus are not ideal for widespread communication. From the SEC's (or target company's) perspective, instant messages present evidentiary hurdles to proving the existence of a group; these fleeting messages are less likely than other media to generate a "written" trail of evidence.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Notes

1 Eugene F. Cowell III, “Internet Technology Permits New Proxy Contest Techniques,” INSIGHTS (Oct. 2001).
2 Investors can communicate quite freely even if they are waging a proxy contest, but they must file all written communications relating to the solicitation with the SEC on or before the date of first use, and file a proxy statement before proxy cards are delivered. *See* Rule 14a-12; Release No. 34-42055 (Oct. 22, 1999).
3 This signal effect was enhanced several years ago when the SEC liberalized the requirements for investors wishing to file a short form Schedule 13G. Those changes narrowed the universe of Schedule 13D filers, making the Schedule 13D filings that remain more significant. *See* Release No. 34-42055, *supra* note 2.
4 Groups can make joint Schedule 13D filings. These filings need only be signed by one member if there is a written agreement acknowledging that the Schedule 13D is being filed on behalf of each member. In the alternative, each member of the group can make its own individual filing.
5 Rule 13d-5(b)(1). For purposes of Section 13(d)(1), the term “person” includes two or more persons who act as a partnership, syndicate, or other group for the purpose of acquiring, holding or disposing of securities. Section 13(d)(3). Only beneficial owners of a company’s securities can be members of a Section 13(d) group. Transcon Lines v. A.G. Booker, Inc., 470 F.Supp. 356 (S.D.N.Y. 1979). However, agreements or arrangements with non-owners may have to be disclosed in the Schedule 13D.
6 A “group” can be found based on the “members’” ownership at the time they agreed to act in concert. The group need not buy additional shares as a unit.
7 In re Gabelli Group, Inc., Release No. 34-26005, 1988 SEC Lexis 1683 (Aug. 17, 1988).
8 Joseph G. Connolly, Jr. and David B.H. Martin, Jr., “Legal Restraints Governing Group Activity,” INSIGHTS (April 1990).
9 Wellman v. Dickinson, 682 F.2d 355 (2d Cir. 1982).
10 *See* SEC v. Savoy Industries, 587 F.2d 1149 (D.C. Cir. 1978); Champion Parts Rebuilders, Inc. v. Cormier Corp., 661 F. Supp. 825 (N.D. Ill. 1987).
11 Similarly, a shareholder is not a member of a group just because it votes in favor of a shareholder proposal or agrees to represent the proponent at a stockholders’ meeting. On the other hand, an agreement by shareholders to co-sponsor a proposal, or to solicit other shareholders to support the proposal, can be probative evidence that those shareholders constitute a group. *See* Release No. 34-39538 (Jan. 12, 1998).
12 *See* Aaron Brown, “eRaider: If They Won’t Take Care of Business, We Will!,” WALLSTREETLAWYER.COM, July 2000 at 14.
13 *See* Release No. 34-42055, *supra* note 2.
14 *See, e.g.,* Pantry Pride, Inc. v. Rooney, 598 F. Supp. 891, 900 (S.D.N.Y. 1984).
15 Karl A. Groskaufmanis and Janet G. Gamer, “Monitoring the Dance: An Assessment of the Regulation 13D-G Amendments,” INSIGHTS (Apr. 1998).
16 For example, in Release No. 34-42055, *supra* note 2, the SEC noted that shareholder proposals and soliciting activity on behalf of a corporate governance proposal “may or may not be control-related,” but also suggested that, in many instances, institutional investors could undertake such activities while preserving their Schedule 13G status.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

17 *See* Texas Gulf, Inc. v. Canada Development Corp., 366 F. Supp. 374 (S.D. Tex. 1973).
18 Under SEC rules, a full copy of the Web site content is required to be filed with the SEC. Many investors subscribe to services that send alerts when a new document regarding a company in which the investor has an interest has been filed with the SEC. Since a Web site filing includes the Web address, all investors who generally follow a particular company quickly become aware of dissident Web sites.
19 Another example is unbundle.com, which was launched by Marriott's labor union in opposition to the company's proposal to retain a dual class equity structure. *See* definitive proxy materials filed by Marriott International, Inc. on April 30, 1998.

About the Authors
Broc Romanek and James Moloney

* Broc Romanek (broc.romanek@rrd.com) is Director of Marketing for RR Donnelley Financial, and Editor-in-Chief of RealCorporateLawyer.com. James Moloney (jmoloney@gibsondunn.com) is an associate in the Orange County, CA office of Gibson, Dunn & Crutcher LLP. The views expressed in this article are the authors' alone and do not necessarily represent the views of their employers.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

NOVEMBER 2001

Volume 5 • Number 6

Web Watch

The Promise of Board Extranets
by Broc Romanek

For several years, the corporate secretary community has debated whether a board of directors should communicate through an extranet. Most agree that board extranets can provide value, such as improved communication and time savings, but that several obstacles still remain. Although one of these obstacles may be a generational gap in the ability of some directors to effectively utilize new technology, security and legal concerns, as well as start-up costs, also loom as significant hurdles.

Despite these hurdles, board extranets are starting to proliferate. A few companies in the high-tech industry have developed their own “home grown” board extranets and have used them for several years. As service providers, such as Corporation Service Company’s Virtual BoardRoom and BoardVantage, have recently emerged to provide more cost-effective options, a greater number of companies are starting to dip their toes in the water.

What is a Board Extranet?

A board extranet is a secure Web site that can only be accessed by a select group of individuals—typically the directors, corporate secretary, and perhaps the general counsel—and that can facilitate communication all day, every day, at any time.

A board extranet can offer much more than the typical hard-copy board package that is mailed to directors before a board meeting. Reasonably current information is available all the time and communications are not “one-way”; directors can post messages and communicate privately among themselves on an ongoing basis. Thus, a board “extranet” essentially is a limited access corporate intranet if you consider outside directors to be employees.

How are Extranets Used?

There are diverse types of materials posted on board extranets. Typically, companies post materials from the board book, meeting minutes and attendance, committee materials, and other corporate governance-related documents. Although these materials tend to be text-based with basic graphics, companies can also post other forms of

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

electronic documents, such as a photograph of a prototype of a new product or property, or a PowerPoint presentation.

Board committees can also make use of extranets. Committee materials can (and, as discussed below, often *should*) be kept separate from general board materials. Just like directors, committee members can collaborate with one another between meetings and while traveling. This can be particularly useful for the audit committee, which has been tasked with additional responsibilities by the SEC and the stock markets. Regular communication among audit committee members appears vital to accomplishing their quarterly tasks on a timely basis.

Once a company decides to develop a board extranet, probably one of the most controversial decisions is whether to allow directors to use it to communicate with each other (as opposed to simply using it as a means for conveying information from management to the directors). Each company and board needs to determine whether to provide this option based on the company's unique security and legal concerns, as well as the needs of the directors. As a practical matter, some managers are not excited about the prospect of outside directors regularly discussing company business outside management's presence. For these companies, a struggle could occur between the board and senior management about whether to include this functionality.

Security Considerations

When compared with companies that currently send materials by express mail, fax, and e-mail, a board extranet appears to be a less risky option. Express mail and faxes are prone to low-tech human intervention, and unencrypted e-mails are easily intercepted. In contrast, board extranets are behind nearly impenetrable firewalls. Of course, any communication among the board about confidential information involves risks. However, if strict security measures are taken, many of these risks can be drastically minimized through use of a board extranet.

As they should, most companies want to protect their extranet from outsiders (such as competitors), as well as from unauthorized company personnel. Specific security measures are dependent on the technology architecture built into the extranet. Some prudent measures include implementing security passwords, data encryption, and firewalls. End-to-end security should be maintained on all aspects of the extranet, including user access, message transmission, document archiving, and disposal of information.

Director education about the need to maintain security is critical. In particular, "tech-challenged" directors should be tutored on the use of the extranet so they do not rely on third parties to communicate for them and thereby become privy to information that is "for the director's eyes only."

Due to security concerns, the number of company employees with access to a board extranet should be limited. Typically, access is limited to the corporate secretary's

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

office, general counsel, key senior executives, and the board. Each additional individual that is granted access may compromise the overall security of the system. In addition, wide access may raise concerns that the company is breaching its compliance code designed to prevent improper insider trading.

This raises the question: does a company's information technology department need to be involved with a board extranet? If so, this adds to the risk of a security breach. Although the IT department can provide valuable technical expertise, board needs traditionally are not an IT specialty.

It is possible to create a seamless extranet that, once built, requires little or no involvement from the IT department. IT employees should not be used to conduct routine tasks, such as posting board materials. That job should remain with the corporate secretary or general counsel's office. When assistance of a technical nature is required, the responding IT employee should be monitored to ensure that the extranet remains seamless and the employee only has temporary access.

Legal Considerations

Another consideration is whether an extranet could be used against the company in litigation. Most electronic information is discoverable today, unless privilege or other exceptions apply.1

For example, if directors are alleged to have breached their fiduciary duties, plaintiffs' attorneys could examine the past activities of the board on the extranet to determine whether directors bothered to download the information provided in an online board book. Plaintiffs challenging the due care exercised by the board (or by a special negotiating or special litigation committee) may seek discovery of all communications among directors via the extranet in order to show that the members did not deliberate fully. Potentially making matters worse, when directors use an extranet for extensive communication among themselves, they may become too casual in their choice of words, and may create documents the company does not wish to see in subsequent litigation.

For the most part, privilege and other legal considerations should not be materially different between the electronic world and the paper world. For example, just as in the paper world, if directors communicate among themselves via the extranet without involving the company's counsel, the communication probably will not be protected by the attorney-client privilege. On the other hand, with an extranet, there may be less risk of inadvertently destroying documents; the system can be set to automatically retain documents and dispose of them in accordance with a company's document retention policy.

As noted above, if a company allows too many employees to have access to the board extranet, this can be used as evidence of a breach of the company's compliance code. A general lack of proper security measures can be similarly damaging. Thus, if a

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

company has established a special negotiating committee or a special litigation committee, extra care should be taken to ensure that communications among the committee members are restricted to the committee's page on the extranet, and that no non-committee members have access to those communications. Otherwise, the independence of the committee may be questioned.

Cost Considerations

Unlike other new technologies for which companies tend to rely on service providers, early board extranet adopters relied on their own personnel for development and implementation. The primary reason for this self-dependence is that many companies had garnered experience building intranets before the emergence of board extranet providers. Once a company successfully developed an intranet for itself, the logical extension was to keep this function in-house as it built a board extranet.

However, custom building an extranet can cost upwards of $300,000, not including ongoing maintenance, up-grades, and changes in technology. Start-up costs will depend on several key factors, including the architecture, functionality, training, and support that a company selects. Only the largest technology companies have the expertise and funding to experiment with "home grown" extranets.

During the past several years, several service providers have emerged that specialize in creating board extranets tailored to the needs of a particular company. These providers include Corporation Service Company's Virtual BoardRoom (www.recordscenter.com) and BoardVantage (www.boardvantage.com). Licensing a board extranet requires only an annual subscription fee (in some cases, as low as $2,500 or $5,000 per year), making licensing a much more cost-effective solution compared to a company custom building an extranet for itself.

The End of Paper?

Those considering board extranets often ask if they mean the end of burdensome paper delivery. Unfortunately, the answer is "not entirely." Despite the high-tech nature of extranets, companies sometimes still need to deliver paper to provide information to directors. For example, crucial sections of the board book normally are still handed out at board meetings. However, the amount of paper is dramatically reduced.

In addition, during the transition phase from paper to electronic board materials, companies typically provide directors with both formats, and then gradually move toward a "paperless" board. For extremely sensitive information, such as that relating to a potential merger, paper often is mailed rather than posted, particularly if the merger partner insists (although the security of a mailed package may be more questionable compared to an online one).

Notes

1 *See* "E-Discovery: Managing Digital Data with a Smart Document Retention Policy," ACCA Docket, p. 19 (Oct. 2001).

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

SEPTEMBER 2001

Volume 5 • Number 4

Web Watch

URL's in Shareholder Proposals: The SEC Staff Takes a Position
by Broc Romanek

During the past few years, there has been a continuous debate over whether a Web site address (also known as a "URL") should be permitted in a shareholder proposal or its supporting statement. Over time, the SEC staff's position on this matter evolved through responses in a series of no-action letters.

In mid-July 2001, the staff issued a Staff Legal Bulletin on shareholder proposals that more definitively addressed this issue and may have answered some aspects of it, once and for all.1 However, this guidance probably is not the last time URL-related questions will arise since the Bulletin leaves the staff in the unenviable position of having to make difficult subjective determinations as to whether the content found at a URL is "false and misleading."

Evolution of Staff's Position

URLs removed

In 1998, the SEC first addressed the use of URLs in shareholder proposals in three no-action letters: Pinnacle West Capital Corp.,2 Templeton Dragon Fund, Inc.,3 and The Emerging Germany Fund, Inc.4 The Templeton Dragon Fund and Emerging Germany Fund letters were processed in the Division of Investment Management because they related to mutual funds and the Pinnacle West letter was processed by the Division of Corporation Finance because it related to an operating company.

In these no-action requests, under the shareholder proposal rule (Rule 14a-8), the companies argued they could exclude the proposals and supporting statements from their proxy materials unless the proponents removed their Web site addresses.5 These arguments included:

• The URL caused the proposal to violate the 500-word limitation (Rule 14a-8(d));
• The URL is "contrary to the proxy rules" since the site's content was not "submitted" to the company (Rule 14a-8(i)(3));
• The URL's content includes false and misleading information (Rule 14a-8(i)(3)); and

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

• The URL's content relates to a personal grievance or is designed to further a personal interest not shared by other shareholders (Rule 14a-8(i)(4)).

In its responses, the staff required the proponents to remove the URLs from their proposals. Although the staff does not provide its reasoning in no-action responses, they appeared to rely on the envelope theory; i.e., the mere reference to a Web site was considered to incorporate the Web site's contents into the shareholder proposal, causing the supporting statement to exceed 500 words.

This interpretation is borne out by commentators who, at the time, tended to focus on the argument that inclusion of a URL allows shareholders to exceed the word limit. In response to this argument, proponents stated that the original intent of the 500-word limit was to keep the costs of printing and mailing proxy materials reasonable and to ensure that the length of proposals did not obscure other important matters addressed in proxy materials. Simply including a URL in a proposal does not implicate these concerns.6

Fresh arguments

The next generation of no-action responses revealed that the real issue in this debate was whether the content associated with the URL was reliable.7 The SEC staff appeared to hear proponents' demands for equal freedom of communication. Notably, companies are permitted to disclose their Web site addresses in SEC filings, and could post solicitation materials on these sites (after filing the materials with the SEC as additional soliciting material).

Another observation by proponents was that shareholders can freely communicate with each other about their proposals outside the parameters of the shareholder proposal rule so long as they do not solicit proxies. Thus, how much real harm would a proponent cause if it communicated online regarding a proposal and advertised that communication in the company's proxy statement?

Third-party URL permitted

In 2000, the staff permitted the same proponent in two letters, Electronic Data Systems Corporation8 and First Energy Corp.,9 to include a URL for a Web site that was not controlled by the proponent and which did not directly solicit support for the proposal. In their no-action requests, the companies argued that allowing a Web site reference subverted the intent of the word limit and that the contents of the Web site may evolve over time to incorporate false and misleading information, or simply information that the company might not be able to address in its opposing statement due to timing considerations. The companies also argued that the proponent was experienced and should be familiar with the staff's prior position regarding URLs.

The proponent replied that he had no control over the Web site at issue, which was hosted by the Council of Institutional Investors. Indeed, he was not even a member of

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

the Council of Institutional Investors. In addition, the proponent noted that each company had numerous Web sites that showed shareholders the most favorable view of management performance and policy and that shareholders were likely to have more contact with the company's Web sites than the one he suggested they visit. Finally, the proponent noted that a URL could help shareholders evaluate the proposal by directing them to pertinent sources of information they may not otherwise have found.

The proponent distinguished the Pinnacle West letter because that involved a Web site developed by a single individual. In contrast, the Council of Institutional Investors' Web site was run by an established and respected corporate governance organization with major corporate members. In addition, the proponent noted that the Pinnacle West proponent admitted his Web site may be "too controversial" for the staff.10

A breakthrough for proponents

In 2001, the staff appeared to go even one step further by requiring Gillette Company to include a proposal even though it contained a URL to the proponent's own Web site that provided more information about the proposal.11 The company made the typical arguments noted above and sought to exclude the proposal's references to the Web site. In response, the proponent observed that a proposal in the proxy statement from the prior year referenced a URL without complaint from the company. In addition, the proponent offered to, and did, link from his Web site to the company's Web site as a way to alleviate the company's concern that shareholders would only get one side of the story.

Current Staff Position

The staff's position in Gillette is carried over to its new Staff Legal Bulletin guidance. In Sections C(2)(b) and F(1) of the Bulletin, the staff presented the following questions and answers related to this issue:

Does referencing a website address in the proposal or supporting statement violate the 500-word limitation of rule 14a-8(d)?

No. Because we count a website address as one word for purposes of the 500-word limitation, we do not believe that a website address raises the concern that rule 14a-8(d) is intended to address. However, a website address could be subject to exclusion if it refers readers to information that may be materially false or misleading, irrelevant to the subject matter of the proposal or otherwise in contravention of the proxy rules. In this regard, please refer to question and answer F.I.

May a reference to a website address in the proposal or supporting statement be subject to exclusion under the rule?

Yes. In some circumstances, we may concur in a company's view that it may exclude a website address under rule 14a-8(i)(3) because information contained on the website

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

may be materially false or misleading, irrelevant to the subject matter of the proposal or otherwise in contravention of the proxy rules. Companies seeking to exclude a website address under rule 14a-8(i)(3) should specifically indicate why they believe information contained on the particular website is materially false or misleading, irrelevant to the subject matter of the proposal or otherwise in contravention of the proxy rules.

Possible Consequences of Staff's Position

From the Bulletin, it is clear that the 500-word limit argument is ineffective and that the staff will apply a facts and circumstances test regarding whether a referenced Web site contains false and misleading information. Since the company has the burden of proof under the shareholder proposal rule, the staff will make its decision primarily based on a company's arguments, along with any rebuttal offered by the proponent. Clearly, the staff does not have the resources to continuously check the evolving information on a Web site to ensure that it is not false and misleading, particularly during its busy period just before proxy season. Consequently, companies must carefully present their arguments when first filing no-action requests, monitor the proponent's Web site for any problematic developments thereafter, and inform the staff if more troublesome information is posted on the site.

As a practical matter, it will be difficult for companies to "win the day" with arguments complaining of false and misleading proponent Web sites. Since this is such a subjective determination, proposals rarely are excluded on this basis, although it is possible the staff will apply a different (and more flexible) standard for removal of URLs than it does for complete exclusion of proposals.

Even if the staff takes company arguments to heart about false and misleading information, it may allow the proponent an opportunity to cure the troubling content on a Web site before forcing the removal of a URL. This is the typical result when companies complain about false and misleading information in a proposal.

The probable result of the staff's position is that a more extensive "dialogue" between companies and proponents will be played out on the Web. The Gillette experience is a perfect example. After the staff sided with the proponent to include the URL, not only was the proponent able to post his proposal on his Web site, he added "Frequently Asked Questions" as well. Even more notable was that he posted the company's statement of opposition from the proxy statement and then added a rebuttal to that disclosure.12

It is not too difficult to imagine a scenario where a proponent and management go back and forth rebutting each other's statements about a proposal—perhaps right up until the date of the shareholder's meeting! Since shareholders who vote on these matters get the benefit of more information, it remains to be seen whether or not this is a good thing. Clearly the staff will be unable to monitor this sort of continuous banter—which is akin to a dialogue during a contested election of directors—if it occurs on a regular basis.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Notes

1Division of Corporation Finance, Staff Legal Bulletin No. 14 (July 13, 2001).
2 Pinnacle West Capital Corp. (available Mar. 11, 1998).
3 Templeton Dragon Fund, Inc. (available June 15, 1998).
4 The Emerging Germany Fund, Inc. (available Dec. 22, 1998).
5 Note that the remainder of a proposal is not affected if the staff asks a proponent to remove a URL unless the company is successful in making arguments under other provisions of the shareholder proposal rule.
6 *See* Howard M. Friedman, “Commentary on a Rare Luddite Victory—The Templeton Dragon Fund Shareholder Proposal No-Action Letter,” VILLONOVA J. LAW AND INVESTMENT MANAGEMENT (Winter 1999).
7 *See* Sanjay Shirodkar and Frank Zarb, Jr., “The Shareholder Proposal Rule in the Internet Age,” WALLSTREETLAWYER.COM (Jan. 2000) at 16.
8 Electronic Data Systems Corporation, 2000 SEC No-Act. LEXIS 460 (available Mar. 24, 2000).
9 First Energy Corp., 2000 SEC No-Act. LEXIS 353 (available Mar. 7, 2000).
10 The proponent also distinguished Emerging Germany Fund, Inc. because it involved a message board that had daily numerous postings by anonymous participants that could have included the proponent.
11 Gillette Company 2001 SEC No-Act. LEXIS 175 (available Feb. 1, 2001).
12 This information was posted on the Corporate Monitoring Web site at www.corpmon.com.

About the Author
Broc Romanek

*Broc Romanek *[broc.romanek@rrd.com]* is Director of Strategic Development for RR Donnelley Financial, Editor-in-Chief of RealCorporateLawyer.com, and a member of the Board of Advisers of WALLSTREETLAWYER.COM. The views expressed in this article are the author’s alone and do not necessarily represent the views of RR Donnelley Financial.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

By Broc Romanek

©INSIGHTS: The Corporate & Securities Law Advisor Vol 15, No. 7 (July 2001)

Republished with permission from Aspen Law & Business

Drafting Disclosure Tailored for the Web

While investors are increasingly accessing investment information via the Web, companies are continuing to draft their disclosure documents in a traditional manner and are posting these documents on the Web. While drafting for the Web does require a change in drafting habits, the end result is more effective communication that is more easily digested by investors.

Although the Web is now more than seven years old, the art of drafting disclosure has not changed dramatically due to this new medium. Companies are missing a valuable opportunity to communicate with their shareholders and potential investors. There already is evidence about how investors prefer to read online, which can now guide companies in drafting Web disclosure that is best suited for investors. [1] As investors get a taste of "usable" writing, they may ask for online disclosure that is easily navigable and scannable. In addition, as more companies write for the Web in their online marketing efforts, it is only a matter of time before this skill migrates over to investor relations' Web pages.[2]

Companies and their counsel have recently demonstrated that they are capable of embracing a new way to draft disclosure. The face of disclosure has changed dramatically as a result of the Securities and Exchange Commission's (SEC's) "plain English" initiative.[3] Over the past few years, the SEC's Division of Corporation Finance Staff issued thousands of "plain English" comments targeting particular language that it believed was not sufficiently clear to the average investor.[4]

Why Draft for the Web?

At this point you may ask, "Why should companies even care what investors want to read?" Disclosure documents still are liability driven; not marketing oriented. In other words, the primary goal of a draftsman is to avoid liability by not misleading investors. For the most part, companies do not seek to obtain new, or maintain current, investors by the text of what they disclose -- or by how they present disclosure -- in their SEC filings.

This could change due to the Web. First, investors now have easy and free access to a company's disclosure so that it is more likely that disclosure will be read. In addition, the retail investor culture is shifting. As investors increasingly make their own investment decisions, they are more willing to conduct their own research. The strong interest in Regulation FD by the investors community certainly reflects a heightened interest in what companies are saying.[5]

Despite the migration of investors to the Web, most companies merely post on their investor relations' Web sites the same linear documents that they drop in the postal mail.[6] Even worse, quite a few companies merely link to their ASCII filings from the

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

EDGAR database which is virtually illegible in print, much less on the Web. Change is inevitable as companies recognize that they may be harming their credibility with investors. Companies that do not draft disclosure tailored for the Web will appear unsophisticated and uncaring and they will be chastised for drafting "shovelware" disclosure by institutional and retail investors alike.[7]

How to Draft for the Web

The dilemma is how to draft for both an online and offline audience. One possible solution is to create multiple versions of the same document, each with identical or similar disclosure -- but different formatting and navigation. Since 1996, the SEC has permitted companies to create multiple versions of the same document, each with differing content -- so long as each version meets the applicable legal requirements.[8] Companies can have an unlimited number of versions of a particular document -- and each version can have different text, graphics, audio, or spreadsheets. This provides companies with a great deal of flexibility.

Only a few pioneer companies have taken advantage of the flexibility to create multiple versions of required documents. For example, in its 1997 initial public offering (IPO), Ameritrade Holding Co. delivered either a CD-ROM or a paper prospectus to each interested investor. The CD-ROM prospectus consisted of two files: hypertext disclosure in a portable document format (PDF) and a 10-minute video presentation about Ameritrade's operations (including actors using Ameritrade's services).[9] Although Ameritrade provided a textual description of the multimedia as part of the paper version of the prospectus, it was not obligated to do so because companies are not required to deliver identical versions of a document.[10]

Companies probably face incremental risk by delivering multiple versions of disclosure documents since an investor may claim that the versions it received omitted material information that was contained elsewhere. With careful drafting, however, this risk can be minimized so that the risk should not be much more than drafting a single document -- ensuring that all material information is presented. In practice, the fraud-on-the market theory should limit this risk because the total mix of information available to investors would include the multiple versions that would be filed with the SEC. Further comfort is provided by a recent case in which the federal district court found that a company did not violate Section 12(a)(1) because graphic material was filed as part of the registration statement as required under Rule 304(b)(1) of Regulation S-T, even though the investor relied on the electronic prospectus.[11]

One way to avoid risk is by simply changing the format of the disclosure's presentation, but not modifying the disclosure in the overall document itself. In other words, the "order" of the disclosure would change, but not the disclosure itself. This is because documents would not be posted "linearly." The format plays an important role because investors on the Web may be unwilling to spend the time to navigate a linear format to find disclosure that interests them.

Web Writing Considerations

Once companies get used to the idea of drafting multiple versions of a document, the question is what to draft for the Web. Although PDF files ensure that a disclosure document appears as it does in print, it does not permit the best features of the Web --

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

ease of navigation and searching. Accordingly, Hypertext mark-up language (HTML) is better suited to craft something that investors can best navigate and read.
Although creating two different formats of disclosure documents obviously involves more time and money, the benefits should exceed the cost. Overall, the cost should not be too great since the actual disclosure will be the same or similar. To test the waters, companies may want to experiment with filings that are in demand and involve decisionmaking by investors, such as proxy materials and prospectuses.
The following ten points (discussed in detail in subsequent paragraphs) address a number of ways to enhance an investor's experience with online disclosure:

1. Design process and strategy
2. Navigation is key
3. The power of links
4. Convert cover pages to "homepages"
5. The need for speed
6. Brief is bliss
7. Make disclosure easy to skim
8. Even more "plain English"
9. Legibility
10. The pros and cons of multimedia

Occasionally, some of these methods may be constrained by the SEC's application of existing laws to the Web. For example, it appears that the SEC requires companies to maintain substantially the same "order" of periodic reports online as offline, but allows companies to be flexible with the order of content when drafting prospectuses.[12] The SEC's position relating to periodic reports is too restrictive because linear thinking does not work online.[13] Despite the presence of some regulatory restrictions and other gray areas, companies still can innovate under existing laws and interpretive positions -- and the SEC's regulatory paradigm is constantly evolving to accommodate the Web.

Design Process and Strategy

Companies should standardize how they design their disclosure documents. One step in this direction is designating one person to coordinate the design process and strategy. This person -- ideally an attorney that is Web savvy -- should ensure that each department responsible for drafting a portion of the document does not have its own design. For example, the financial statements prepared by the independent auditors should not "look" dramatically different than the other disclosure in the document.
In addition, the order of the document should not follow the company's hierarchical structure or fall within departmental lines. So that the design of the document does not evolve randomly, the structure of a disclosure document should be predetermined bearing in mind how investors will likely use it. Although an internally centered design is likely to evolve by default, an effort must be made to ensure that the end product fulfills the primary goal -- inform investors.
It is easy for a company to believe that it has provided adequate navigational tools by placing an omnipresent table of contents in a column on the left of the site. This design emphasizes the breadth of the document since investors are constantly aware of their choices. This design, however, comes at a cost -- normally nearly a quarter of the page that otherwise is available for reading. Investors probably would prefer to have

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

additional reading room with a depth-emphasizing navigation bar. Depth bars can depict a complete hierarchical path from the document's homepage down to the current page. With this "breadcrumbs" design, investors get a sense of their current location relative to the document as a whole and can easily move to a higher-level page.
Frames create special problems and should be avoided altogether. The overriding concern is the potential for investors to be misled. The SEC has noted that the risk of investor confusion is higher when third-party content is framed -- making it more likely that a company is deemed to adopt the linked content under the SEC's link liability framework.[14] In addition to heightened legal risk, framed content normally cannot be printed properly. Besides not fulfilling the SEC's mandate that disclosure must be printable, this deprives investors of the ability to review the information more extensively later.[15]
Ensuring that a document is not too wide is crucial for the online reading experience. Investors detest the need to scroll horizontally and often will quickly give up reading rather than endure the need to constantly scroll. Since investors have varying monitor sizes, it probably is best to use layouts that accommodate most investors. The most common monitor, with a 15-inch screen, is 640 pixels wide. Since the borders of most monitors slightly encroach on the viewable screen, 600 pixels is the safest width to use at this time.

Navigation Is Key
Compared to print, investors can more easily -- and are more likely to -- control where they go to seek information online. With a print document, investors rely almost solely on the "Table of Contents" as well as their historical experience with similar documents to find information. The Web truly offers investors the ability to more easily navigate through a document -- if companies provide the opportunity. This probably is the most fundamental difference between an online and offline document.
On the Web, users like to control their own destination. Investors do not like to be forced to enter a document through a cover page. If possible, it is likely that other Web sites will use "deep" links to various points within the document. Often, investors will not navigate through a document as expected. So long as there is an adequate navigation system from each page, it should not matter where an investor enters the document and where he or she goes -- investors are made aware of the information choices available. Without an effective navigation system, a company probably faces heightened risk if investors do not enter its disclosure document through the cover page.
It is important for companies to assist investors so that they know:
* Where they are within a document -- so that they know where to go from here;
* Where they have been -- so they do not waste time or in case they want to reread previously visited information; and
* Where they can go -- which is the primary purpose of a navigation system.
The first goal is most easily accomplished with a hierarchical line across the top of the page -- or at a minimum, with a caption on the top of the page that identifies its location. Each page thus needs its own identification label. The second goal also is not too difficult since browsers already have "back" (*i.e.,* return to prior page visited) and "history" (*i.e.,* list of most recently visited pages) functionality. Using the standard purple color for used links also satisfies this goal.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

The most important goal of navigation is informing investors where they can go. Again, a hierarchical line serves this purpose, as does useful and descriptive links strategically scattered throughout the disclosure. A table of contents probably does not need to be made continuously accessible, even from a pull-down menu. In contrast to using links, pull-down menus are unable to show an investor that they have already been there -- thereby not fulfilling the second goal.

An invaluable tool to help investors find information is a scoped search function. This tool allows investors to search for terms just within the disclosure document.[16] This tool should always be highly visible, preferably at the top of each page. Boolean search should not be used since studies show that most investors are not sophisticated searchers. For example, if an investor wanted information relating to either earnings or sales, they would input "earnings and sales," instead of "earnings or sales."[17] The first search would unintentionally return fewer results compared to the second.

The Power of Links

The power of hyperlinks is often misunderstood and underestimated. Links are not meant to split a long linear flow of disclosure into multiple pages. Instead, companies should use links to:

* Provide structure and navigation;
* Allow associated content to be easily accessible; and
* Help investors scan content.

Structural navigation links can be used to split information into logical topical chunks. Then investors can choose the topics they wish to focus on, yet still be aware of what else is available. With long linear disclosure, investors are more apt to quickly give up and never realize what other information choices were available -- and they tend to find it difficult to search for particular information. In addition, it is nearly impossible to read this disclosure online; investors are forced to print out entire disclosure documents to find information relevant for them.

Investors tend to use links as guideposts to what the surrounding content is about -- and as a way to rest their eyes when scanning. As a result, the decision about what particular words to use in a hypertext link is critical. To serve as proper guideposts, links should not exceed two to four words in length. Only words that convey important information should be made into links; additional explanatory language can be included with these words so long as they are not part of the link itself. These explanations should be brief -- with a maximum of 60 characters -- and serve to allow investors to make an informed decision about whether to follow a particular path.[18]

Even though blue is not the easiest color to read online, it has become the universally accepted convention to indicate that particular text is a link. Similarly, purple is used to indicate that an investor has already visited a particular link. Since deviating from this norm only serves to confuse investors and cost them time, the established conventions should be followed. Surprisingly, more than a few companies experiment and do not follow these conventions.

Although the usefulness of linking to third-party content is evident, it is not recommended in SEC filings due to the liability that attaches. The SEC has made it clear that any third-party content linked from a company's disclosure document is deemed part of that document for liability, delivery, and filing purposes.[19] Although it

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

may be tempting to link to innocuous content from prospectuses or periodic reports for background purposes -- such as a site devoted to providing raw data on a company's industry -- a company should refrain because the content is outside of its control and yet the company would be responsible for it if it linked to it.

Even more challenging is determining how to file content that may change on a daily basis and convincing a Web site owner to provide a consent, if required.[20] Consents are required whenever content is linked because the company believes that such content is valuable as the report or opinion of an expert or counsel -- even if only a quote or summary of a report or opinion is linked. Of course, most third parties are not willing to provide a consent since they then have Section 11 expert liability for their content even though they are not raising capital or making a required disclosure for themselves.

Convert Cover Pages to "Homepages"

Based on usability studies, investors likely scan the first page they see to find matters of interest.[21] If they do not find anything of value, they resort to understanding the document's navigation system to locate interesting content. Under the current SEC regulations, the first page of online disclosure normally consists of either the facing page of a registration statement or a cover page of periodic report, prospectus, or proxy statement.[22] Neither of these is overwhelming in their usefulness, particularly facing pages.

Ideally, the first page of a disclosure document would be its "homepage." From this page, investors could make informed choices about what information they want to review from a series of descriptive links -- or from a highly visible search tool. Since a page normally loads from top to bottom, the most useful information should be placed higher on the homepage. To reduce clutter on homepages, the techniques of aggregation, summarization, filtering, and truncation should be used.[23] To make this "homepage" more relevant, it could contain even more useful information than normally is available on the first page of a disclosure document.[24]

The Need for Speed

When deciding how to draft online content, companies should ensure that the content of each page "loads" quickly.[25] Online investors are extremely impatient. At this time, it has been proven that we feel like we are moving freely through information if pages load within one second. In contrast, load delays of more than 10 seconds are likely to lose an investor's interest.[26]

Even though many investors -- particularly institutional investors -- have broad bandwidth connections of T1 or T3 lines, there are numerous investors still connecting through a dial-up modem. To accommodate these investors by keeping download times under 10 seconds, a page should contain no more than 34 kilobytes of data. This rules out using most types of multimedia that can take quite a long time to load, even with broad bandwidth connections.

Brief Is Bliss

You probably have noticed that you do not enjoy reading documents online because it tends to make your eyes tired. Studies now show that we read 25 percent slower online

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

than reading hard copy.[27] In addition, scrolling takes an additional effort from investors. As a result, online text should be kept shorter than it would be presented in print.

The drafter's challenge is to reduce text by at least 25 percent -- and probably more -- so that the reading experience is comparable to reading from paper. Reducing text while not omitting information that renders the information misleading is critical. One possible solution is to make ample use of links and to approach drafting with a design strategy that involves layering of -- or "drilling down" to -- information. This technique can allow a company to have identical online and offline disclosure documents -- just with differing formatting.

By relegating information that is more detailed or background in nature to "secondary" pages, information that is valuable to a minority of investors is still available -- yet does not interfere with the majority who does not want to wade through it. The question then is whether the SEC and the courts would view links to more complete information as the equivalent of traditional linear disclosure. Although the SEC acknowledged that the envelope theory does not work in every circumstance and has limited the theory's application in its link liability framework, it likely would view content linked together within the same disclosure document to be considered together.[28] Based on this and other judicial precedent, an argument can be made that links to more detailed information can make information complete.[29]

Make Disclosure Easy to Skim

Investors do not read online as much as "skim" or "scan." Instead of reading text word-by-word, they tend to pick out keywords, links, and paragraphs that appear interesting. To accommodate this unique method of reading, companies should draft their disclosure with more captions and ensure that each caption is meaningful by itself. The SEC recognized this trait even for print when it forced companies to draft the captions of risk factors so that they stand on their own.[30]

Compared to print, captions should be clearly evident standing on their own because there is less information surrounding it to place captions in context. For example, charts and subheadings may be on the same page of a print page to provide more meaning to a caption -- those same pieces of information may be linked or on a different page online.

Each caption should fully explain what the related text means, yet be as short as possible. Typical leading articles can be omitted, such as "A," "An," or "The." The first few words should convey the most meaning of the words in the caption. Clever captions that do not convey the full and true meaning of the associated content should be avoided.

More frequent use of bullets and similar design elements is necessary to allow investors to easily scan through text. Using boldface for key words and phrases and other highlighting techniques -- such as the use of colored text -- also can assist investors to understand disclosure. As learned from the plain English initiative, "white space" can be invaluable to help investors comprehend disclosure. This is even more important online.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Even More "Plain English"

Although disclosure generally has undergone great change due to "plain English," further improvements for the Web can be made. Since investors are scanning online text, it is important that the most important message in a paragraph is disclosed in the first sentence. This follows the "inverted pyramid" principle used by most print media journalists. A paragraph should start with a short conclusion and more detail should follow. This allows investors to more easily skim paragraphs, yet still derive value from them.

In fact, these "topic sentences" should dominate the paragraph itself. "One idea per paragraph" should be an online rule of thumb. Each paragraph should have no more than three sentences, and it is perfectly fine to have paragraphs that consist of only one sentence. Whereas one or two sentences per paragraph should be the online norm, it is uncommon to find such short paragraphs in a print disclosure document.

The bottom line is that it is extremely important to draft simple sentences. Convoluted phrases and sentences are nearly impossible to untangle online. If a company must disclose details about complex matters, the disclosure should be straightforward. Complicated concepts can be more fully explained by linked content. Plain English taught the drafting community that complex matters can be explained without resorting to legalese. The same lesson should be applied even more stringently online.

Legibility

It should not even bear mentioning that online disclosure should be legible. Yet this is a common problem. The SEC's online legibility standard is fairly flexible. Companies must merely present "all required information in a format readily communicated to investors, and where indicated, in a manner reasonably calculated to draw investor attention to specific information."[31] Based on this loose standard, perhaps it is not surprising that online disclosure frequently is too small, has poor resolution, or has obscuring background coloration. The most obvious examples are companies that post their ASCII EDGAR filings online -- the text in these documents is very difficult to read online due to its poor resolution.

Black and white should be the norm with sufficiently large font sizes so that investors can easily read the text, even from a handheld device, if possible. Text should never move or zoom on its own. Microsoft Explorer and AOL's Netscape browsers are not compatible. Accordingly, Web pages should be HTML coded -- and tested -- in the various versions of each browser since an investor's browser dictates how a page will actually layout on its computer. This is a challenging and time consuming task but necessary to ensure that each investor can properly view the disclosure as intended.

The Pros and Cons of Multimedia

The appropriate use of multimedia can provide great benefits, particularly graphs and charts. For example, in a recent IPO, a biotech company included an effective flowchart in its prospectus to describe its product.[32] Without the flowchart, most investors probably would not be able to fully comprehend its business.

Multimedia, however, should be used judiciously until more investors have broader bandwidth connections. Investors without broadband rarely access multimedia because of the associated lengthy download time. If multimedia is used, companies should

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

clearly describe what is in the multimedia disclosure so that investors do not waste time downloading content that will not live up to their expectations. Text itself should never be rendered as images since that needlessly increases its load time. The bottom line is that the use of multimedia that is merely gratuitous frustrates investors, so any extraneous images or photos should be avoided.
In addition, it may take time for companies to learn how to derive value from using multimedia. For example, the few companies that provide video Webcasts of their analyst conference calls normally just use "talking heads." This actually detracts from an investor's experience since it does not offer anything more for investors to consider. Investors actually prefer "audio only" Webcasts to these unsophisticated videos.

Conclusion
Drafting "usable" disclosure for the Web is not difficult. There are fairly simple guidelines to follow that do not necessarily require knowledge of the technological underpinnings of the Web. While writing for the Web does require a change in old drafting habits, once mastered, companies will be providing investors with information they truly want and are capable of reading and digesting.

Notes About the Author

Broc Romanek (broc.romanek@rrd.com) is Director of Strategic Development for RR Donnelley Financial and Editor-in-Chief of realcorporatelawyer.com. The views expressed in this article are the author's alone and do not necessarily represent the views of RR Donnelley Financial.

Notes

1. Numerous studies are mentioned throughout the best book on Web usability, Jakob Nielsen's Designing Web Usability (2000).

2. Sun Microsystems has an excellent tutorial on how to write for the Web at *http://www.sun.com/980713/webwriting/.*

3. In Release No. 33-7497 (October 1, 1998), the SEC adopted the new "plain English" rule, Rule 421 of Regulation C. This rule only applies to disclosure made under the Securities Act of 1933 (Securities Act) but the Staff made clear that portions of periodic reports and proxy statements incorporated by reference also must comply with Rule 421. *See* Question 3 of Updated Staff Legal Bulletin 7 (July 7, 1999).

4. In Updated Staff Legal Bulletin 7 (July 7, 1999), the SEC provided 41 common comments to help companies comply with Rule 421 of Regulation C of the Securities Act.

5. In Release No. 33-7881 (August 15, 2000), the SEC mentions that it received over 6,000 comment letters after it proposed Regulation FD, most of them from retail investors.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

6. Although the SEC permits companies to file their disclosure documents in HTML, relatively few companies have done it. *See* Release No. 33-7855 (April 24, 2000). Even if they do, some do not take advantage of the basic benefits of using HTML, such as a providing linkable table of contents or a search tool.

7. In fact, to convince the SEC that investors are ready to accept implied consent for electronic delivery, companies should be prepared to show that they have done a better job of preparing online disclosure. In Section D of Release No. 33-7856 (April 28, 2000), the SEC asked the public to comment about what circumstances indicate that implied consent should be universally applied. In response, some organizations have argued that the SEC should change its position about implied consent.

8. In Example 7 of Release No. 33-7288, the SEC made clear that companies could deliver multiple versions of the same disclosure document under certain circumstances as follows:
An investment company produces both an electronic version (such as a CD-ROM) and a paper version of its prospectus. Each version contains all information required by, and otherwise complies with, the applicable form and all other applicable provisions of the federal securities laws. The electronic version contains a movie that does not appear in the paper version. Each version of the prospectus indicates that there may be other versions of the prospectus and, if the issuer determines to make such other versions available, provides information on how to obtain such other versions. The paper version does not include a summary or transcript of the movie in the electronic version. Both versions of the prospectus are filed with the Commission as part of the company's registration statement, or separately pursuant to Rule 497. The use of either version of the prospectus to satisfy delivery requirements would be permissible. The issuer (or other party to whom the law assigns the responsibility) remains responsible for ensuring that each version satisfies applicable statutory requirements.

9. Ameritrade Holding Co., Form S-1 (SEC File No. 333-17495). The video presentation included a text legend at the beginning identifying the video as part of the statutory prospectus.

10. Rule 304 of Regulation S-T requires that companies file a script or fair and accurate description of the multimedia (but this description may not be subject to civil or antifraud liability). This script or description can either be filed as part of the SEC document itself or as an appendix at the end of the document. If an appendix is used, it should be placed at the end of the prospectus, as noted in footnote 309 of Release 33-6977 (March 18, 1993).

11. *DeMaria v. Andersen* 2001 Westlaw 303725 (S.D.N.Y., 00 Civ. 2337 (WHP) March 29, 2001). In this case, the plaintiff complained because the paper prospectus contained a bar graph depicting historical online publishing revenues and net losses on a quarterly basis while, in the electronic prospectus, there was only a narrative description of the bar graph and that this description contained a discrepancy. The court held that under

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Rule 304(b)(1), the graphic material included in the paper prospectus, but omitted from the electronic prospectus, was "deemed part of" the registration statement filed with, and declared effective by, the SEC, so that there was no cognizable claim that shares were sold in contravention of Section 5 and thus there was no violation of Section 12(a)(1).

12. In footnote 20 of Release 33-7233 (October 6, 1995), the SEC stated that: Electronically delivered documents must be prepared, updated, and delivered consistent with the provisions of the federal securities laws in the same manner as paper documents. Regardless of whether information is delivered through paper or electronic means, it should, of course, convey all material and required information. If a paper document is required to present information in a certain order, then the electronic document should convey the information in substantially the same order. For example, in an audio or video prospectus, the information required to be on the cover page of a paper prospectus pursuant to Item 501(c) of Regulation S-K [17 C.F.R. 229.501(c)] (e.g., red herring language) must be among the first information presented through the audio or video media.

13. The SEC liberalized its "order" of online content position for prospectuses when it adopted the plain English rule. Plain English, however, only applies to filings made under the Securities Act. Rule 421(a) of Regulation C under the Securities Act: The information required in a prospectus need not follow the order of the items or other requirements in the form. Such information shall not, however, be set forth in such fashion as to obscure any of the required information or any information necessary to keep the required information from being incomplete or misleading. Where an item requires information to be given in a prospectus in tabular form it shall be given in substantially the tabular form specified in the item.

14. The SEC's statement about framed links is in ns.59 -- 60 and accompanying text of Release 33-7856 (May 4, 2000).

15. In the text accompanying footnote 22 in Release No. 33-7233 (October 9, 1995), the SEC analogized to paper delivery by requiring companies to provide investors with an opportunity to retain a permanent record of any electronically delivered information.

16. Using informative page titles is important if a company uses a search engine that displays search results to navigate a document. In HTML, each page has a title in the "header" section that specifies what the page's content is about.

17. The weakness of most search engines is that they do not include spell checks or synonym expansion. If these functions are available, they are invaluable since investors may have difficulty spell checking their own typing or thinking of synonyms for search terms.

18. A new feature -- the "link title" -- is available with Internet Explorer 4.0 and newer versions. When a mouse hovers over a link, a "link title" pops up that contains explanatory information about the related content.

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

19. The SEC addressed third-party content in footnote 57 and accompanying text as well as Example 6 of Release 33-7856 (May 4, 2000). Rule 105 of Regulation S-T addresses the liability for content linked from a filed document.

20. Example 6 of Release 33-7856 (May 4, 2000) emphasizes the need to file third-party consents under Rule 436(a) in many cases. Rule 437 provides that a company may apply to the SEC Staff to not require a consent, but the company must provide an affidavit that obtaining the consent is impractical or involves undue hardship, and the Staff rarely grants such applications.

21. A series of Web usability studies from the *1997 International Journal of Human Computer Studies* is available at *http://ijhcs.open.ac.uk/.*

22. Items 501 of Regulation S-K and Regulation S-B set forth the requirements for the outside front cover page for disclosure documents filed with the SEC. Note that glossy annual reports are not required to be filed with the SEC -- merely submitted. As a result, companies are free to innovate subject to antifraud considerations.

23. Aggregation is combining similar disclosures in one place on the homepage. Summarization is self-explanatory and can be used more often with linked pages that have more detail. Filtering is removing any content that does not add value to the homepage. Truncation is the use of only initials or initial words from common words or phrases to save valuable space -- note that truncation may render some statements so incomprehensible that disclosure becomes misleading.

24. For example, a list of key financial ratios with links to a company's financial statements and related notes.

25. "Loading" (response time) is how long it takes for content to appear on a Web page that is selected by an investor.

26. *See* pp. 42 -- 48 of Jakob Nielsen's Designing Web Usability (2000).

27. *Id.* pp. 101 -- 104. Note that monitors with 300 dpi resolution -- which makes the online reading experience akin to reading paper -- are now available but expensive. Once their prices come down, this issue likely will be solved.

28. The "envelope" theory provides that content linked together is considered as if it was mailed in the same envelope. The SEC first introduced this theory in Example 15 and Example 16 in Release 33-7233 (October 6, 1995). The SEC limited the theory's application in Section II.A.4 of Release 33-7856 (May 4, 2000).

29. In *Rasheedi v. Cree Research, Inc.,* (Middle D.N.C., Oct. 17, 1997), the US District Court for the Middle District of North Carolina ruled that forward-looking statements accompanied by cautionary language may qualify for the safe harbor provided by the

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).

Private Securities Litigation Reform Act of 1995 even if the cautionary language does not identify the specific factor that ultimately caused the forward-looking statements not to come true.

30. As part of the plain English initiative, Item 503(c) of Regulation S-K was amended to require companies to use subheadings that adequately describe the risk that follows. In Updated Staff Legal Bulletin 7 (July 7, 1999), the SEC stated, "Item 503(c) seems to be the least understood of the plain English requirements." In that Bulletin, the SEC provided sample risk factor disclosures and subheadings to help companies comply with Item 503(c).

31. Rule 420(b) of Regulation C under the Securities Act states:
Where a prospectus is distributed through an electronic medium, issuers may satisfy legibility requirements applicable to printed documents, such as paper size, type size and font, boldface type, italics and red ink, by presenting all required information in a format readily communicated to investors, and where indicated, in a manner reasonably calculated to draw investor attention to specific information.

32. The flowchart is on p. 36 of Seattle Genetics' Pre-Effective Amendment No. 5 to Form S-1 filed March 6, 2001 (File No. 333-50266).

This material is protected by copyright. Copyright © 2002 various authors and the American Corporate Counsel Association (ACCA).