Congress Must Learn to Surf the Internet if it Ever Wants to Catch the Next Wave of Securities Fraud, 17 J. Marshall J. Computer & Info. L. 589 (1999)

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CONGRESS MUST FIRST LEARN TO SURF THE INTERNET, IF IT EVER HOPES TO CATCH THE NEXT WAVE OF SECURITIES FRAUD

I. INTRODUCTION

Scott recently passed the bar exam and accepted an associate position with a top law firm in the Midwest. Since Scott does not have financial obligations beyond his living expenses, he has been looking for investment opportunities to secure his excess income.

Jeff recently graduated from a well-known university in the Midwest. He has not been able to find a job since graduation. Jeff recently thought of a new scam to raise some capital, since he is running low on funds due to his lack of employment. He designed a web page offering a secure investment with a twenty-percent rate of return.

1. Scott is a fictional character created for this hypothetical scenario in order to create a mental imagery of how a vulnerable investor is easily tricked out of his money via the Internet.
2. His salary is well above what he expected to receive his first few years out of law school. Fortunately for Scott, his parents had started a savings plan for him when he was a very young boy and were able to pay for his entire education.
3. Jeff is a fictional character created for this hypothetical scenario to create a mental imagery of how a crook with a home computer can easily take money from unsuspecting victims.
4. Jeff is a financial wizard and he also has a knack for computer programming. When Jeff was in high school, he was able to tap into the high school computer system and change his own grades.
5. S.E.C. v. Odulo, Litigation Release No. 14,616, 60 S.E.C. Docket (CCH) 120 (Aug. 24, 1995). S.E.C. v. Odulo illustrates a real case which was brought by the SEC involving an offer similar to the one in the hypothetical. Id. In August of 1995, the SEC filed a complaint against Dennis Odulo for soliciting investors over the Internet in get rich quick schemes. Id. Odulo offered bonds for sale to raise capital for a company called Golden Waters. Id. Odulo claimed the bonds would return a “whopping 20% rate of return.” Id. He also assured the investors that the bonds were secured against losses by an insurance policy, which was found to be nonexistent. Id. Odulo also made up several phony names of advisers who endorsed the bonds. Id. It was also found that Odulo failed to disclose the nature of the Golden Water venture, which was to acquire and raise eels. Id. The SEC found that Odulo had no prior experience in this area of expertise. Id. Odulo consented to an injunction from further violations of securities laws but a monetary penalty had to be waived because of his financial situation. Id.
Scott recently purchased a new computer and subscribes to a local Internet provider. Much of Scott's free time is spent surfing the Internet. He recently came across some web pages advertising investment opportunities; one of them is offering a twenty-percent rate of return. Scott is considering investing his entire savings into one of these investment web-based opportunities. Scott remembers a class he had on Internet law in law school and that the Securities and Exchange Commission ("SEC") Enforcement Division ("Division") has a program specifically designed to control securities fraud on the Internet. With this in mind, Scott feels confident that his decision to invest is a safe one.

While this scenario is entirely fictional, there are many people like Scott searching for investment opportunities to secure their hard-earned money. Unfortunately, there are many scam artists like Jeff who are just waiting to prey on the next unsuspecting consumer.

One risk that an investor faces when deciding to allocate funds to a particular investment is the integrity of the opportunity. If integrity is lacking in the investment and it turns out to be a sham, the investor may lose his entire investment. Securities fraud is an issue that has plagued the SEC since its inception. Securities fraud not only causes financial

6. Steven Wolowitz & Anthony J. Diana, Unexpected SEC Issues are Arising Online, Nat’l L. J., Feb. 9, 1998, at B11 n.1. Explaining that the SEC states that “liability provisions of the federal securities laws apply equally to electronic and paper based media.” Id. The SEC further explained that “[e]lectronically 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.” Id. The SEC's enforcement division will pursue all electronic frauds the same as paper frauds and will use the enforcement tactics that are needed to address any new problems that arise via the Internet. Richard R. Lindsey, Remarks from Opening Statement Concept Release on Exchange Regulation and Foreign Market Access to the United States (visited May 23, 1997) <http://www.sec.gov/news/speeches/161.txt>.


8. Id. at 821. The ease with which anyone can create his or her own Web pages also gives an advantage to the cyber thief. Id. In the comfort of one's own home a securities thief can create a sleek Web page that is full of fraudulent material and present it as a credible securities offering. Id. By adding links to other web sites, such as the SEC's homepage, a securities thief can create the perception that the SEC or other reputable agencies endorse their fraudulent Web site. Id.

9. Id. One major problem the SEC faces with the introduction of Internet trading is the convenience it poses for scam artists. Id. The range of scams the SEC has seen in recent year's range from traditional stocks and bonds to eel farms and portable nuclear reactors. Id. Given the ease of offering securities over the Internet the SEC anticipates that this is just the beginning. Id.

10. MICROSOFT ENCYCLOPEDIA, SECURITIES AND EXCHANGE COMMISSION (1996). SEC is an independent, quasi-judicial agency of the United States government, which protects the public from malpractice committed in the securities and financial markets. Id. The SEC was created by the Securities Exchange Act of 1934. Id. The SEC enforces sanctions,
hardships on those caught up in the fraud, but it also jeopardizes the integrity of the entire securities market. History has proven that incidents of securities fraud are more prevalent when there is an increase in the popularity of securities trading. Financial historians have noted that an increase in the popularity of securities trading was a contributing factor behind the great crash of 1929. Today's advances in technology and the widespread use of the Internet have once again brought popularity to the area of securities trading. The Internet has made securities trading more accessible and more popular to everyone. However, the downside to this popularity is that the Internet makes the opportunities to perpetrate securities fraud more complex and tougher to police than ever before.

which include the issuing of injunctions, the initiation of administrative proceedings against brokers-dealers licenses, and the initiation of criminal prosecutions throughout the United States Department of Justice against people charged with securities fraud and manipulations. Id. The SEC played a major role in the prosecutions, which took place in the late 1980s, which charged high profile individuals and firms with insider trading and other securities violations. Id.

11. American National Finance Corporation, SEC No-Action Letter, 1976 WL 12538 (S.E.C.) (Aug. 27,1976) (discussing the purpose the Securities Act of 1933). Id. The purpose was two fold: it was passed to protect investors from the speculators and fraudulent investments that perpetrated the crash and to restore integrity in the markets. Id.


13. Alexander C. Gavis, The Offering and Distribution of Securities in Cyberspace: A Review of Regulatory and Industry Initiatives, 52 Bus. Law. 317, 377 n.3 (1996). The Internet is the name for an extensive worldwide network of computers. Id. It is believed that the Internet as we know it today started in 1987, when the National Science Foundation upgraded its national supercomputers to network speeds, which allowed real time collaboration for simultaneous users. Id. However, it was not until the mid - 1990s that the Internet became popular outside the research arena. Id.

14. Cella & Stark, supra note 7, at 821. The popularity of the Internet for securities trading is obvious, because the cost and simplicity of putting together a Web page that can be viewed by millions is as easy as typing a word processor. Id. For very little expense virtually anyone can put together a Web page as sleek as any Fortune 500 company. Id. Finding space on the Web is very cheap these days, most servers provide free Web sites with an access agreement. Id. It is currently estimated that eleven of adult home computer owners trade securities online. Nua Ltd., INTERNET SURVEYS (last modified Feb. 23, 1998) <http://www.nua.ie/etrg.find/sur.com>.

15. Cella and Stark, supra note 7, at 823. It is sometimes unclear whether a posting on the Internet falls with the jurisdiction of the federal securities laws. Id. Several factors must be determined for a securities posting to qualify within the SEC's jurisdiction and the nature of the Internet makes that difficult. Id. Areas which trouble the SEC most are those which are completely unique to Internet trading. Id. These unique areas include jurisdictional problems which arise because of the Internet's vast presence, privacy issues which are raised with the use of e-mail, and bulletin boards created for private use often raise questions of how "public" an "offer" really is. Id.
Despite the popularity in the area of securities trading and all of the new challenges the Internet brings to the area of securities fraud, Congress has not chosen to react with new legislation. Instead, Congress has chosen to remedy the problems through the use of existing laws that were written over fifty years ago.\textsuperscript{16} This decision by Congress is at odds with other decisions it has made with respect to other areas of law that have been impacted by the Internet. Congress reacted to the effects of the Internet on gambling with proposed legislation aimed specifically at problems the Internet creates for this area of law. Given the enormous impact securities law has on the nation's economy it seems that Congress would want to create laws that are aimed specifically at the issues surrounding securities trading over the Internet. But instead of adopting a new legislative remedy, Congress has elected to rely on laws that were written long before anyone conceived of a tool as powerful as the Internet. It seems that Congress adopted a "wait and see" approach in this area of the law. Perhaps Congress could learn by taking a closer look at the proposed laws to stop Internet gambling.\textsuperscript{17} It appears that the solutions to the potential problems the Internet introduces to the area of securities trading may lie in proposed legislation such as The Gambling Prohibition Act.\textsuperscript{18}

The SEC has taken positive action toward protecting investors from fraud occurring over the Internet.\textsuperscript{19} The SEC has initiated a program that enables it to use anti-fraud weapons to directly attack new methods


\textsuperscript{17} John T. Fojut, \textit{Ace in the Hole: Regulation of Internet Service Providers Saves the Internet Gambling Prohibition Act of 1997}, 8 Depaul-Lca J. Art & Ent. L. 155, 157 (1997). Senator Jon Kyl (R-AZ) has recently introduced legislation that would make Internet gambling illegal. \textit{Id.} The proposed bill would amend the Federal Wire Statute, 18 U.S.C. § 1084(a) (1995) so that it would cover "wire and electronic communication." \textit{Id.} Internet gambling operators would no longer be able to circumvent the law by using wireless communication. \textit{Id.} Additionally, the bill would eliminate the phrase "on any sporting event or contest" from § 1084. \textit{Id.} Consequently, the amended version of § 1084 settles any dispute over the degree of coverage of the current § 1084. \textit{Id.} Finally, an additional paragraph would be added to section 1084(a) that eliminates the requirement that the party be in the business of gambling. \textit{Id.} Thus, the implication is that even the occasional gambler would be subjected to the law. \textit{Id.}

\textsuperscript{18} \textit{Id.}

\textsuperscript{19} SEC Solicits Comments on Regulation of Markets, Fed. Reg. Release No. 34-38672, (last modified May 28, 1997) <http://www.sec.gov/news/concept.htm>. The SEC is reevaluating its oversight in the securities market in light of the dramatic changes in technology. \textit{Id.} In light of these changes, the SEC has released a concept release requesting comment on both its overall approach to regulation of markets as well as specific options under the current regulatory framework for addressing the changes in technology. \textit{Id.}
of committing fraud that may arise in the future.\textsuperscript{20} This anti-fraud program is a great step forward in the policing efforts of securities regulations. However, the question remains as to how effective these programs will be without changes to the present legislation governing securities law.\textsuperscript{21} The Securities Act of 1933 ("Securities Act")\textsuperscript{22} and The Securities Exchange Act of 1934 ("Exchange Act")\textsuperscript{23} are two pieces of legislation which currently govern securities law. These Acts were written to protect securities traded through conventional paper transactions.\textsuperscript{24} The Sessions of Congress which wrote these Acts could not have conceived of an electronic medium like the Internet being used for securities trading.\textsuperscript{25} Despite the differences between the conventional paper transactions and the modern electronic transactions, neither the SEC nor Congress has proposed new legislation to help protect Internet investors.\textsuperscript{26}

This Comment analyzes the unique problems associated with securities trading on the Internet. Part II of this Comment provides an overview of the Securities Act and the Securities Exchange Act and their relationship with traditional securities fraud. In addition, Part II examines the current developments of online trading and the SEC's regula-

\begin{itemize}
\item \textsuperscript{20} Cella \& Stark, \textit{supra} note 7, at 836. The present program designed by the enforcement division is a multifaceted approach. \textit{Id.} It combines surveillance, aggressive prosecution, self-policing, and liaison work to achieve its goals. \textit{Id.}
\item \textsuperscript{21} Gavis, \textit{supra} note 13, at 321. The present legislation, which governs securities law, is the Securities Act of 1933 and the Securities Exchange Act of 1934. \textit{Id.} The Securities Act of 1933 has the objective of providing the investing public with full and fair disclosure of the character of securities and of preventing fraud in the sales of securities. Securities Act, Preamble, Pub. L. No. 73-22, 48 Stat. 74 (1933).
\item \textsuperscript{22} \textit{See generally} Securities Act of 1933, 15 U.S.C. § 77a (1994). The characteristics of the Securities Act of 1933 are described as:
1. The most important source of law regarding the public offering of securities.
2. The laws principle purpose is to require full and fair disclosure of material facts to the prospective investor.
\textit{Id.}
1. It contains antifraud provisions comparable to those in § 12 and §17 of the Securities Act of 1933.
2. It Contains proxy, short swing profit, tender offer and periodic reporting requirements applicable to the typical issuer after it first sells securities to the public. It Vest in Board of Governors of Federal Reserve System, not the Securities and Exchange Commission, authority for control of margin requirements, designed to prevent an excessive use of credit for the purchase or carrying of exchange listed and certain over the counter securities.
\textit{Id.}
\item \textsuperscript{24} \textit{See} Gavis, \textit{supra} note 13, at 321.
\item \textsuperscript{25} \textit{Id.}
\item \textsuperscript{26} Cella and Stark, \textit{supra} note 7, at 834.
\end{itemize}
tory responses to these issues, while exploring potential future developments in online trading. Part III examines current state and federal securities laws and explains why these laws do not adequately address the unique problems associated with Internet trading. Finally, Part IV of this Comment concludes with two propositions. First, that the federal and state governments cannot effectively regulate securities trading without the help of Congress; and second, that Congress must realize the need and urgency for changes of existing laws to preserve the integrity of the markets for the next millennium.

II. BACKGROUND

A. CURRENT LAWS GOVERNING SECURITIES TRADING

The Securities Act and the Exchange Act are the two primary pieces of legislation governing securities law. Congress was prompted to write these laws in response to a great deal of changes that the market endured following the great crash of 1929. The changes taking place were mainly due to the market's sudden increase in popularity. The increase in popularity, coupled with a lack of regulation, was a motivating factor in Congress' decision to take action by enacting the Securities Act and the Exchange Act.

These laws, written in the 1930's, were written in an era when transactions were made through traditional methods of paper trading. At that time Congress was facing many unprecedented issues, but even with their wisdom and attempts at foresight, Congress could not have conceived the problems that securities law would face with the emergence of an electronic medium like the Internet. Securities regulation on the Internet presents a new era in securities trading which must be dealt with on its own terms. Today's Congress must realize that the laws created in 1933 and 1934 were for another era of securities trading.

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27. Sen. Francis Maloney, Radio Address (Feb. 25, 1938), in 83 CONG. REC. 789, 790 (1938). "After the crash in 1929 when hundreds of thousands of American investors saw their savings swept away, . . . Congress gave immediate attention to the subject of abuses in the investment field." Id. at 790.
28. Id.
29. Levitt, supra note 12.
30. See Gavis, supra note 13, at 321.
31. John C. Coffee Jr., Brave New World?: The Impact(s) of the Internet on Modern Securities Regulation, 52 BUS. LAW. 1195 (1997). There are between 30 million and 60 million users of the Internet and the numbers are still growing. Id. Already, the Internet reaches over seventy-five countries with full service access to most of them. Id.
32. Christina K. McGlosson, Who Needs Wall Street? The Dilemma of Regulating Securities Trading in Cyberspace, 5 COMM. LAW CONSPект UST 305, 322 (1997) (discussing the expansive effects the global and electronic markets have on the securities market). Id. The Securities Act of 1933 and Exchange Act of 1934 were designed to restrict the securities market. Id. The use of the Internet for securities trading expands the market. Id.
1. The Securities Act of 1933

Federal regulation of securities began as a reaction by Congress to control securities fraud not controlled by state blue-sky laws. A large number of fraudulent securities were a major contribution to the Wall Street crash of 1929. As a result, Congress enacted the Securities Act of 1933 to prevent the fraudulent sale of securities. Congress wanted to rebuild strength and integrity in the securities market after the crash of 1929. Therefore, the primary purpose of the Securities Act is to protect purchasers of securities and regulate the distribution of securities. The Securities Act sets out special requirements for the issuance of securities and requires registration of securities with appropriate government agencies. These registration requirements help the SEC monitor the integrity of investment opportunities and ensure the public is being offered an honest opportunity to invest in a legal venture.

2. The Securities Exchange Act of 1934

Unlike the Securities Act of 1933, which focuses primarily on the initial issuance of securities, the Securities Exchange Act of 1934 focuses on federal regulation of securities, which are already issued and being traded on secondary markets. Secondary markets differ from primary markets in that primary markets trade in newly issued securities, while Securities Act and The Exchange Act need to be amended or replaced in order to co-exist with these expansive electronic markets. However, that may not be possible, these acts may be outdated and incapable of regulating electronic markets. See Robert W. Hamilton, Corporations Including Partnerships and Limited Partnerships 368 (5th ed. 1994). A "blue sky law" is a state regulation governing securities. The first blue-sky law was enacted in 1911 in Kansas and it focused on regulating fraudulently valued securities. Id.

Levitt, supra note 12.


15 U.S.C. § 77e (1994). These requirements include filling out registration statements with the SEC and issuing a prospectus for prospective investors. Id.

Id.


B. THE RECENT GROWTH OF INTERNET TRADING

The rapidly increasing use of the Internet for commercial purposes is an unavoidable result of modern technology. As of today, the Internet is estimated to be in use by an excess of 100 million people in over 23 million households worldwide. With these figures, it is no surprise that a tremendous number of brokers and investors are using the Internet as a substitute for the traditional mediums of exchange.

Trading on the Internet is no longer limited to stocks and other...

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40. J. FRED WESTON & THOMAS E. COPELAND, MANAGERIAL FINANCE 36 (8th ed. 1989). Investment banking firm sells newly issued securities in the Primary markets. The investment bankers acquire the securities from the issuing corporations through an underwriter. *Id.* The New York Stock Exchange (hereinafter the NYSE) is the oldest exchange in the United States, it is an example of an exchange based market, and is the largest exchange with respect to total capitalization of shares traded on it. McGlosson, supra note 32, at 317. In addition to the New York Stock Exchange there are six other exchanges registered with the SEC. *Id.*

On an electronic-based market, market makers compete in the market place based on their spreads, while on an exchange-based market a single specialist trades in a particular issue. *Weston & Copeland, Managerial Finance* 36 (8th ed. 1989). A specialist is a firm that matches the buy and sell orders that come in, almost simultaneously, on an exchange. *Id.* A specialist is also responsible for maintaining an orderly market for a particular security. *Id.* The term "market makers" refers to brokers and dealers on the over-the-counter market who stand ready to buy and sell securities. *Id.* The market makers function much like wholesale suppliers of goods or merchandise. *Id.* Where a stock trades infrequently, perhaps because it is a new or small corporation, the matching of buy and sell orders by a specialist may take an extended period of time. *Id.* To avoid the problems this may cause they maintain an inventory of securities. *Id.* “At one time, these securities were held in a safe, and when they were traded, they were literally passed over-the-counter.” *Id.* Market makers quote the highest bid and the lowest asked price currently available. *Id.* The bid price is the highest price the market maker is willing to pay for the quoted security, while the asked price is the lowest price at which he is willing to sell that security. *Id.* The difference between the bid and asked price is the spread. *Id.* at 427-28. The spread represents the market makers’ profit margin. Scott J. Paltrow, Nasdaq Spreads Have Narrowed, Study Shows Investing: A Computer Analysis of the Top-Selling Issues Shows a Significant Change in the Trading Margin for 49 of 50, L.A. Times, Jan. 5, 1995, at 1; Weston & Copeland, supra note 38. Nasdaq is a computerized quotation system through which brokers and dealers in the over-the-counter securities market communicate. *Id.*

41. See Coffee, supra note 31. There are currently 112 million Internet users worldwide.


43. Theresa W. Carey, Surf's Up, BARRONS, Mar. 17, 1997, at 33. It is estimated that 1.5 million brokerage accounts exist on-line, and this number is expected to grow to 20 million by the year 2001. *Id.* Currently, thirty-three brokers offer on-line trading; these figures are up from twenty brokers in 1996. See supra, text accompanying note 4.
lated securities. Today anyone can trade United States Treasuries online. Mutual funds are also available on-line through various discount brokerage firms. Initial public offerings ("IPO") which were once unattainable by small investors are now available on the Internet. The Internet also provides many forums for discussing various investment opportunities, as well as, web pages full of information incorporating financial and investment concepts.

C. The SEC's Recent Reaction to Internet Trading

The Internet opens up a new frontier for the trading industry. However, it also presents a new frontier for cyber-fraud. From the confines of one's own home, a scam artist can take advantage of an unsuspecting investor with a minimal detection. Securities violations on the Internet present new problems to the area of securities law. While the SEC reacted by creating a task force to develop regulatory measures for the Internet, neither Congress nor the SEC has initiated any new legislation to address these issues.

The SEC has taken the lead in addressing the issues investor's face with Internet fraud by initiating steps toward regulating Internet trad-

44. The traditional means of exchange involved a great deal of paperwork and expensive meetings. Today with a click of a button a trade can be made, an office call sent, or an office conference to millions of people can be conducted.


46. Id.

47. See McGlosson, supra note 32, citing Andrew Osterland, IPOs in Cyberspace, 165 Fin. World, Apr. 22, 1996, at 24. Spring Street Brewery, a New York City microbrewery, made the world's first Internet IPO. Id. The company raised $1.6 million and sold 870,000 shares without sharing any of the proceeds with Wall Street Investment Bankers. Id. The company linked its official circular to the Internet through a web site and invited all Internet users to view their materials. Id. A user could download the circular with an attached subscription agreement right into their own home. Id. The subscription agreement could then be e-mailed back to the company. Id. The secondary trading of Spring Street's stock was then traded on a bulletin board called Wit trade. Id. This trading medium allowed traders to conduct transaction without brokerage fees. Id.

48. Cella and Stark, supra note 7, at n. 22. Although investors can receive IPO information by contacting an underwriter, the investor must know about the offering, and would likely have to wait in order to receive the most recent information. Id.


50. Cyber fraud is a term the author uses to refer to all types of fraudulent trading practices on the Internet.

51. See Cella and Stark, supra note 7.


53. Id.
ing. Through the Division of Enforcement, the SEC has set up programs which deal directly with regulating securities. The Division initiated a multifaceted approach to dealing with the technological advances the Internet may bring to the area of securities law. The Division's approach consists of a combination of surveillance, aggressive prosecution, self-policing, education, and liaison work. The Division has the tools in place and it is ready for the future. By taking a proactive approach, the Division is prepared to handle any securities vio-

54. See Cella & Stark, supra, note 7, at 834. The Division is an arm of the S.E.C. that monitors fraudulent activity in the markets. Id. Since the inception of the Internet, the Division has attempted to approach new problems from every angle. Id.

55. Id. The SEC has historically responded quickly to the evolving changes in industry practice, such as foreign payment program, insider trading program, and municipal securities program. Id. Each of these programs shared a common theme; a commitment to protect the investor from unethical conduct within an area of law. Id.

56. See Cella & Stark, supra note 7, at 834 and accompanying text (explaining how the Division is preparing itself for future problems that may arise on the Internet).

57. Id. The Division has beefed up its surveillance to meet the needs of the future. Cella & Stark, supra note 7, at 834. The Division has all the commercial online accounts to monitor activity. Id. They have Pentium processors to get the job done right. Id. They have advanced T1 lines, which allows information to travel at speeds of 1500 bits per second, much faster than the average modem. Id. The staff attorneys in the Division are encouraged to investigate anything that looks suspicious, whether they are at home or the office. Id. They have authority to initiate full scale investigations on any of this suspicious activity that they find. Id. The SEC also has a cyberforce of volunteers who watch the Internet for a few hours a week looking for suspicious activity. Id.

58. Id. This is the most deterring aspect of the Division's program. Id. at 836. The prosecution of cases gets the message out to those who may be considering securities fraud. Id. In the past few years the SEC has taken action in several of these cases. Id. S.E.C. v. Odulo is a recent case illustrating the SEC's efforts at prosecuting actions of securities fraud on the Internet. S.E.C. v. Odulo, Litigation Release No. 14,616, 60 S.E.C. Docket (CCH) 120 (Aug. 24, 1995).

59. Cella & Stark, supra note 7, at 843. There exists an incredible bond amongst the Internet culture and they do not like to see the Internet used for exploitation. Id. The Division has tapped into this culture by providing a Complaint Center which users can contact at anytime to lodge complaints concerning suspicious activity. Id. The Complaint Center usually gets complaints concerning Internet fraud but all complaints are welcome. Id.

60. Id. By educating the public the Division can solicit more involvement in enforcing securities frauds. Id. at 845. The education process also works the other way because experienced users are providing the Division with tools and ideas to attack problems they are not aware of. Id.

61. Internet Gambling Legislation Introduced on Capital Hill, 13 No. 12 COMPUTER L. STRATEGIST 6 (1997). The Division has been successful at coordinating its efforts with other government agencies to track down and prosecute securities violations committed on the Internet. Id. at 845. The Division also works very close with self regulatory organizations, such as the New York Stock Exchange, to deter securities fraud. Id.

62. See Cella & Stark, supra note 7, at 847. (discussing the division's strategy and operation already in place to attack the future problems the Internet brings to securities law).
lation that fraudulent investors may bring to the Internet.63

The SEC has been responsible for regulating the distribution and sales of securities over the past fifty years.64 From traditional face to face sales, to more recent sales via telephone, the SEC has not instituted, nor have they sought from Congress, any changes to the federal securities laws regarding technological advancements.65 Instead, the SEC relies on updating its rules and regulations to address technological advancements.66

The programs initiated by the Division represent a considerable effort to alleviate problems arising in the Internet trading arena. However, these efforts may not be enough. It is time that the SEC and Congress address the bigger picture and realize that, without new laws that directly address the unique problems the Internet presents to the area of securities regulation, the regulations initiated by the SEC may ultimately be futile efforts.67 Congress should make these adaptations by amending former laws to better serve the unique and unanticipated situations that the Internet presents, or by writing a new set of laws which specifically deal with securities trading on the Internet.68

D. THE FUTURE OF ONLINE TRADING

It is estimated that over 12,000 accounts exist on-line today, but it is predicted that these figures will rise to over nine million by the year

63. Id.
64. MICROSOFT ENCARTA, SECURITIES AND EXCHANGE COMMISSION (1996).
65. See generally SUBCOMM. ON OVERSIGHT AND INVESTIGATIONS OF THE HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 96TH CONG., 2D SESS., NATIONAL MARKET SYSTEM: FIVE YEAR STATUS REPORT (Comm. Print 1980). Since 1975, the SEC has generally been the organization to oversee the development of a national market system for securities. Id. The SEC's role generally has been to facilitate the market participants' development and use of new technologies in the trading of securities, not to mandate specific market structures. Id.
67. Id.
68. Id. An area of law which Congress has been giving a great deal of attention, is the area of Gambling on the Internet. Id. Senator Jon Doyle of Arizona has proposed the "Internet Gambling Prohibition Act of 1997" which will create criminal penalties for Internet wagering. Id. This bill will amend two previous provisions of Title 18 that criminalizes the transmission of betting and wagering information. Id. The bill will extend 18 U.S.C. §§ 1081 and 1084 to cover transmission and receipt of information by communication facilities rather than the wire facilities, which are covered by the original law. Id. By changing the term from wire facilities to communication facilities, the bill cover bets and wagers placed on the Internet. Id. The bill is available on line at http://www.senate.state.ny.us. Id. See generally State of Minnesota v. Granite Gate Resorts Inc., 568 N.W.2d 715 (1997).
The increase of on-line trading will provide a niche market for a new mid-tier broker. This broker will provide service and advice at an inexpensive price. This enhanced technical service and lower prices will be a major victory for the customer. This victory is likely to make investing on the Internet very appealing to everyone from the experienced trader to the layperson interested in securing a future.

Electronic brokerage firms predict that it is only a matter of time before true Internet trading is commonplace. These firms predict that soon buyers and sellers will meet directly at the web site, completely bypassing the security exchanges. The Internet is opening up a completely new era of securities trading. The changes taking place today are similar to those that took place in the 1920's and 1930's. However, the threat of securities fraud on today's economy is heightened because the contemporary fraudulent trader has access to the Internet and its limitless ability to disseminate information to virtually anyone at any time. Like the Congress who created The Securities Act and The Exchange Act, the Congress of today also faces a new revolution in securities trading and it is up to this Congress to deal with the potential threat before the threat becomes reality.

69. See Carey, supra note 43.
70. See generally McGlosson, supra note 32, at 312 (predicting that "mid tier" brokers, a hybrid between discount brokers and full service brokers, will capture 60% of on line accounts by the year 2001).
71. Id. Mid-tier brokers will charge flat rates of between $30 and $75, while full service brokers will be charging between $100 and $150 per trade. Id. John Downs & Jordan E. Goodman, Dictionary of Finance and Investment Terms 351 (3d ed. 1991).
73. Vanessa O'Connell & E.S. Browning, Stock Orders on Internet Poised to Soar, WALL ST. J., June 25, 1996, at C1. Presently there are over 13 electronic brokerage firms taking orders on-line. Id. Some of these electronic brokers are affiliated with large discount brokers, while others are electronic trade specialists such as E-trade. Id.
75. K. Robert Bertram, Offers and Sales of Securities on the Internet: State Registration and Enforcement Issues, 1 No. 2 GLWSLAW 14, (1997). The Internet does not recognize any boundaries. Id. Therefore, regulators are forced to re-evaluate the present framework which is based upon boundaries. Id.
76. Id.
77. See generally McGlosson, supra note 32, citing Bradley D. Belt, From the Industrial Age to the Information Age: Rethinking the Regulation of Securities Markets, WASH. Q. 19, 115 (1996) (explaining the development of the securities markets and discussing the issues that some regulators will face, and suggesting an appropriate framework which to regulate the electronic securities market).
III. ANALYSIS

Given the potential threat associated with the Internet in areas of securities trading and securities law, it seems logical that Congress should simply enact a statute that criminalizes securities frauds that occur over the Internet. However, Congress has chosen not to do this, but instead relies on laws that were written in an era long before the Internet was conceived. The problem is that these laws do not adequately address the problems the Internet presents to the area of securities law because these laws did not contemplate Internet trading. The following section analyzes the various ways the Federal Government, state governments, and the SEC have taken toward regulating securities trading on the Internet and concludes with a proposed solution that Congress should consider when dealing with the issue of Internet trading.

A. FEDERAL AND STATE REGULATIONS ON THE INTERNET

1. Inadequate Regulations Through No Action Letters

With respect to Internet trading, the SEC has chosen to regulate through “no action” letters. These letters are a request sent to the SEC by a company requesting that the SEC give the company permission to continue a certain procedure. For instance, if a corporation wishes to issue a particular security over the Internet but is not sure whether its method for issuing securities is in compliance with federal regulations, it simply writes the SEC a letter and explains its proposed action. The SEC replies with a letter notifying the corporation of whether it is in compliance with federal regulations. The problem arising from the “no action” letter is that the letter only provides SEC compliance for that particular request. Therefore, this method of regulation falls short of any form of uniform, industry wide regulation. The “no action” letters help provide some framework for a particular company requesting a letter, but the letters provide virtually no framework for the industry as a whole.

78. McGlosson, supra note 32, at n.131, 322. (explaining that no action letters are written by the SEC staff in response to specific requests of whether a proposed course of action will comply with a security law or not, therefore, these no action letters do not have any precedent value).

79. Id.

80. Id. at 319; Joseph McLaughlin, SEC Approves Use of Electronic Prospectuses and Proposes T + 3 Relief, INSIGHTS, Apr. 1995, at 4. The SEC Division of Corporate Finance’s stated that the electronic delivery of a prospectuses must disclose the same information as the paper prospectus. Id. However, when it comes to graphic material it may be replaced with a narrative description or tabular representation. Id.

Without a framework or uniform laws in this area, the state regulators are left with little guidance for prosecuting violations that occur over the Internet.

2. Inadequate Regulation Through State Initiatives

State regulators are increasingly interested in the area of securities fraud, particularly in the area involving registration requirements. Each state requires companies who issue securities to comply with their state registration requirements in addition to the federal requirements. The Internet introduces problems for state regulators because companies that post securities offerings on the Internet in one state are instantly able to disseminate information in every other state because of the Internet’s limitless boundaries. This global dissemination makes it nearly impossible for state regulators to enforce their own registration requirements. The fact that anyone in any state can download this information and later use it for their own benefit allows companies making offerings over the Internet to frustrate state securities laws.

Pennsylvania was the first state to address the registration issue involving Internet trading. On August 31, 1995, the Pennsylvania Securities Commission issued an order exempting securities that are offered for sale on the Internet from state registration requirements if certain conditions are met. To avoid potentially inconsistent state regulations, the North American Securities Administrators Association Inc.


83. Id. Another problem with the use of “no action” letters is that they do not provide the adequate protection that can be provided through proper legislative means. For instance, Corporations rely on the “no action” letter as an adequate means of legislation when they should be lobbying Congress for better protection through federal regulations.

84. Bertram, supra note 75.
85. Id.
86. Id.
87. Id.
89. Kenneth W. Brakebill, Regulatory Problems Posed by Internet Securities Transactions, 18 HASTINGS COMM. & ENT. L.J. 901, 935 (1996). The three conditions set out by the Pennsylvania Securities Commission which exempt a company offering securities on the Internet are: (1) the offer indicates, directly or indirectly, that the securities are not offered to a person in Pennsylvania; (2) the offer is not specifically directed to any person in Pennsylvania by any other means; and (3) no sales of the securities are made in Pennsylvania as a result of the Internet offering.
("NASAA") adopted a resolution in 1996. This resolution encourages all states to develop a uniform policy concerning the regulation of the offering of securities on the Internet. Under the NASAA, resolution states would be able to treat any unregistered Internet offering as an offering in their own state, and that state would then have the power to exempt the offering from registration requirements.

State regulators welcome the idea of cooperative regulations when it comes to Internet trading because many regulators do not have the authority to issue orders or rules concerning the exemption of securities laws in their state. However, the resolution proposed by NASAA may not be the best solution available because inconsistencies will continue to develop between different jurisdictions and different regulatory agencies. The only way to insure that uniform regulation standards are established is through federal legislation. The SEC has taken some effort to regulate through its "no action" letters and the states have taken efforts through statewide regulation. However, this piecemeal legislation does not provide for a uniform regulatory system that is necessary for the market to operate smoothly.

B. The Problems Associated With The SEC's Current Regulation

The SEC has regulation efforts in place to attack some of the problems that the Internet presents to the area of securities law. However, the obstacles that the Internet community presents to these regulatory efforts may prove to be more challenging than expected. The first obstacle the SEC faces is the issue of free speech. Absent any formal legislation, the SEC has placed themselves in an awkward situation. On one hand, the SEC has the job of encouraging the use of the Internet as a new and innovative way of stimulating on-line trading. On the other hand, the SEC has the duty of protecting the public from any new develop-

90. K. Robert Bertram, Advanced Technology Issues - The Internet, and State Securities Regulations- The Primer, PA. BAR ASS'N Q., July 1996, at 137, n.24. (explaining that testing the waters programs continue to develop through the SEC and other pilot programs to determine whether a security will survive interest before the company registers it with the SEC.)
91. Id.
92. Id. The Pennsylvania order prohibited the sale of securities, which were once offered on the Internet to prohibit the company from using the Internet as a Testing the Waters program. Id.
93. Brakebill, supra note 89, at 935 (explaining how over a dozen states have already adopted the Pennsylvania order).
94. Id.
95. See Coffee, supra note 31, at 1225.
96. Id.
97. Id. at 1208.
opments in the area of securities fraud. The SEC has the difficult job of positioning itself so it can respond quickly to any fraudulent activity while also considering the privacy of the Internet community.

One difficulty the SEC will face when trying to enforce securities regulations on the Internet is the expansive interpretation of free speech principles as applied to on-line communications by the leaders of the Internet communities. The Internet's informal and uncensored environment creates a lawless mentality among its users. This user mentality, coupled with an anti-governmental sentiment that accompanies most writings on the Internet, make it clear that the SEC and any other regulatory division may have difficulties when implementing regulatory control devices on the Internet. Despite the SEC's wishes to respect the privacy of the Internet community, the parameters of the First Amendment do not grant a right to commit fraud. Therefore, the SEC will have the task of finding a balance between advocating free speech and prosecuting those who go too far.

C. INADEQUATE FEDERAL LEGISLATION: SECURITIES ACT 1933 AND EXCHANGE ACT OF 1934

So far, it does not appear that the Internet itself has given rise to any new forms of securities fraud. However, the ease with which information is disseminated over the Internet has created an ideal environment for traditional fraud to flourish. It is this overwhelming and unmonitored free flow of data that adds a new element to traditional law that should be carefully scrutinized by Congress.

1. Insider Trading

Insider trading is a traditional violation that is made easier by the widespread use of the Internet. A corporate insider may use various codes to communicate with others through postings of a corporation's in-
The potential for coding makes it more difficult for regulators to decipher communications and determine if the information is legal or not. The anonymity available on the Internet makes it very difficult to trace the illegal trader's identity. The use of e-mail and chat rooms makes the dissemination of illegal information much easier than the traditional methods of setting up meetings and phone calls.

Under the traditional theory of insider trading, SEC Rule 10b(5) is violated when a corporate insider trades in the securities of his own corporation and his knowledge is based on non-public information. Rule 10b(5) prevents the informed corporate insider from taking advantage of the uninformed stockholder. The thrust of this rule is rooted in the general anti-fraud provisions contained in section 10(b) of the Exchange Act. However, this area of law has historically been vague and inconsistent due to the legislature's lack of a definition of insider trading in the Exchange Act.

The courts have had a great deal of difficulty reaching an agreement concerning the definition of insider trading. In Chiarella v. United

Internet and its vast wealth of information allows for a great deal of information to be exchanged at extremely high speeds. Id.

107. Id.
108. Id.
109. Report on Enforcement Issues, supra note 105. There are many reasons why dissemination of information is easier and more efficient over the Internet. Id. First, information that is disseminated over the Internet is International. Id. Second, the information is transferred instantly. Id. Third, information sent over the Internet is practically free. Id. Fourth, the information has an opportunity to reach a vast amount of people all at once. Id. Finally, the information can be as detailed as the sender would like for it to be. Id.

110. See Phillips & Zutz, The Insider Trading Doctrine: A Need for Legislative Repair, 13 Hofstra L. Rev. 65 (1984). Explaining that insider trading is generally expressed as trading in the securities market while in possession of material information that is not available to the public. See Coffee, supra note 31, at 1229.

111. Jonathan R. Macey, From Fairness to Contract: The New Direction of the Rules Against Insider Trading, 13 Hofstra L. Rev. 9 (1984). Liability for insider trading traditionally has been premised under §10(b) of The Securities Act and the SEC's Rule 10(b)(5), even though section 16(b) of the Exchange Act of 1934 explicitly regulates trading by insiders. Id. The reason section 10(b) and Rule 10(b)(5) is relied on is because the scope of section 16(b) is extremely limited. Id.

112. United States v. Chiarella, 445 U.S. 222, 228 (1980). Liability for insider trading exists because there is a relationship of trust between the shareholders of a corporation and those insiders who have confidential information by reason of a position they hold with the corporation. Id. The relationship is based on the insider not using that information in a way that benefits them personally. Id.

113. See Macey, supra note 111. The liability does not necessarily arise from the trading of securities with non-public information, but from the breach of a fiduciary duty or other similar relationship of trust and confidence. Id.

114. Id.
the defendant traded in the market based upon information he gathered while working for a financial printer. The United States Supreme Court adopted a narrow scope of the definition of insider trading holding that the courts would not impose liability on a person who acquired information through his employment and then personally used that market information for personal gain in the market place. However, in United States v. Carpenter, the defendant supplied outside traders with confidential information he obtained at work. The Second Circuit adopted a wide scope of the definition of insider trading and held that criminal liability for insider trading is proper where breach of an employer's confidentiality policy occurs. Neither of these two decisions dealt with issues involving the Internet. However, these cases will serve as precedent to any Internet trading cases that involve insider trading.

Based on the holdings of Chiarella and Carpenter, problems will arise for the judicial system because the use of the Internet for trading securities can allow an insider to use information that is intercepted on the Internet without being liable under the traditional laws of insider trading. For example, if a third party intercepts e-mail from a corporate insider and then uses that information to personally trade securities, he may escape liability under the insider trading rules because he

115. Chiarella, 445 U.S. at 228. A markup man employed by a financial printing company, traded on information he obtained while on the job. Id. Even though the confidential information did not disclose any names, he was able to deduce the names from the information and traded on it. Id. The Supreme Court held that the conduct did not violate Rule 10(b)(5). Id.
116. Id.
117. Id. The Court in this case held that silence in connection with the purchase or sale of securities may also operate as a fraud actionable under section 10(b) of the Exchange Act of 1934. Id. This type of liability must be premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction. Id.
118. Id. at 233. The Court held that formulation of such a broad duty, which seems to depart radically from the established doctrine that a duty arises from a specific relationship between the two parties should not be undertaken absent some explicit evidence of congressional intent. Id. In this case no such evidence emerges from the language or legislative history of section 10(b) that the explicit intent arises. Id.
119. United States v. Carpenter, 791 F.2d 1024 (2d Cir. 1986), aff'd, 484 U.S. 19 (1987). This is the most recent pronouncement by the court on the scope of insider trading based on the misappropriation theory. Id. The court in explaining their theory found that a Wall Street Journal employee had misappropriated a confidential publication schedule by using it for his own benefit in a scheme to purchase and sell securities. Id. According to one critic this expansion by the court to include criminal liability based on a breach of employers confidentiality is not the protection originally warranted in the Securities Act. Obermaier, WHO'S AN INSIDER? WHAT'S INSIDE?, N.Y.L.J., July 1, 1986, at 1.
120. Carpenter, 791 F. 2d at 1024.
121. Id. at 1028.
122. See Cohen, supra note 106.
does not owe a fiduciary duty to the corporation. In this instance the third party who intercepts e-mail and then makes trades based on information gathered from that e-mail, could escape liability under the holding in Chiarella because, like the defendant in Chiarella, the third party in the present instance owes no duty to the Internet provider or to the seller of the companies securities. The third party trader would also escape liability under the stricter rule set out by the Second Circuit in Carpenter because the third party would not owe a duty to the Internet provider because he is a subscriber of the Internet service, not an employee of the service. By analyzing landmark decisions in the area of insider trading and developing analogous scenario's that involve the Internet, it becomes clear that current laws may not adequately protect investors.

2. Outsider Manipulation

Outsider manipulation is among the various types of traditional fraud that is easily accomplished over the Internet. False statements can be sent over the Internet through e-mails, web sites, and bulletin boards. These false statements can cause shareholders to panic and sell their stock at a very low price. Outsider manipulation can be even more convincing when the message is sent anonymously, or under several aliases that give the impression that the information is coming from several sources.

The Exchange Act contains a provision that makes it illegal for any person, individually, through others, or through agents, to manipulate

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123. Id. Such violations may violate other Federal laws but they would not violate the laws currently set out by Congress to protect securities. Id
124. Id.
125. Id.
126. See Wolowitz & Diana, supra note 6. A manipulator may start a rumor on a web site or in a chat room about a particular corporation. Id. This rumor may then reach shareholders who believe the information is true and sell their stocks for a low price. Id. The manipulator buys the stocks at the low price and then when the rumor clears and the stock prices are up the manipulator cashes in his earnings. Id.
127. Securities Regulation and Law Report, June 14, 1996, at 751. There has been a great deal of discussion that chat rooms have been used to manipulate stocks and that other aspects of the Internet such as e-mail and bulletin boards may also be used as tools to manipulate stock prices. Id.
128. Id.
129. Report on Enforcement Issues, supra note 105. A characteristic of the Internet is that it allows senders of information to mask their identities through anonymizing tools. In addition to providing a user with the capability of being completely anonymous, the Internet allows users to impersonate others through a process called "spoofing." Id. "Spoofing" is the process of stealing another's identity off the Internet by intercepting e-mail or by using spy programs, which monitor messages, sent out by users. Id.
the prices of securities by disseminating false information.\textsuperscript{130} The current law only provides protection if the manipulator violates a fiduciary duty.\textsuperscript{131} The Internet presents a problem for this traditional law because a third party using the Internet may intercept a confidential e-mail containing information about a corporation and distribute it freely to other traders without violating a fiduciary duty.\textsuperscript{132}

Another problem that exists is that the anti-manipulation provisions are only applicable to manipulation directed at securities registered on national exchanges.\textsuperscript{133} The Internet is a breeding ground for small growth companies because the costs for setting up are low.\textsuperscript{134} Therefore, the use of outsider manipulation may not violate the current laws when small growth companies are involved because they are typically not registered on national exchanges.\textsuperscript{135}

3. Unregistered Sales

The Internet also provides an ideal environment for the sale of unregistered securities.\textsuperscript{136} Anyone can put together a web site and offer for sale a security without ever seeking approval by the SEC.\textsuperscript{137} In addition to this fraudulent activity, an individual may give fraudulent advice regarding the validity and the integrity of the unregistered illegal investment.\textsuperscript{138} This gives the fraudulent trader the opportunity to endorse his


\textsuperscript{131} United States v. Chiarella, 445 U.S. 222, 228 (1980). A financial printer owed duty to his corporate client not to appropriate confidential business information. United States v. Carpenter, 701 F.2d 1024, 1030 (2d Cir. 1986), aff'd, 484 U.S. 19 (1987). A reporter owed a duty to a newspaper not to appropriate confidential business information that was scheduled to be published in a column of his employer's publication. \textit{Id.}

\textsuperscript{132} But see United States v. O'Hagan, 117 S Ct. 2199, 2207 (1997). Liability under 15 U.S.C. § 78i(a)(2), (3) for insider trading also applies to the misappropriation theory, which states that a person commits fraud in connection with a securities transaction, and thereby violates section 78 i(a)(2) and (3), when he misappropriates confidential information for securities trading purposes. \textit{Id}

\textsuperscript{133} \textit{Id.}

\textsuperscript{134} See supra text accompanying note 14.

\textsuperscript{135} Cella and Stark, supra note 7, at 818. The ease of gaining access to the Internet has given smaller growth companies an opportunity to make public offerings to a vast audience.

\textsuperscript{136} Lively v. Hirschfeld, 440 F.2d 631 (10th Cir. 1970). The Securities Act provides that a person who purchase an unregistered security has the right to rescind the sale to recover any of the resulting damages. \textit{Id.} The defendant then bears the burden of proving that an exemption applies. \textit{S.E.C. v. Ralston Purina Co}, 346 U.S. 119, 126 (1953).

\textsuperscript{137} Cella & Stark, supra note 7, at 821. For very little expense, anyone can put together a web site that will look as professional as a web site from any corporation. \textit{Id.}

own illegal action.\textsuperscript{139}

It is unlawful under the federal securities laws to sell unregistered securities, unless the security qualifies as an exemption provided in the Exchange Act.\textsuperscript{140} An exemption is granted to companies offering securities intrastate.\textsuperscript{141} Most companies that frequently sell or deal with securities are aware of the process necessary to qualify as an exemption.\textsuperscript{142} However, problems can arise when a company, intending to comply with an exemption, offers securities over a web site.\textsuperscript{143} Due to the vast audience that a web site offers, the corporation may not realize exactly to whom the securities are being offered. This could create a problem to a company making an offer that is intended to be an intrastate offering, but may instead be deemed to be interstate because of the access the Internet offers to out-of-state residents.\textsuperscript{144}

Another exemption is given to private offerings.\textsuperscript{145} Again a problem could arise if information is posted on a web site. Such a posting may in fact create a public offering and would fail to qualify as an exemption.\textsuperscript{146} These problems could cause companies who thought they were complying with the rules to be guilty of committing securities violations.

\textbf{D. Hyperlinks to Analysts Reports}

Finally, the use of hyperlinks\textsuperscript{147} makes it very easy for a person seeking to offer false information to gain credibility by linking their own web site to a credible organization. An example would be a fraudulent organization linking their own web site to the SEC's web site, thus, giv-

\begin{itemize}
\item \textsuperscript{139} O'Connell & Browning, supra note 73.
\item \textsuperscript{140} Securities Act, 15 U.S.C. § 77c, 77d (1994).
\item \textsuperscript{141} 15 U.S.C. § 77c(a)(11) states that exempted securities include:
Any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory.
\item \textsuperscript{142} Wolowitz, supra note 6, at b11.
\item \textsuperscript{143} Id.
\item \textsuperscript{144} David L. Stott, \textit{Personal Jurisdiction in Cyberspace: The Constitutional Boundary of Minimum Contacts Limited to a Web Site}, 15 J. MARSHALL J. COMPUTER & INFO. L. 819, 826 (1997). The Internet has a worldwide nature. \textit{Id.} For example, when a site becomes available it is almost instantaneously available to anyone worldwide. \textit{Id.} This allows users to access the site from any state or country. \textit{Id.}
\item \textsuperscript{145} 15 U.S.C. § 77d(2) (1994).
\item \textsuperscript{146} Id.
\item \textsuperscript{147} Report on Enforcement Issues, supra note 105. These links allow readers to access information that has been previously published in electronic format. \textit{Id.} The links also provide credibility to a web site by associating with a legitimate organization such as the SEC. \textit{Id.}
\end{itemize}
ing the perception that the SEC endorses its web site.\textsuperscript{148} Hyperlinks are the essence of the Internet system and the validity of a web site is often determined by the extent to which it is hyperlinked.\textsuperscript{149}

A company’s use of a hyperlink could inadvertently expose the company to liability under current securities law.\textsuperscript{150} The Private Securities Litigation Reform Act of 1995\textsuperscript{151} provides a “safe harbor” for certain forward-looking statements.\textsuperscript{152} Therefore, only statements made by the issuer, persons acting on behalf of the issuer, or an underwriter retained by the issuer, are protected.\textsuperscript{153} Problems arise with the current law, because if a plaintiff can prove that a company, by providing a link to an analyst, adopted the analyst’s forecast, then the company will not be able to use the protection provided by the safe harbor provision.\textsuperscript{154} As the use of the Internet for trading securities continues, loopholes will continue in current securities law, and thus, will leave many issues open. Congress should recognize this and take action to insure that the judiciary does not become a super legislature in the area of Internet securities regulation.

\section*{E. New or Amended Legislation as an Alternative Source of Regulation}

It is apparent that problems exist with the current regulation efforts designed to deal with Internet trading. It is also apparent that the Internet is growing at an exponential rate and that the growth rate of Internet trading will soon follow.\textsuperscript{155} This Comment proposes an alternative to the current regulations: Congress should adopt new laws

\begin{thebibliography}{99}
\bibitem{148} O'Connell & Browning, \textit{supra} note 73.
\bibitem{149} Cella and Stark, \textit{supra} note 7. Just like visiting a web site, the use of links are free, so the fraudulent trader will provide links on his web site to many legitimate corporations. \textit{Id.} The trader may also link his sight to the SEC, giving the investor the false impression that the trader’s web site is endorsed by the SEC. \textit{Id.} A final way for the trader to produce false validity is to link his page to a phony newsletter created by him. \textit{Id.}
\bibitem{150} Grassi v. Information Resources Inc., 63 F.3d 596 (7th Cir. 1995) (plaintiff claiming that a company’s inaccurate earnings projection constituted securities fraud).
\bibitem{152} \textit{See} Securities Act § 27A(c)(1). \textit{See also} Securities Exchange Act § 21E(c)(1). The safe harbor applies to private actions under the Securities Act of 1933 and The Securities Exchange Act of 1934, where the claim is based on a forward looking statement, which is misleading or untrue as to a material issue of fact. \textit{Id.}
\bibitem{153} \textit{Id.}
\bibitem{154} \textit{Id.}
\bibitem{155} \textit{See} George Cole, \textit{Censorship in Cyberspace—George Cole Explores the Practicalities of Policing the World's Biggest Computer Network}, \textit{FIN. TIMES}, March 21, 1996, at 20. No one is exactly sure how large the Internet community really is, but it is estimated to range from thirty to over fifty million users. \textit{Id.} Experts estimate that the number of Internet
or amend existing laws by following the framework developed in the proposed gambling legislation.\textsuperscript{156}

1. \textit{New or Amended Legislation}

The regulation efforts that federal and state governments currently practice, in the area of securities law, lack uniformity.\textsuperscript{157} The SEC's "no action" letters provide compliance for particular issues, but fail to regulate broad areas of law.\textsuperscript{158} State initiatives and the NASAA resolution still leave room for inconsistencies.\textsuperscript{159} The Securities Act and the Exchange Act provide uniform protection in this area of law, but fail to provide language that adequately protects against certain aspects of the Internet trading.\textsuperscript{160} To preserve the integrity of securities trading, Congress needs to change the language of the Securities Act and the Exchange Act to include all aspects of Internet trading.\textsuperscript{161}

An interesting amendment has been proposed in the Senate, in the area of Internet gambling.\textsuperscript{162} This proposed legislation could offer a framework to legislators who may, in the future, wish to propose new legislation in the area of securities law.\textsuperscript{163} Current gambling laws do not users doubles annually. \textit{Id.} See Mike Snider, \textit{Searching for Ways to Direct Internet Traffic},\textit{ U.S.A. TODAY}, Mar. 14, 1996, at D1.

156. Peter H. Lewis, \textit{Limiting a Medium Without Boundaries: How Do You Let the Good Fish Through the Net While Blocking the Bad?}, \textit{N.Y. TIMES}, Jan. 15, 1996, at D1. If the United States believes it can eliminate Internet gambling through regulation, it fails to understand the basic premise of the Internet structure. Anthony M. Rutkowski, the former head of Internet Society, states that: "[The nature of the Internet, if not contemporary telecommunications and transportation technologies in general, make restricting informations access into a particular jurisdiction] intrinsically impossible to achieve." \textit{Id.} Therefore, any regulation that is proposed must proceed from an initial position that accounts for the global nature of the Internet. \textit{Id.}

157. McGlosson, \textit{supra} note 32 (discussing the framework in which regulators should setup any future legislation).

158. McGlosson, \textit{supra} note 32 (explaining that no-action letters lack precedent value).

159. Brakebill, \textit{supra} note 89 (discussing the conditions set out by the Pennsylvania Securities Commission).

160. Lewis, \textit{supra} note 156.

161. Scott M. Montpas, \textit{Gambling On-Line: For a Hundred Dollars, I Bet You Government Regulation will not Stop the Newest Form of Gambling}, 22 \textit{U. DAYTON L. REV.} 163, 178 (1996) (discussing the effects that the Internet has on existing laws and the need for Congress to address these problems with amendments to existing laws or new laws). Senator Jon Kyl (R-AZ), has proposed a bill that would amend the Federal Wire Statute, 18 U.S.C. § 1084(a) (1995). \textit{Id.} The proposal would allow language to be included in the old law which would cover any fraud committed over the Internet. \textit{Id.} Congress cannot continue to rely on laws that were written prior to the conception of the Internet to sufficiently provide justice in this new era of technological advancements. \textit{Id.}

162. Fojut, \textit{supra} note 17 (discussing the proposal of the Internet Gambling Prohibition Act by Senator Jon Kyl (R-AZ)).

adequately protect citizens when the Internet is used as a tool to facilitate gambling. In response to this lack of protection, legislators have introduced the “Internet Gambling Prohibition Act of 1997” ("Gambling Prohibition Act") which suggests that Congress should make some changes to the language of Title 18 § 1081, known as the Wire Act. ¹⁶⁴

The amendments proposed in the Gambling Prohibition Act were prompted by legal, social, and economic concerns.¹⁶⁵ First, the Gambling Prohibition Act addresses the legal aspect by specifically criminalizing all Internet gambling.¹⁶⁶ However, proponents of an amendment to the securities law would not want to criminalize all securities trading on the Internet. Proponents of amending the securities laws would want to criminalize all fraudulent trading and activities occurring on the Internet which would otherwise be actionable if other mediums of trading were used.

Second, the Gambling Prohibition Act criminalizes Internet gambling to curb the effects gambling has on our society.¹⁶⁷ The proponents of an amendment to the securities law should consider the effects that securities fraud has on our society. A society that relies on the integrity of its markets should find comfort in knowing they are protected in all areas of the trading arena.

Third, the Gambling Prohibition Act criminalizes Internet gambling to minimize the loss of revenue that might otherwise stay in the United States.¹⁶⁸ The proponents of an amendment to the area of securities law should also consider the economic effect securities fraud has on society. In most cases of securities fraud, it is the taxpayer that is ultimately punished.

The Gambling Prohibition Act effectuates these concerns by redefining the language used by the Congress who wrote the Wire Act long before anyone could have conceived of the Internet.¹⁶⁹ For example, the current scope of the Wire Act does not include data and information that is transmitted over the Internet.¹⁷⁰ The Wire Act only protects against "wire communication" and not "electronic communications".¹⁷¹ According to Fojut, supra note 17, at 161.
ingly, legislators have proposed to amend the language of the Wire Act. These amendments have the effect of expanding the law and preventing lawbreakers from circumventing legislation by using the Internet and claiming it is not a wire communication. Proponents for an amendment in the area of securities law should also redefine the terms of the Securities Act and the Exchange Act to include the Internet trading.

IV. CONCLUSION

The Internet is growing at an exponential rate. The use of the Internet for trading securities is also growing at an alarming rate. The SEC has already taken precautions to deal with the problems the Internet creates in the area of securities law. The SEC’s Division of En-

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172. Id. There is reason to believe that the gambling explosion may be peaking. Id. A backlash against gaming proliferation is the biggest risk to growth. Id. This backlash may begin with Congress, which has seen several bills introduced in the last year. Id. One proposal, the Crime Prevention Act of 1995, would make Internet gambling illegal. See 141 CONG. REC. S19114 (1995). A second bill would create a National Commission to study gambling. Furthermore, several cities that have legalized gambling have not reaped the promised benefits. See Ken Armstrong, Risky Business: Can Gaming Win in Cities?—Chicago May Get Tip from New Orleans, Chi. Trib., Nov. 29, 1995, at Bus. 1 (explaining that New Orleans failed as a test market for major cities looking into the prospect of legalizing gambling). Id. Yet, even though gambling may be beginning to face resistance in new markets, the amount wagered in 1995 was still more than the amount wagered in 1994. Id.

173. 18 U.S.C. § 1084 (1994). Other federal statutes could apply to Internet gambling. For example, 18 U.S.C. § 1955 (1994) makes it illegal to run an “illegal gambling business.” The statute provides that an “illegal gambling business” is any business that: (1) violates state law, (2) involves at least five people, and (3) has operated for thirty days or grossed over $2,000 in one day. 18 U.S.C. § 1955(b)(1)(i)-(iii) (1994). Like section 1084, section 1955 does not cover the individual gambler; however, section 1955 is not limited to “any sporting event or contest” as is section 1084. See 18 U.S.C. § 1955(2) (defining gambling to include bookmaking and a variety of other gambling activities such as slots and lotteries). Furthermore, a violation of section 1955 does not require the use of interstate wires as does section 1084. Although section 1955 provides an alternate method for criminalizing Internet gambling operations, it still suffers from the enforcement dilemma that haunts section 1084, that is how to stop operators who run their businesses in foreign countries. Another federal statute that could apply to Internet gambling, is the Racketeer Influenced and Corrupt Organizations Act (“RICO”). 18 U.S.C. § 1961(1) (1994). Under RICO, a “racketeering activity” includes a violation of section 1084. Id. Although not all Internet gambling activities are covered by section 1084, gambling operators would be considered in the business of gambling. Id. Thus, those gambling operators convicted of violating section 1084 could be forced to forfeit any property “derived . . . directly or indirectly, from racketeering activity . . . .” 18 U.S.C. § 1963(a)(3) (1994).

174. See supra text accompanying note 32.

175. Cella & Stark, supra note 7 at 834. The SEC has taken steps to try to prevent fraud on the Internet. They have a volunteer corp that surfs the web in search of securities violators. Id. The SEC has taken action in several cases and plans to initiate more actions as the violators multiply. Id. The complaint center has proven successful with some complainants doing their own investigative work. Id. The office of Investor Education and Assistance has published an extremely informative Investor Alert manual. Id. The man-
enforcement has beefed-up their support for monitoring fraud through an
approach which includes a combination of surveillance, prosecution, self-
policing, education, and liaison work.\textsuperscript{176}

This aggressive approach by the SEC may help to deter fraud on the
Internet. This Comment, however, illustrates that without changes to
existing laws, the fraudulent trader will still attempt to circumvent the
law regardless of the SEC's efforts.\textsuperscript{177} Legislators have addressed the
effects the Internet presents in other areas of law by proposing new legis-
lation.\textsuperscript{178} It only seems appropriate that Congress should heavily scruti-
nize an area of law, such as securities trading, which is so vital to the
preservation of our economy. As the new millennium approaches, Con-
gress must address the issues presented by Internet securities trading,
and make adaptations that will allow Internet trading to flourish with
minimal fraud through the next century.\textsuperscript{179}

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\textsuperscript{ual includes a checklist of things to do prior to making an Internet purchase. Id. The SEC has teamed up with various enforcement groups including the FTC, Dept. of Justice, FBI, and the FCC. Id.}

\textsuperscript{176} Id.

\textsuperscript{177} Compare the need for securities regulation to the need for gambling regulation. H.R. Rep. No. 967, 87th Cong., 1st Sess. (1961), reprinted in 1961 U.S.C.C.A.N. 2631. The purpose of the bill is to assist the various States and the District of Columbia in the enforcement of their laws pertaining to gambling, bookmaking, and like offenses and to aid in the suppression of organized gambling activities by prohibiting the use of wire communication facilities which are or will be used for the transmission of bets or wagers and gambling information interstate and foreign commerce.

\textsuperscript{178} Lewis, \textit{Supra} note 156.

\textsuperscript{179} Id. It is important that Congress understand the urgency that is created by the Internet and not refuse to get involved just because they do not understand the Internet. Id.