Securities Fraud in Cyberspace: Reaching the Outer Limits of the Federal Securities Laws

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I. INTRODUCTION

Securities regulation is an area of the law in which existing rules are being rendered obsolete by technological developments. More and more securities activities in both the primary and the secondary markets are moving on-line these days. However, the rules for regulation of such activities were drafted before the dawning of the computer age and do not adequately cover the novel issues raised by securities issuance and trading in an electronic world. While the Securities and Exchange Commission ("SEC") and state securities regulators have begun to address the consequences of use of the new medium by issuers, intermediaries, and investors, many basic questions remain unasked and unanswered by such regulators.¹

¹ See John C. Coffee, Jr., Brave New World? The Impact(s) of the Internet on Modern Securities Regulation, 52 Bus. Law. 1195 (1997) (outlining the major issues raised by use of the Internet).
While use of the Internet for securities transactions has been praised for the convenience and lowered costs it affords, the Internet has also served as a breeding ground for fraudulent activity. Internet-related stock fraud is now one of the most common types of investment fraud.  

Realizing the ease with which such fraud can occur, the SEC identified combating such fraud as a priority and set up the Office of Internet Enforcement ("OIE") in 1998, which has brought over 200 enforcement actions.  

Despite its recognition of the scope of the fraud problem and its willingness to take steps to put special enforcement mechanisms into place, the SEC has not publicly proposed any changes to the antifraud provisions of the federal securities laws or SEC regulations tailored to this new form of fraud. To the contrary, the highest ranking SEC officials have taken the position that Internet fraud does not require the enactment of new statutes or the promulgation of new regulations. Former Director of the SEC Division of Enforcement Richard Walker stated that such fraud, although perpetrated through new means of electronic communication, is essentially of the same type as traditional securities fraud and can be prosecuted under existing laws and regulations. Former SEC Chairman Arthur Levitt compared the provisions of the federal securities laws to those of the U.S. Constitution in their ability to remain relevant in spite of societal change, concluding that it is unnecessary for the SEC "to pronounce a totally new and radical scheme of regulation specifically tailored to on-line investing."
This view cannot be maintained in the long-term because it fails to take into account the unique characteristics of the new communications medium that is the Internet. A complete overhaul may be unnecessary, but some revisions are critical. While the SEC's position on this matter may serve the agency's interests, its strategy makes for bad law, stretching existing provisions to reach these new cases by using flawed reasoning. A new approach that takes into account the differences between traditional securities transactions and those that take place in cyberspace needs to be devised and implemented.

Recent SEC enforcement actions involving Internet fraud involve a variety of fact patterns, but share certain common characteristics and can be categorized. One category involves so-called "cyberhype," including "pump and dump" schemes, in which the stock of small companies, often microcap stocks, are promoted for profit over the Internet through the use of unsolicited e-mail "spam," chat rooms, bulletin boards, investment websites, or investment newsletters. Such activity may involve fraud if the promoter makes material misrepresentations, fails to disclose its intention to dispose of its stock at a profit into the rising trading market that develops after such promoter's recommendation, or fails to disclose that it promoted the stock for compensation. This Article will focus on a recent case involving a subcategory of such scams, namely the use of investment websites and on-line investment newsletters to generate interest in a stock, as an example of the failure of pre-cyberspace law to adequately address the new world of online securities fraud. In the first and most widely-publicized action of this type, the SEC sued Yun Soo Oh Park, a/k/a Tokyo Joe ("Park" or "Tokyo Joe"), who operates a popular investment website called Tokyo Joe's Societe Anonyme ("S.A.") frequented by day traders.

6. Richard Walker has advocated using the enforcement process to combat Internet securities fraud on a case-by-case basis rather than adopting new regulations. His stated reasons include the ability to respond quickly to new types of fraud without the need for engaging in a lengthy rule-making, the dangers of promulgating rules that are both over-and under-inclusive, and the unwillingness to reopen issues resolved by the courts. Richard Walker, Regulation vs. Enforcement in an On-Line World, Speech to Bond Market Association (Oct. 25, 2000), at http://www.sec.gov/news/speech/spch413.htm (last visited May 31, 2002). It is also possible that the SEC prefers an ad hoc enforcement approach rather than promulgating rules, or seeking amendments to the statute, to avoid conflicts with industry groups opposed to new regulation.

7. SEC Chairman Harvey Pitt announced, prior to his confirmation, that he will undertake a broad review of federal securities laws to simplify and modernize them. He did not refer specifically to antifraud provisions relating to the Internet. See Shannon Murray, SEC Nominee Vows to Update Securities Law, at http://www.law.com (last visited May 31, 2002).

which was settled after pre-trial litigation, offers interesting insights into the legal theories used to support the SEC's enforcement proceedings in this area. This Article will argue that such theory, based upon the existing antifraud provisions of the securities laws, is inadequate to deal with this new type of securities fraud in a coherent manner. Revised measures that take into account the nature of cyberspace transactions are needed to ensure that the securities regulatory scheme provides greater certainty and adequate notice to market participants.

This paper is organized as follows. Part II examines the growing phenomenon of Internet securities fraud and the SEC enforcement program initiated to combat it. Part III critiques the Tokyo Joe enforcement action as an example of the confused jurisprudence that may develop when pre-cyberspace laws are used to prosecute alleged fraud involving Internet investment advisers and points out the need for reform. Part IV argues that securities fraud in cyberspace must be treated differently than securities fraud involving conventional communication media and proposes an alternative regulatory model for the new breed of online advisers that takes such differences into account.

II. THE RISE OF SECURITIES FRAUD ON THE INTERNET AND THE REGULATORY RESPONSE

A. The Impact of the Internet on the U.S. Securities Markets

The wedding of advances in information technology with the delivery of financial services is a marriage made in cyberheaven. The information superhighway called the Internet is ideally suited to facilitate the exchange of company, market, and product facts that form the lifeblood of the financial services industry.9 It does so with speed and accuracy, making available up-to-date, and in some cases, real-time information about the markets that, in the case of individual investors, would be otherwise unavailable or more difficult to obtain.10

9. An outgrowth of a communication and resource sharing instrument for advanced research scientists in government and academia called ARPANET, the Internet today is a decentralized network of computer networks that can be accessed by anyone with a computer terminal and an Internet service provider connection. See JOSEPH KIZZA, CIVILIZING THE INTERNET 1-13 (1998).

The use of information technology in the securities industry is pervasive. Issuers file required disclosures with securities regulators electronically and use the Internet to keep shareholders and potential investors informed about financial performance and recent developments. Investment advisers and broker-dealers are making required disclosures through electronic means also, as well as providing information about their services and investment information to customers through their own websites. The stock exchanges and the NASDAQ use electronic systems for order delivery and automatic quotation. In addition, both primary and secondary market transactions are moving online in rapidly increasing numbers. Securities offerings are taking place over the Internet. Many brokerage houses now offer on-line trading services for investors. While the statistics vary depending upon the source, there is a consensus that the use of the Internet in the securities industry is significant, especially in the area of retail brokerage transactions by individuals.


16. According to the SEC, more than one in three trades by retail investors took place online as of 1999. Unger Report, supra note 10, at 12. Former SEC Chairman Arthur Levitt reported to Congress that there will be close to 5.5 million domestic online brokerage accounts by the end of 2000 and 20 million are expected by 2003. SEC Chairman Arthur Levitt, Appropriations for Fiscal Year 2001, Testimony at the Senate Subcomm. on Commerce, Justice, State and the Judiciary,
While many praise the use of the new technology in the securities markets, securities regulators, like unwelcome wedding guests who step forward to explain why the bride and groom should not be joined together, have begun to voice their reservations. Many of the same characteristics that make the Internet a useful tool for providing information are problematic when viewed from the perspective of the agencies charged with enforcement of the antifraud provisions of the securities laws. Vast amounts of detailed information can be transferred rapidly to a huge international audience at very little cost to the sender.\footnote{Comm. on Appropriations, at http://www.sec.gov/news/testimony/ts052000.htm (last visited May 31, 2002) [hereinafter Levitt 2000 Testimony].} Information on the securities markets is disseminated over the Internet in several ways, including the use of web pages controlled by a single entity or individual and accessed by many readers; bulletin or message boards on which information may be posted anonymously by many individuals who have access to it; e-mail messages that can be sent to a wide audience on an anonymous basis; and so-called “push” technologies that disseminate information to individuals who are on-line without their having accessed a website or bulletin board devoted to securities markets.\footnote{See International Organisation of Securities Commissioners (“IOSCO”), Technical Committee, Report on Enforcement Issues Raised by the Increasing Use of Electronic Networks in the Securities and Futures Field, at http://www.iosco.org/docs-public/1997-report_on_enforcement_issues.html (last visited May 31, 2002) [hereinafter IOSCO 1997 Report]. As of 1997, IOSCO estimated that the Internet was being used by 50 million people in over 23 million households. Id. at 1.} While much of the information supplied stems from legitimate sources and is accurate, some of it does not and may be false or misleading. The technology is so cheap and easy to use that perpetrating a fraud can be a virtual cakewalk; even high school and university students have been prosecuted for committing stock frauds over the Internet.\footnote{Id. at 3-4.} Finally, the size of the potential audience for Internet frauds is much larger than those perpetrated through use of traditional communications media, thereby magnifying the impact of any particular fraudulent scheme.

Distinguishing fact from fiction in this environment is often difficult for recipients of electronic information over the Internet. This is attributable to at least three factors. First, there is no gatekeeper or other screening device available on the Internet to keep out false in-
formation about securities at the present time. Although Internet service providers, as the link between users and the Internet, have the ability to monitor both users and content, they do not verify the accuracy of the information that is being transmitted.  

Second, it may be difficult or impossible for the viewer to verify the identity or credentials of the sender. Internet users may employ various tools to conceal their identity and remain anonymous. These include use of a remailer site or anonymizer software that obscures the sender's identity by acting as a middleman. Other tools permit users to impersonate others and to alter or falsify e-mail messages. Use of such techniques means that the true identity of individuals or entities using the Internet may be masked and information transmitted by a single individual or entity can be retransmitted in a manner that makes it appear to emanate from several different sources. These features create special problems for enforcement agencies which are surmountable as long as the anonymous senders are traceable. Third, the sender may deliberately confuse the recipient by inserting a hyperlink to a legitimate source of information, such as a regulatory agency's web page or a well-known newspaper or news service, giving a fraudulent message the appearance of legitimacy. The risk that investors will be unable to spot scams over the Internet increases the likelihood that securities fraud will occur.

B. The SEC Enforcement Program for Internet Fraud

The SEC has recognized the importance of technology and taken steps to address the impact of the Internet on regulation of the securities markets. Most emphasis has been given to the problem of combating Internet fraud, a course of conduct identified as a high-level priority for the SEC by former SEC Chairman, Arthur Levitt. The antifraud program consists of two main elements: enforcement proceedings and investor education. Such activities are handled through the OIE, which administers the Enforcement Division's In-

20. See Coffee, supra note 1, at 1225-1227 (discussing the gatekeeper function and monitoring problem in this context and lack of legal obligations by online services to perform such monitoring).


22. Relevant considerations include whether data is maintained by service providers and whether regulators may compel discovery of such records under applicable rules. See id. at 7-8.

23. See id. at 5.


26. See id. at 4-5.
ternet program and coordinates the activities of the SEC "cyberforce," a group of some two hundred attorneys, accountants and investigators who conduct Internet surveillance.\textsuperscript{27} The OIE also runs an online complaint center for the Enforcement Division, which receives reports of Internet fraud from the public.\textsuperscript{28} Finally, the SEC staff has issued several investor bulletins warning of the pitfalls in on-line investing, day-trading, and microcap stock trading.\textsuperscript{29}

To date, the OIE has conducted five Internet fraud sweeps, which have resulted in more than 200 Internet-related enforcement actions, naming over 750 individuals and entities.\textsuperscript{30} These actions have involved several types of securities fraud, with some actions involving more than one type of offense. There are three main types of Internet securities fraud, namely market manipulation, including pump and dump schemes; offering frauds consisting of promises of high returns with no risk disclosure; and illegal touting.\textsuperscript{31}

All of these enforcement actions have been brought under existing securities statutes and regulations used as the basis for such enforcement proceedings. The SEC has neither amended nor sought to amend any antifraud provision or regulation using both fraud and market manipulation theories of liability. This is in marked contrast

to another area of securities regulation, namely the registration, filing, and disclosure requirements of the federal securities laws, where the SEC has amended certain regulations, among other regulatory actions, to take account of the distinct nature of the Internet. The SEC's approach to Internet fraud, however, fails to take into account the adequacy of existing laws to address the special problems associated with such fraud.

This approach is inconsistent in one important respect with the prevailing federal agency standards for approaching Internet fraud. The SEC participated in the Clinton Administration's Working Group on Unlawful Conduct on the Internet ("Internet Working Group"), which recommended a three part program for dealing with unlawful conduct on the Internet, namely 1) development of a regulatory policy framework that treats online conduct in a manner consistent with treatment of offline conduct and takes privacy and civil liberties concerns into account, 2) an emphasis on increased enforcement activities, and 3) a focus on investor education to prevent and minimize the risks of unlawful conduct. The SEC's program seems to comport with the second and third recommendations, but falls short with respect to the first recommendation. The Internet Working Group's report noted that if existing laws adequately cover unlawful conduct in the offline world, they should adequately cover unlawful conduct in cyberspace, although in some cases relevant federal laws may need to be amended to "better reflect the realities of new technologies, such as the Internet." As the next two sections of this Article will argue, Internet securities fraud is an area where changes are clearly needed.

The SEC approach also does not conform fully to the prevailing international standard for similar reasons. The SEC is a member of IOSCO, an international organization composed of securities regulators and self-regulatory organizations from approximately 100 countries, which has studied the issue of Internet securities activity extensively. It has developed five key principles that regulators should consider when formulating policies regarding Internet securities activities, including the principle that the fundamental policies

32. See SEC 1997 Report, supra note 24, at app. B.
34. See id. at 59.
underlying securities regulation—protection of investors, ensuring that markets are fair, efficient, and transparent, and reducing systemic risk—should also govern Internet-based activities. While IOSCO believes that the existing regulatory framework developed to help investors can generally be adapted to securities transactions over the Internet, it recommends that regulators review the existing framework to ensure there are no legislative or regulatory gaps. While the SEC takes the position that there are no gaps, the case of Tokyo Joe, the flamboyant king of the day traders, will be used to illustrate a flaw in the existing regulatory framework for Internet securities fraud.

III. THE CASE OF TOKYO JOE: WHY THE EXISTING REGULATORY FRAMEWORK DOES NOT WORK

When the SEC filed its complaint against Tokyo Joe and S.A. in the Federal District Court for the Northern District of Illinois in January 2000, the website had been in operation for only a year and a half, but had already attracted several thousand subscribers and Park had

36. The other four principles are the following: 1) regulators should not impede the legitimate uses of the Internet by market participants and markets, 2) regulators should strive for transparency and consistency in application of regulations; 3) regulators should cooperate with regulators in other jurisdictions; and 4) regulators should remain flexible in their approach because technology will continue to evolve. IOSCO 1998 Report, supra note 35, at 27-29.

37. See id. at 27.

collected over a million dollars in membership fees.  He began his
career as an online stock trading guru after posting e-mail messages
on bulletin boards run by Silicon Investor and Raging Bull. Investors
who were impressed by his postings began to contact him directly for
stock picks, which he initially made available for free via e-mails, but
later for fees that increased over time through his website.

Park’s website, then as now, has both a publicly accessible area
and a members-only area. The public area is directed towards recruit-
ing new subscribers and contains information about membership.
Members have access to a message board and receive multiple daily e-
mails from Park containing stock picks, market news, and trading
tips. They also have access to a chat room in which Park and mem-
bers discuss the markets and stocks they are currently trading, ex-
change trading techniques and receive real time investment advice
from Park regarding when to buy stocks. Park also posts some of his
stock picks on the public portion of his website as well as other public
Internet message boards. Neither Park nor S.A. has ever registered
as an investment adviser or broker-dealer.

The SEC alleged that Park had engaged in a scheme to defraud
S.A. members. Specifically, he engaged in an activity knows as “scalp-
ing,” in which he profited by purchasing stocks, issuing recommenda-
tions to buy to S.A. members, and then selling his stock into the
buying flurry resulting from trading activity of such members. He
failed to disclose his position in the stocks that he recommended and
his intent to sell while S.A. members bought and caused prices to rise.
He often issued limit orders within minutes of issuing a buy recom-
mandation to S.A. members. In addition, in order to attract S.A.
members he issued false performance results that included hypotheti-
cal trades he did not make, inaccurately reported his actual trades,
reported actual losses as winning trades, and failed to list all trades
and recommendations, including losing trades. Finally, the govern-
ment alleged Park engaged in “touting,” by recommending stock in ex-
change for receipt of stock or other compensation from the issuer,
information not disclosed to S.A. members. The SEC claimed that
Park had violated Section 10(b) of the Securities Exchange Act of 1934

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39. See Plaintiff’s Complaint at 1, United States Sec. and Exch. Comm. v. Gun Soo
Oh Park, a/k/a Tokyo Joe, and Tokyo Joe’s Societe Anonyme Corp., 99 F. Supp. 2d
889, (N.D. Ill. 2000) (No. 00C0049) [hereinafter Complaint].
40. See Stuart Bressman, SEC Goes After Guru “Tokyo Joe,” E-Securities, 2 No. 6
ESECURITY 1, (Feb. 2000).
41. See Complaint, supra note 39, at 6.
42. See id.; see also, Tokyo Joe’s Societe Anonyme, General Membership FAQ, at
43. See Complaint, supra note 39, at 7.
44. See id. at 7-12.
45. See id. at 12-14.
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(“1934 Act”) and Rule 10b-5 thereunder, Section 17(b) of the Securities Act of 1933 (“1933 Act”), with respect to the alleged touting activity only, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 (“Advisers Act”). The government sought a permanent injunction and ancillary relief in the form of disgorgement (plus interest) and civil money penalties.46

Unlike many of the other enforcement actions involving Internet securities fraud brought by the SEC, this case was not settled immediately. Instead, Park and S.A. moved to dismiss the complaint. With respect to the Advisers Act claims, they argued that such Act was inapplicable to them since neither was an “investment adviser,” not having given personalized investment advice to on-line subscribers.47 The defendants also argued that the antifraud provisions of such Act should not be applied because their rights under the First Amendment would be violated. With respect to the Section 10(b) and Rule 10b-5 claims under the 1934 Act relating to the alleged omissions of material fact only, the defendants argued that the SEC failed to allege a duty to disclose.48 They also argued that any misstatements made were not “in connection with” the purchase or sale of securities, a required element for a finding of liability, because they did not provide personalized investment advice.49 In addition, the defendants moved to dismiss the complaint in its entirety for failure to plead fraud with particularity as required by Rule 9(b) of the Federal Rules of Civil Procedure.50

The court denied Tokyo Joe’s motion.51 It held that the government had alleged facts sufficient to establish that the defendants were “investment advisers” under the Advisers Act and could be subject to the antifraud provisions of that Act without violating their rights under the First Amendment.52 Regarding the Section 10(b) and Rule 10b-5 material omissions claims, the court noted that, while an “investment adviser” may have an Advisers Act duty to disclose his scalping it is unclear whether this duty extends to 1934 Act disclosures, where a duty to disclose must stem from a relationship outside securities law.53 The court then found that Tokyo Joe may have had a duty

46. See id. at 17-18.
47. See Defendant’s Memorandum of Law in Support of Motion to Dismiss at 3, United States Sec. and Exch. Comm. v. Gun Soo Oh Park, 99 F. Supp. 2d 889 (N.D. Ill. 2000) (No. 00C 0049) [hereinafter Memorandum in Support of Motion to Dismiss].
48. See id. at 12.
49. See id. at 5.
50. See id. at 24.
52. See id.
53. See id.
to disclose his scalping activity because it is possible that he established a relationship of "trust and confidence" with users of his website through his daily communications with them.\textsuperscript{54} Finally, the court stated that the misstatements were "in connection with" the purchase or sale of securities because the defendant hyped the stock in anticipation of a price increase and there was a marked increase in activity of the shares thereafter.\textsuperscript{55} Moreover, the requirement was satisfied because it could be expected that the advisees would act on the advice and purchase shares.\textsuperscript{56}

The defendants appealed the decision, which was dismissed by the Federal Court of Appeals for the Seventh Circuit.\textsuperscript{57} In March of 2001, the defendants settled the case with the SEC by consenting to the entry of an order permanently enjoining them from violating the antifraud provisions of the federal securities laws and requiring disgorgement and payment of civil money penalties.\textsuperscript{58} In addition, the defendants agreed to post on their website a hyperlink to the court order for a period of thirty days.\textsuperscript{59}

Although the Tokyo Joe litigation did not result in a decision on the merits, and therefore no judicial opinion on the substance of the SEC's case, it does provide some insight into SEC policy on Internet fraud and the legal theories available under the current regulatory regime to support such an enforcement action. An examination of such theories reveals certain flaws, suggesting the need for legal reform.

A. Section 206(1) and (2) of the Advisers Act

Park has consistently taken the position that he is not an investment adviser under the Advisers Act and is therefore not required to register with the SEC. Posted on the Tokyo Joe website is extensive disclaimer language addressing just that issue, including statements that S.A. is not registered as an investment adviser or broker dealer, that all statements are opinions of Tokyo Joe and should not be viewed as solicitations to buy, sell, or hold, and that investors should not rely on information provided on the website, but should use such information merely as a "starting point" for doing their own re-

\textsuperscript{54} See id.
\textsuperscript{55} See id. at 1.
\textsuperscript{56} See id.
\textsuperscript{57} See N.D. Ill., Civil Docket for Case #00-CV-49, #49, United States Sec. and Exch. Comm. v. Gun Soo Oh Park, 99 F. Supp. 2d 889 (2000). The grounds for dismissal was lack of jurisdiction.
\textsuperscript{59} See id.
Moreover, the disclaimers include several statements disclosing the facts that Park and S.A. may be holding shares of stock prior to mentioning such stock on the website and intend to sell such shares, without further notice, if there is a sharp price rise. The website also states that Park does not hype stock over his website, but rather uses fundamental research analysis in making his picks.

However, based on the plain meaning of the definition in the Advisers Act, it is at least arguable that Tokyo Joe and S.A. are investment advisers. Any person who engages in the business of advising others, either in face to face conversations or through writings about the value of securities or the advisability of buying or selling them for compensation, or who issues analyses or reports concerning securities for compensation and as part of a regular business, is deemed an investment adviser and, as a consequence, is required to register with the SEC and becomes subject to the antifraud and regulatory provisions of the Advisers Act. Tokyo Joe, through his S.A. website, provides advice for a monthly fee to third parties as to the value of securities and as to the advisability of trading in such securities, both through the multiple e-mails that he sends to each client daily and through discussions in the chat room. The wrinkle, however, is that the advising took place in cyberspace and did not involve either face to face meetings or conventional forms of written communication.

Certain categories of persons are expressly excluded from the investment adviser definition, including banks, lawyers, accountants, engineers, teachers, broker-dealers, publishers of bona fide newspapers, news magazines, or financial publications of general and regular circulation, and persons advising on the value of government securities and certain exempt securities. Tokyo Joe does not appear to fall into any of the listed categories. Therefore, absent some other exclusion, Park and S.A. are subject to the Act.


61. Id.


65. The Advisers Act excludes certain categories of investment advisers from the registration requirements. Sections 203(b)(3) and 203A(a)(1)(A) are examples. The first such exclusion applies to any investment adviser who has advised fewer than fifteen clients within the past year and who does not hold herself out generally to the public as an investment adviser. It is unlikely that Park could fall within this exclusion because, through his popular website, he certainly advises far more than fifteen clients in any one year and holds himself out to the public generally as an investment adviser willing to serve anyone with a credit card number. The second exclusion applies to any investment adviser with less than $25,000,000 of assets under management who is regulated under the law of the
In the litigation, Park maintained that he and S.A. were not investment advisers because their advice over the Internet was impersonal and did not provide specific recommendations suitable to each subscribers' investment objectives. Park denied having any personal or professional relationship with anyone who subscribed to his website.\textsuperscript{66} In fact, at one point in a media interview, he explained his choice of the name S.A. by noting that, for the most part, "I don't know these people."\textsuperscript{67} According to the defendants, the Advisers Act was intended by Congress to regulate only those who were in a fiduciary relationship with others and not individuals furnishing investment advice solely by means of publications.\textsuperscript{68}

In the SEC's view, the defendants fell within the statutory definition of investment adviser, since they gave individualized investment advice for a fee through the e-mails sent to subscribers and through the chat room.\textsuperscript{69} Therefore, the defendants could only avoid application of the Advisers Act if they were able to establish that they fell within one of the categories of persons expressly excluded from the definition. The SEC argued that Park and S.A. did not fall within the publishers exclusion because their business did not consist of publication of a bona fide financial newsletter of general and regular circulation.\textsuperscript{70} The website was not bona fide because it allegedly contained both false and misleading statements and recommendations in which Park had a personal financial interest, since he would profit by selling into the rising market caused by his clients' buying activity. Furthermore, the website was not of general and regular circulation because recommendations were timed to specific market activity.

There are problems with the arguments of both sides in this case. On the one hand, Park and S.A. are incorrect in their assertion that their contacts with the subscribers were entirely impersonal. On the contrary, Park's subscribers probably felt an attachment to Park based on their frequent contact with him over the Internet. Indeed, they trusted him enough to subscribe to the S.A. website and to base their day trading decisions on Park's recommendations. It is highly
unlikely that they would have continued their subscriptions if they did not trust him.

On the other hand, the SEC is trying to enforce a provision of the Advisers Act that does not contemplate the use of computers and Internet connections for delivery of investment advice. The definition does not mention electronic means of communication and the status of persons who deliver investment advice through such means rather than in face to face conversations. With respect to the availability of the publishers exclusion, electronic publications are not covered at all; the types of financial publications contemplated by the drafters of that definition are produced using conventional print media, not electronic media. Two consequences flow from these deficiencies. First, it is unclear whether those who advise others solely through the Internet and never in geographic space, namely in meetings and through writings on paper, are covered by the definition. Second, if such persons are deemed covered by the definition, the availability of the publishers exclusion is also unclear, because Internet investment advisers operate in a paper free environment. An attempt to label an online stock picker an investment adviser under the Advisers Act would require using the process of reasoning by analogy, just as would an effort by the same person to claim the benefits of the publishers exclusion. As is apparent from the Tokyo Joe litigation, this exercise is conceptually difficult because, as discussed in Part IV, the online and offline worlds are fundamentally different. Park is somewhere in between the conventional investment adviser and the impersonal publisher. The difficulties in interpretation in this case arise in part because he represents a third category of persons who render advice about investing and is neither expressly covered nor excluded by the existing regulatory scheme.

Complicating the analysis is the Supreme Court's decision in Lowe v. SEC,\textsuperscript{71} which both sides in the Tokyo Joe litigation relied upon to support their respective positions. In that case, the SEC sought to permanently enjoin publication of financial newsletters by Lowe and several corporations he controlled, none of whom were registered as investment advisers. One of the corporations had previously been registered under the Advisers Act, but its registration had been revoked due to Lowe's state law convictions for serious misconduct relating to his investment advisory business. The newsletters in question were print publications and contained both general commentary about the securities markets, a discussion of market indicators and investment strategies, and specific recommendations for buying, selling, or holding stocks.\textsuperscript{72} The SEC contended that the Lowe group's publishing activities violated the order revoking the corporation's registration

\textsuperscript{72} See id. at 185.
and prohibiting Lowe from associating with any investment adviser. The defendants in Lowe argued that the registration requirement violated their First Amendment rights because it operated as a prior restraint on speech.

The Federal district court for the eastern district of New York denied the relief requested by the SEC and the Second Circuit reversed. Lowe and the other the defendants petitioned the Supreme Court for review, with the Court certifying the constitutional question of whether an injunction against the publication and distribution of Lowe's newsletters was prohibited by the First Amendment. The Supreme Court held that the publishers could not be permanently enjoined from publishing, with the majority opinion justifying its decision on statutory grounds. Justice Stevens reasoned that the publishers fell within the exclusion for bona fide publishers of newspapers of general and regular circulation and therefore were not investment advisers subject to the registration requirement. In construing the Advisers Act requirements, the majority distinguished between personal and impersonal investment advice, noting that this distinction was necessary to implement Congressional intent. According to the majority, the legislative history of the Advisers Act indicates that Congress intended to regulate the business of personalized investment advising, including the incidental activity of related publishing activities, but did not intend to regulate the press through the licensing of nonpenalized publishing activities. Such line drawing was necessary to accommodate the First Amendment concerns, according to the majority. By setting forth a statutory basis for its disposition of the case, the majority stated that it did not need to decide the constitutional issue.

In a concurring opinion, Justice White, joined by Justices Burger and Rehnquist, argued that the publishers were investment advisers but that the registration requirement as applied to these defendants was an unconstitutional prior restraint on speech. Justice White did not believe that application of the antifraud provisions of the Advisers Act requiring investment advisory publishers to disclose material facts, such as their scalping activity, raised the same serious First Amendment problems as the registration requirement. The Court has not revisited this issue since Lowe, and, therefore, the constitutional question of whether the investment adviser registration provisions of the Advisers Act constitute an invalid prior restraint is still open.

Lowe is viewed as preventing SEC enforcement actions seeking to require Advisers Act registration of publishers of investment newslet-

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73. See id. at 204, 207, 211.
74. See id.
75. See id. at 225.
ters. Prior to Lowe, the SEC had taken the position that the registration requirements and the antifraud provisions of the Advisers Act were applicable not just to those who gave personalized investment advice for a fee in face-to-face dealings with clients but also to those who rendered impersonal investment advice exclusively through investment advisory reports or newsletters. The federal courts concurred in such interpretation. Since Lowe, the SEC has ceased bringing registration enforcement actions against those who are publishers of such investment newsletters. In the Tokyo Joe litigation, the SEC sought only to enforce the antifraud provisions of the Advisers Act, ignoring the registration requirement completely, even though it is arguable that Tokyo Joe and S.A. should be required to register.

Lowe has been the subject of much commentary, none of which, however, is more insightful and cogent than Justice White's dissenting opinion. The majority opinion has muddied the waters surrounding investment adviser regulation because it appears to hold as a matter of law that, regardless of the text of the publishers exclusion in the definition of investment adviser, Congress intended to exclude all nonpersonalized publishing activities from the regulatory scope of the Advisers Act. This reading widens the scope of the publishers exclusion beyond the SEC's historic interpretation of that provision and appears to sweep in all publications. It does not give meaningful guidance as to whether a particular publication might fail to meet the bona fide and general and regular circulation standards.

In addition, the SEC's enforcement program for investment adviser fraud appears to be hampered as a result of Lowe. As Justice White noted in his concurrence, the majority's opinion presumptively overrules the Supreme Court's earlier decision in SEC v. Capital Gains Research Bureau, Inc. In that decision, the Court held that


77. See SEC v. Wall St. Transcript Corp., 422 F. 2d 1371, 1377-1379 (2d Cir. 1970) (stating that court will look at whether the objective was to assist subscribers in forming investment judgments and decisions and not only at whether publication exhibits purely formal indicia of a newspaper; bona fide determination requires differentiating between merchandising activities and publication of expression which is beyond the Advisers Act's regulatory purposes). The majority in Lowe criticized this decision as "recasting the statutory language without even mentioning the apparent intent of Congress to keep the Act free of constitutional infirmities." See Lowe, 472 U.S. at 207.


79. See Lowe, 472 U.S. at 204-208.

80. See id. at 224-226
scalping by the publisher of an investment newsletter offering only impersonal investment advice was actionable under the antifraud provisions of the Advisers Act. Because *Lowe* held that the Advisers Act was not intended to cover nonpersonalized investment advice, it can be argued that not just the registration provision, but also the antifraud provisions should not be applicable to such persons. *If Capital Gains* is no longer good law, it is arguable that the SEC can never prosecute publishers of investment newsletters under such antifraud provisions.

In *SEC v. Wall Street Publishing Institute, Inc.*, a case involving an unregistered investment adviser allegedly engaged in fraudulent activities in violation of the Advisers Act, the SEC took the position that *Lowe* does not preclude antifraud enforcement under the Advisers Act against non-bona fide investment newsletter publishers, such as those who are found to have violated Section 10(b) of the 1934 Act and Section 17(b) of the 1933 Act, and therefore not engaging in disinterested commentary. The court in that case never reached the merits of this argument. Since *Lowe*, however, other lower federal courts have weighed in on the question. An example is *SEC v. Suter*, a Seventh Circuit case in which Judge Posner dismissed an appeal of a district court ruling denying the lifting of injunctive relief under the Advisers Act based on fraudulent activity against a publisher of financial newsletters, relief that had been granted prior to *Lowe*. Judge Posner distinguished *Lowe* on the basis that the publisher in that case was engaged in publishing newsletters full time, did not trade in the securities discussed in the newsletter, and was not accused of violating the 1933 Act. He noted that "[a] person engaged in securities fraud cannot obtain immunity by the simple expedient of publishing an investment newsletter." *Suter* leaves open the possibility that a non-bona fide publisher of investment newsletters may not be covered by the ruling in *Lowe* with respect to fraud enforcement proceedings.

*Park* demonstrates once again the conceptual difficulties involved in determining whether advising activities fall within the Advisers Act regulatory structure. The issues that have been discussed arose in the context of advisers who claimed the benefit of the publishers exclusion based upon their use of print media to disseminate investment advice. Added to the preexisting lack of clarity in the definition

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84. See *SEC v. Suter*, 832 F.2d 988 (7th Cir. 1987).
85. See *id.* at 991.
of investment adviser are the additional problems that exist because of the use of the Internet as the medium of communication.

First, the definition of investment adviser does not encompass those who give only online advice, as opposed to those using face to face meetings or print publications. This was not viewed as a barrier in Park. However, it is a gap in the regulatory structure that needs to be filled. Second, it is unclear what type of publication qualifies for the publishers exclusion, whether online or offline. The SEC proposed a statutory amendment in 1986, which was intended to preserve its enforcement rights with respect to non-bona fide publishers. The amendment, which would have refined the publishers exclusion, was never adopted. The need is all the more pressing now because of the increased activity in advising activities over the Internet. Such an amendment, updated to include the Internet as a form of communication media, seems necessary in order to give market participants greater certainty and adequate notice of the regulatory effect of their actions, as well as furthering the SEC's goal of preserving its statutory mandate to enforce the Advisers Act.

Based on the current state of the law, the SEC's case against Tokyo Joe and S.A. was not watertight. While the SEC's complaint survived a motion to dismiss, Park might have been able to establish that he was not an investment adviser had the case been tried. Part IV of this Article will explore an alternative approach to the regulatory issue that takes into account the nature of investment advising in cyberspace and attempts to fill the gap left by existing law.

B. Section 10(b) and Rule 10b-5 of the 1934 Act

In addition to prosecuting Park's alleged scalping activity under the Advisers Act antifraud provisions, the SEC also claimed that such activity violated Section 10(b) of the 1934 Act and Rule 10b-5 thereof. The theory underlying this claim is that scalping is a form of insider trading activity. It involves a material omission of fact, namely that the alleged fraudster stands to gain from his recommen-

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86. The SEC's proposed text would have amended the definition to include all forms of communications media and to replace the publishers exclusion with an exclusion for newspaper publishers, radio and television station operators, or operators of other communications media that are not principally a vehicle for providing advice, analyses or reports on the value of securities or the advisability of investing in, purchasing or selling such securities. See Lee, supra note 76, at 549-550.

87. See Memorandum in Opposition to Motion to Dismiss, supra note 69, at 17-19. The SEC also claimed that defendants violated Section 10(b) and Rule 10b-5 based on alleged misrepresentations and half-truths. See id. at 16-17. However, those claims will not be addressed.
dation, which omission constitutes fraud under the statute and rule.\textsuperscript{88} The defendants argued that liability based on such a claim can be imposed only where a duty of disclosure exists.\textsuperscript{89} A duty to disclose arises only if the parties have a fiduciary or other similar relationship of trust and confidence. The defendants claimed that they owed no duty of disclosure to the S.A. subscribers because they were not in a fiduciary relationship with them.

Typically, scalping claims involve investment advisers and are prosecuted under the Advisers Act. In \textit{SEC v. Capital Gains Research Bureau Inc.}, the Supreme Court addressed the issue of whether failure to disclose scalping satisfied the fraud or deceit requirement of Section 206. The Court interpreted the provision liberally, taking into account the remedial purposes of the Advisers Act—fostering full disclosure and raising the level of business ethics in the securities industry—as well as the legislative history's characterization of investment as one of trust and confidence requiring strict limitations on the rights of advisers to engage in securities transactions that could conflict with their clients' interests.\textsuperscript{90} The Court held that failure to disclose scalping constituted fraud even in a case where no material misstatements were made.\textsuperscript{91}

The Supreme Court's reasoning in \textit{Capital Gains} suggests that undisclosed scalping could violate Rule 10b-5's prohibition against acts and practices that operate as a fraud or deceit.\textsuperscript{92} This reasoning was used by the court in \textit{Zweig v. Hearst Corporation},\textsuperscript{93} the leading case on the use of Rule 10b-5 to prosecute scalping. That case involved a financial columnist who bought stock at a discount price from the issuer shortly before publishing a buy recommendation in his column. The stock rapidly increased in value upon publication and the defendant sold part of his holdings at a profit. The court found the defendant had violated the rule because he used his column as part of a scheme to manipulate the market and deceive the investing public.\textsuperscript{94} The court's rationale was based upon the same type of duty analysis used by the Supreme Court in \textit{Capital Gains}, namely that the financial columnist in question had a duty to disclose his conflict of interest.

\textsuperscript{88} See Elliot J. Peskind, \textit{Regulation of the Financial Press: A New Dimension to Section 10(b) and Rule 10b-5}, 14 St. Louis Univ. L.J. 80, 89 (1969).

\textsuperscript{89} See Memorandum in Support of Motion to Dismiss, supra note 47, at 13-15. Defendants also claimed that their advice was not "in connection with the purchase or sale of a security," another requirement for a finding of fraud under Section 10(b) and Rule 10b-5. See id. at 16. However, that issue will not be addressed.


\textsuperscript{91} See id. at 196-197.

\textsuperscript{92} See id. at 194; see also Thomas L. Hazen, \textit{Law of Securities Regulation} § 10.9 (3d. ed. 1995).

\textsuperscript{93} See 594 F.2d 1261 (9th Cir. 1979).

\textsuperscript{94} See id. at 1271.
The breach of that duty constituted omission of a material fact in violation of Rule 10b-5.95

In Park, the SEC relied on Capital Gains and Zweig to establish that the defendants' failure to disclose their scalping activity violated Section 10(b) and Rule 10b-5. The defendants relied on the Supreme Court's decision in Chiarella v. United States.96 to call into question the duty analysis used in Zweig. Chiarella was not a scalping case but rather involved a criminal conviction under Section 10(b) and Rule 10b-5 of a financial printer who traded on inside information obtained in the course of his employment by buying stock of target companies that he knew to be the subject of impending tender offers and then selling his shares at a profit after the takeover became public information. The Supreme Court held that Chiarella could not be held liable based on the classic theory of insider trading. He had no affirmative disclosure duty to tell selling shareholders of the target company of the tender offer because he had had no prior dealings with them, was neither their agent or fiduciary and was not a person in whom they had placed trust and confidence but rather dealt with them only through impersonal market transactions.97 Chiarella stands for the proposition that there can be no finding of fraud in a material omissions case absent a duty to speak and such duty only arises when one party has information that the other party is entitled to know because of a fiduciary or other similar relationship of trust and confidence between them.98

The continued vitality of Zweig given the Supreme Court's decision in Chiarella is questionable.99 The Supreme Court has never held that scalping is actionable under Section 10(b) and Rule 10b-5. However, in Lowe, Justice Stevens noted, in discussing Justice White's discussion of the majority decision's implicit overruling of Capital Gains, that other federal statutes including Section 10(b) and Rule 10b-5 and the mail fraud statute, are available to prosecute scalping claims, in addition to the antifraud provisions of the Advisers Act.100

In one post-Chiarella case, a lower federal court accepted the use of Section 10(b) and Rule 10b-5 to prosecute scalping violations by an investment adviser. In SEC v Blavin, a federal district court found a violation of Rule 10b-5 where a publisher of financial newsletters recommending the purchase and sale of securities, who the court found to be an investment adviser who was unregistered in violation of the Advisers Act, failed to disclose scalping activity and also allegedly made

95. See id. at 1268.
97. See id. at 232-33.
98. See id. at 235, 228.
99. See Loss & SELIGMAN, supra note 82, at 3648-3653.
100. See Lowe, 472 U.S. at 209 n.56.
various material misstatements in such newsletters. This leaves open the possibility that the use of Rule 10b-5 for scalping violations is a viable theory, at least in some federal circuits, for those who owe fiduciary duties due to their status as investment advisers.

Given the current state of the legal doctrine in this area, the Section 10(b) and Rule 10b-5 claim against Tokyo Joe and S.A. could have succeeded only if the SEC had been able to establish that such defendants stood in a fiduciary relationship to the S.A. subscribers. Even if Zweig did survive Chiarella, an argument made by the SEC that the district court in Park accepted, Zweig standing by itself seems inappropriate to Park for it involved impersonal financial publications, a status that Park and S.A. would have great difficulty establishing. Blavin holds, however, that such a cause of action may be maintained even after Chiarella if fiduciary duties like those owed by an investment adviser can be found. Part IV of this Article will propose an alternative theory on which the requisite finding of fiduciary duty on the part of Park might be based.

Even if the duty analysis suggested by the preceding discussion is not viable, the misappropriation theory may be available for cases like Park. In Carpenter v. U.S., the Supreme Court upheld the conviction of R. Foster Winans, a Wall Street Journal reporter who traded in advance of recommendations made in his Heard on the Street column, and a group of co-conspirators, for violations of the federal wire fraud statute and Rule 10b-5. The Second Circuit upheld the convictions under Rule 10b-5 based upon the misappropriation theory of insider trading. An evenly divided Supreme Court affirmed the convictions under Rule 10b-5 without opinion. Any doubts about the availability of the misappropriation theory for scalping violations due to the failure of a majority of the Court to affirm on that basis may

101. See SEC v. Blavin, 557 F. Supp. 1304, 1311 (E.D. Mich. 1983), aff'd 760 F.2d 706 (6th Cir. 1985); see also Laird v. Integrated Resources, Inc., 897 F.2d 826, 833 (1990) (acknowledging that an investment adviser was a fiduciary who is required to disclose conflicts of interest for the purpose of assessing liability under Rule 10b-5).

102. The misappropriation theory extends liability under Section 10(b) and Rule 10b-5 to persons who are not covered under the so-called classic theory, which is premised upon the existence of a fiduciary relationship with the company whose shares are being traded. It is premised upon obtaining an informational advantage obtained through unlawful means, including outright theft or use of information for personal advantage that was supplied for business use only. The misappropriator is deemed to have breached a duty to the source of the information. Identified by Justice Burger in his dissent in Chiarella, the theory was later accepted by the Supreme Court in United States v. O'Hagan. See Loss & SELIGMAN, supra note 82, vol. VIII at 3631-3653.


104. See Carpenter, 791 F.2d 1024, 1026 (2d Cir. 1986).

be overcome by the Supreme Court's later acceptance of the misappropriation theory in the context of insider trading violations in United States v. O'Hagan.\textsuperscript{106} However, there is some question as to whether this theory could be applied to an Internet website operator that is itself the source of the published information. Unlike Carpenter, who was deemed to have misappropriated inside information regarding the contents of an upcoming column from the newspaper publisher itself, Park and S.A. cannot be said to have misappropriated the information from another party.

\textbf{IV. AN ALTERNATIVE APPROACH TO THE REGULATORY ISSUE}

The legal problems identified in the prior section—namely the doubtful applicability of Section 206 of the Advisers Act and Section 10(b) and Rule 10b-5 of the 1934 Act to the scalping activity of Tokyo Joe and S.A.—turn on the issue of whether fiduciary duties can arise in cyberspace. In the case of the Advisers Act, the antifraud provisions apply only to those deemed investment advisers. The personalized, face-to-face nature of the conventional investment advisory relationship has been characterized as fiduciary in nature, and the failure to disclose scalping activity as a breach of duties arising in that context. In the case of Section 10(b) and Rule 10b-5 of the 1934 Act as applied to scalping activities, which involve omissions of material fact, it is necessary to find a fiduciary duty to speak before remaining silent constitutes fraud.

Based upon the Conventions of the pre-cyberspace world, in which human relationships develop over time through repeated contacts in geographic space, it is doubtful that Tokyo Joe and S.A. owed fiduciary duties to their subscribers because their relationship did not arise in geographic space. However, it may be possible to develop a conceptual framework that could support the existence of fiduciary duties in cyberspace. Such a framework might serve as an alternative basis for a finding of fraud liability in cases like the Tokyo Joe litigation. In order to do this, it becomes necessary to examine the nature of human interactions over the Internet.

Such an inquiry must begin by viewing the Internet as not simply a tool for information gathering, but as an environment.\textsuperscript{107} It presents a new context for human interaction separate and distinct from geographic space. If the Internet is approached from this broader perspective, one can begin to reconceptualize the nature of human relationships in the context of cyberspace. Such reconceptualization can lead one to conclude that it is possible to develop a rela-

\textsuperscript{107} See M. Ethan Katsh, Law in a Digital World 115, 118 (1995).
tionship with someone over the Internet. We have all heard stories about people developing close personal friendships, even falling in love, through e-mail exchanges or through conversations in a chat room. We also know that many business transactions, from electronic banking to sales of products to securities trading, take place over Internet websites on a daily basis. Each of these interactions, to a greater or lesser extent, is based on the concept of trust. Given the right set of circumstances, including frequent and successful contact over an extended period of time, it is not too far a stretch to imagine that use of an Internet website, like S.A. in the Park case, could give rise to a fiduciary duty of good faith and fair dealing on the part of the website operator.

A number of commentators have suggested that virtual communities exist in cyberspace. A virtual or online community has been described as a gathering place for a new form of social interaction in which people form bonds based on common interests rather than geographic proximity. The exact nature of such communities has not been established, but some broad concepts can be drawn from the available literature. First, virtual communities are characterized by their interactive nature. Internet users not only receive information but give up information. It is this key feature of the new medium that makes the Internet a communication tool, permitting users to exchange information and viewpoints. In fact, it is the human need for interaction with others with shared interests that forms the basis for online communities. Far from being a medium that fosters anonymity, the Internet fosters the formation of social communities that share some of the same characteristics as communities based on physical proximity.

Second, virtual communities give rise to feelings of trust and commitment among its members. This characteristic is the glue that holds virtual communities together and keeps its members coming back for more. The importance of trust in the virtual community has been recognized in both the commercial and noncommercial context.
While virtual communities initially arose in a noncommercial context, the concept of a commercial online community has been identified and discussed in both business and commercial law literature. In a study of Internet marketing, Hagel and Armstrong identified five defining elements of virtual communities in the business context: 1) a distinctive focus; 2) the provision of a broad range of published content combined with communication capacity of such content by members through bulletin boards, real-time chat rooms, and e-mails; 3) opportunities for exchange of member-generated content; 4) the provision of access to competing publishers and vendors; and 5) organization as a profit-making commercial enterprise. According to Hagel and Armstrong, it is this profit incentive that will shape the evolution of virtual communities by members rewarding organizers of virtual communities that deliver attractive financial returns. Regarding the second element, Hagel and Armstrong suggest that there are certain duties that are owed by the organizer to the members—namely commitment to quality content by organizer prescreening and organizing information and certification of authenticity and qualifications of members providing such information. Hagel and Armstrong argue that the profit motive will create new forms of virtual communities whose strong commercial element will enhance and expand the basic requirements of community—trust and commitment.

In the Park case, it is arguable that the S.A. website gave rise to formation of a commercial virtual community composed of day traders. Four of the indicia of a commercial online community outlined by Hagel and Armstrong can be identified in the operation of the S.A. website, namely a focus on the highly particularized activity of day trading, the provision a broad range of information regarding both trading opportunities and strategies combined with an opportunity for member discussions of such content among each other and with Park through the chat room, opportunities for members to express their views not only in the chat room but also through use of the bulletin board, and organization as a profit-making venture. Only the element of affording access to competing providers of such services is not present. This fact does not undermine the analysis because Hagel and Armstrong note that not all five indicia need to be present to form a virtual community, although the greater the number of indicia present, the more a community will thrive.

114. See Cliff Allen et al., supra note 111; Hagel & Armstrong, supra note 112; Frankel, supra note 113.
115. See Hagel & Armstrong, supra note 112, at 8-10.
116. See id. at 9.
117. See id. at 29.
118. See id. at xi.
The implication of a finding that a virtual community arose is the recognition that the members and Park developed personalized relationships giving rise to feelings of trust and commitment. While Park maintained in the litigation that he gave no personalized advice tailored to specific individuals or their portfolios, such testimony is contradicted by the fact that all members of the community by definition had similar trading objectives and interests. If a virtual community characterized by trust and commitment did exist, one can argue that Park owed a type of fiduciary duty to the S.A. subscribers. Hagel and Armstrong suggest that organizers of an online community owe a duty to the members to guarantee quality content. Applying that principle to the context of the S.A. community, Park could be said to have a duty to refrain from distributing content tainted by his own conflict of interest, namely engaging in scalping without specific disclosures of his interest in a particular stock at the time of making a recommendation.

Such an analysis solves two conceptual problems involving the Advisers Act raised in the Tokyo Joe litigation. First, it clarifies the status of Park and S.A. as investment advisers. While he did in a sense “publish” his opinions, as well as other more generic information on trading strategies, over the Internet, he cannot claim to be a publisher of a bona fide financial publication of general and regular circulation. He gave personalized advice specifically tailored to the needs of the day traders who subscribed to the S.A. website. In addition, if one can conclude that as an organizer of a virtual community he owed certain duties to its members, one can further conclude that through his scalping activity he breached that duty, thereby giving rise to possible fraud liability under Section 206 of the Advisers Act. In addition, under Section 10(b) and Rule 10b-5, he can be said to have breached his duties to disclose his scalping as well, duties that stem from his fiduciary relationship with his subscribers.

Park’s own characterization of his relationship with his subscribers is based upon a world view that does not hold true in cyberspace. He appears to view distribution of content over the Internet as the equivalent of print publishing, which it is not. He is certainly not an investment adviser in the conventional sense because he does not hold face-to-face meetings with clients in the sense of being in physical proximity with them. However, he does meet with them daily in cyberspace through a combination of his e-mails, chat room conversations, and bulletin board postings. Indeed, it is highly likely that he had more personal contact with customers than do many registered and regulated investment advisers. Park was wrong to name his website Societe Anonyme; he should have called it Societe Intime.

The analysis set forth is not the end of the inquiry, but rather the beginning of a new way of looking at online investment advisory relationships. Additional work will need to be undertaken in order to clar-
ify whether this new look is valid and how it works in individual cases. One view of how online communities arise is presented, but there may be other, alternative views that need to be explored. The conditions under which fiduciary duties arise in cyberspace, as well as the nature and extent of such duties, could be further refined. Whether this framework can be extended to other cyberspace contexts impacting securities regulation is another possible avenue for further inquiry. Finally, there is the question of how the courts will respond. The concept of a virtual community as the basis for legal liability is not yet established in our jurisprudence, but perhaps its day will come.

There are, no doubt, other possible solutions to the regulatory issue raised in this Article and to the problem of Internet fraud generally. Some commentators have floated such ideas already. John Coffee has raised the possibility of imposing a gatekeeper function on operators of chat rooms where fraudulent statements are sometimes posted and acted upon by investors. Such gatekeepers, who include the major online service providers who sponsor such chat rooms, might be charged with the responsibility of deleting postings sent by anonymous remailers. David Johnson and David Post have suggested that members of an online community as well as service providers, both of whom have an interest in preserving the safety and integrity of cyberspace, could play a regulatory role by developing a self-governance system. I will leave these solutions to be addressed on another occasion, along with other proposals on combating Internet securities fraud that no doubt will be developed as we continue our travels through this new place called cyberspace.

119. Coffee, supra note 1, at 1226.