

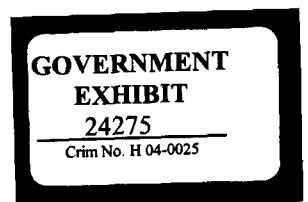
CONFIDENTIAL

Panel on Investor Information

PROPOSED DRAFT OF REPORT

November 14, 2000

To panel members: This draft is for discussion. It is an attempt to summarize what we think we have heard from the panel members. It does not purport to reflect your collective view until you have reviewed and agreed with it.



EXECUTIVE SUMMARY¹

This report represents the findings of a panel established at the suggestion of the Securities and Exchange Commission because of its concerns about the ability of investors to adequately value companies in the "New Economy." While not experts, the panel members are individuals with significant experience as senior corporate executives, investment bankers, venture capitalists, and academics.

The primary objectives of the panel were to determine ~~(1)~~ whether current company disclosure provides members of the investment community with the information they need to assess company value and ~~(2)~~ what, if anything, the government and business organizations should do to improve company disclosures. In the course of exploring these topics, the panel also addressed a third issue: ~~(3)~~ the impact of disclosure on two specific concerns about the market, its recent extreme volatility and the lack of a level playing field between large and small investors.

As the panel discussed these issues, we agreed upon a common frame of reference that helped us in developing our conclusions. In looking at question one, we agreed that the fundamental drivers of value in the new economy remain a company's potential to generate profits and cash flow. While assessing profit and cash flow potential is much harder today as technological change creates new business models and new winners and losers at a breathtaking pace, investors still must ultimately assess these core drivers of value. With regard to question two, we agreed during this period of rapid change and high uncertainty, prescriptive disclosure regulations can have more unintended and undesirable side effects than during stable times. Accordingly, the panel believes that a better approach to facilitating disclosure improvements is the creation of an environment that makes it easier for companies to disclose more without undue concern about legal risks.

With these perspectives in mind and based on our analysis and discussions, we concluded the following:

1. Currently, investors do not have all the information they ultimately need to value very high growth companies. The current formal reporting system (GAAP and SEC disclosures) was designed primarily to record historical financial transactions and is limited to a narrow range of relevant information. In particular, this system does not provide guidance about reporting intangible assets, which are so critical in evaluating Internet companies and other high growth companies. These intangible assets range from easy to identify assets such as technologies and brand names to less defined intangibles such as business processes and customer relationships.

¹ For the final version of this document, we will work with one or more lawyers to ensure that references to legal issues are properly stated. We will also have the text reviewed by a professional editor.

Some companies have voluntarily provided supplemental information to help investors, but these efforts vary widely in quality and uniformity.

2. One of the principal barriers to moving forward with better reporting is the absence of a framework or language for supplemental reporting that could be immediately implemented. Many academics and practitioners have proposed new frameworks or partial solutions, but none has gained clear acceptance by the financial and business community. With this limitation in mind, the panel believes that the best way to address the situation is a two pronged approach:

- Recognizing that economic change and uncertainty will not go away soon and that it will probably take time for a new disclosure framework to be developed and adopted, the government should seek to achieve a better balance between the need to protect investors from false and misleading disclosures and the need to encourage innovative communications by companies. One way to improve this balance is to significantly expand the safe harbor provisions for most disclosures of non-financial information. Furthermore, the SEC can facilitate well-intentioned experimentation by carefully choosing its enforcement stance.
- For the longer term, the panel encourages the establishment of a formal effort to develop a systematic approach to supplemental disclosures, particularly around intangible assets and related operating metrics. The effort should involve the SEC, the FASB, the AICPA and the accounting firms, as well as investors, academics and key industry groups. The panel does not envision a wholesale replacement of GAAP, but rather a coherent framework and language for supplemental disclosures to help investors assess the future profit and cash flow potential of companies. The panel is wary of lots of little changes to current reporting requirements that could cause more harm than good. Accordingly, we should not jump to interim solutions that are not complete and thoroughly syndicated.

3. Improved reporting, while helping investors value companies will not eliminate market volatility (although some reduction may be achieved), nor will it level the playing field between large institutional investors and small individual investors. The reason that improved reporting does not solve these issues is largely because company reporting is only one of many factors that influence these particular market characteristics. For example, in the current environment, a high level of uncertainty about future company performance will remain even if investors know more of what managers know. This uncertainty will drive volatility regardless of what companies report to investors.

In addition to the conclusions and recommendations above, the panel discussed a number of other ideas related to company reporting. In summary, the panel favored more use of the Internet to communicate with investors. We debated the idea of third party verification of non-financial disclosures, but ultimately concluded that the difficulties and substantial costs of third party verification would not outweigh the

- expanding safe harbor
- change GAAP
add the bells
& whistles

relatively small improvements expected. We also discussed ideas such as additional disclosures about management and founding investors, but did not achieve consensus.

BACKGROUND

This report represents the findings of an independent panel that examined whether the needs of the investment community, in valuing “new economy” companies, are being adequately met by the current disclosures of these companies. The panel was organized at the suggestion of the chairman of the SEC, Arthur Levitt, but has operated entirely independent of the SEC.

The primary objectives of the panel were to determine

1. Whether current company disclosure provides members of the investment community with the information they need to assess company value.
2. What, if anything, the government and business organizations should do to improve company disclosures.

In addition to these questions, the panel also discussed two additional concerns that were raised during the establishment of this panel: specifically, the extreme volatility in the stock markets in 1999 and 2000, and the perception that, at a time when many more Americans were participating in the stock market, there was not a level playing field between big and small investors. Accordingly, the panel assessed whether improved disclosure by companies would have an impact on volatility and a leveling of the playing field.

The panel members are not technical experts. They are individuals with significant experience as senior corporate executives, investment bankers, venture capitalists, and academics. (See Appendix A for a complete list of panel members.) As a result, our recommendations are written to provide directional guidance. They are not detailed proposals. In addition, Appendix B includes the individual views of some panel members on topics that the entire panel did not take a position.

The panel also recognizes that many other groups are examining issues related to valuation in the current economic environment. For example, several of the large accounting firms and a number of academics are looking at the valuation of intangibles. Other groups like the FASB are focused on accounting issues such as revenue recognition, accounting for business combinations, and accounting for employee stock options.

While our discussions focused on Internet related companies, we believe that the distinction between these and other companies as regards to investor information is increasingly be blurred. Therefore, our recommendations apply equally to all companies.

This is a [preliminary/final] report. It is a reflection of three meetings of the group, a number of smaller informal discussions, plus several consultations with legal and accounting experts. It will be widely distributed to relevant institutions such as the SEC, FASB, NASD, the stock exchanges, and the major accounting firms.

[Furthermore it will be posted on the web site, xxx.org. We welcome comments from all interested parties by xxx, xx 2000. We will issue a final report, taking into consideration comments received, by xxx xx, 2000.]

CONCLUSIONS BASED ON COMMON FRAME OF REFERENCE

In exploring the issues, we agreed upon a common frame of reference that helped us in developing our conclusions. In particular, we agreed on the following:

- ¶ With regard to the first question about whether investors have the information they need to value companies, we believe that answering the question requires a common framework for understanding what drives the value of a company. The panel agreed that the fundamental drivers of value in the new economy remain a company's potential to generate profits and cash flow
- ¶ With regard to question two about actions that the government and business should take, we discussed the pros and cons of regulation in general. We agreed that during this period of rapid change and high uncertainty, prescriptive disclosure regulations can have more unintended and undesirable side effects than during stable times. Accordingly, the panel took the position that a better approach to facilitating disclosure improvements is the creation of an environment that makes it easier for companies to disclose more without undue concern about legal risks.

Value Ultimately Will Reflect Potential to Generate Profits and Cash Flow

We are living in a unique time where rapid technological innovation is changing our world. In the past, technological change often led to improved productivity or a small number of new products. Today, the Internet is fundamentally changing the way businesses interact with consumers and each other. There is no doubt that these changes will lead to substantial value creation for the economy as a whole, but there is tremendous uncertainty about which business models and companies will succeed and how value will be distributed between businesses and consumers. This uncertainty makes it extraordinarily difficult to measure the value of companies and has led to unprecedented high levels of volatility in the stock market. (See Appendix C for a more detailed discussion of the changes in the economic environment.)

The uncertainty about consumer behavior, technology, and competitive dynamics is naturally reflected in the record high levels of volatility in the stock market, particularly the NASDAQ. The Wall Street Journal noted that before 1998, there had never been a year where the NASDAQ index had more than 10 trading days when it went up or down more than 2%. Yet in 1999, the NASDAQ index experienced 25 days where it went up or down more than 2% and in the first 8 months of 2000, the index experienced over 90 such days.

In this uncertain environment, it appears that the stock market may have initially overvalued emerging companies in the Internet market. It was hard, with even the most optimistic outlook, to rationally explain the valuations of many Internet companies during late 1999 and early 2000. As of November 2000, the values of many of these companies have declined to only 10% to 30% of their highs. This suggests that, as in past waves of investor euphoria, the valuation of these companies will ultimately reflect their potential to generate earnings and cash flows. There have been many explanations for this “irrationality” in the market.

- ¶ Some observers point to the emergence of unsophisticated individual investors, particularly day traders, as trading became very inexpensive, and the amount of investment information available on the Internet exploded. It can be argued that these traders are generating tremendous trading volume leading to unrealistically high prices.
- ¶ Others cite the imbalance between the supply and demand for shares of Internet companies. Many companies have gone public with less than 20% of their shares available to outside investors. Many investors wanted to buy these shares but the supply was artificially limited.
- ¶ Some blame the securities analysts at investment banks. They argue that the analysts’ objectivity may have been compromised by their need to support the investment banking side of their firms.
- ¶ Finally, some blame a general speculative fever.

These explanations might hold some truth. History suggests, however, that we should not be surprised by episodes of market “irrationality”. One of the most recent experiences was the biotechnology bubble in 19xx. Japan experienced its major bubble in the late 1980s and early 1990s. As always, fundamental economics prevailed in the end.

Supportive Environment Best Way to Ensure Quality Disclosure

Prescriptive regulation of disclosures often have unintended side effects. This is particularly true in this period of rapid change, challenging the traditional regulatory approach to keep pace. The panel believes that a better approach to encouraging and facilitating disclosure is the creation of an environment that makes it easier for companies to disclose more with undue concern about legal risks

Managers have strong incentives to maximize their company’s share price, which means competing not only for customers but also for investors. As a result, investors and professional analysts have considerable influence on what companies disclose. Analysts also have strong incentives to search out information to get an edge for their clients. This interaction creates a powerful market for information about companies.

In today's legal environment, however, companies often are advised against what might be useful disclosures for fear of lawsuits. As a result, companies hold back disclosures or they provide useless boilerplate disclosures. For example, it is not uncommon now for the risk factor section of IPO prospectuses to include more than 10 (check) pages of every imaginable risk, typically building on what other companies have disclosed, rather than focusing on the key issues facing the company.

Clearly, the legal framework should protect investors against fraud, but there needs to be a balance between protecting investors from the small number of companies that will deliberately mislead investors and the benefits to most investors and companies from improved disclosure. It appears to many panel members that right now the system is not balanced and that it creates risks for companies seeking to communicate honestly with investors.

CURRENT REPORTING PRACTICES NOT ADEQUATE

The first question the panel addressed was whether current company disclosure practices provide the investment community with the information they need to assess company value. We concluded that currently, investors do not have all the information they need to value companies. In particular, current reporting rules do not provide guidance about reporting the creation of intangibles assets, which, today, are so critical in evaluating both Internet companies and traditional companies. Some companies have made significant progress in voluntarily providing supplemental information to help investors, but these vary widely in quality and uniformity.

Gaps in Current Reporting System

The current financial reporting system, as mandated by the SEC and FASB, was designed to accurately report historical financial transactions. In today's world, the importance of historical financial performance has diminished. As we argued earlier, a company's value is driven by its ability to generate profits and cash flows over the long term. It used to be that historical financial performance was a reasonably good indicator of future profits and cash flows. Investors could build their expectations off of historical financial performance, supplemented by information about the quality of management and the future competitive landscape of the industry. This is impossible today when technology is creating new markets and new business models at lightning speed, when companies are going public before they have a track record, when business models based on quickly winning market share before achieving profitability are becoming increasingly common.

To illustrate some of the gaps in the current reporting system, let us describe a simplified model of how companies create value. Value creation can be modeled in three stages:

1. A company creates or purchases the tangible and intangible assets that it needs to create and sell its products and generate profits. Intangible assets include brands, technologies, business processes, customer and supplier relationships and organizational capabilities. Tangible assets include factories and inventories.
2. A company then converts its tangible and intangible assets into products and services that it sells to its customers. It begins to develop customer relationships and takes market share from other companies (or develops a new market if the product is new).
3. The sales of these products and services are ultimately converted into a stream of profits and cash flows.

For mature companies, the current levels of profits and cash flows are often good indicators of how a company is performing in terms of intangibles and products. Investors can often take short cuts in assessing long-term profits and cash flows, by looking primarily current profits and cash flows. Many fast growing companies haven't yet reached a level of maturity where there are any profits or cash flows to be reported, however. Some of them may not even have reached stage 2 yet, where they can report sales of real products or services.

We will use a simplified example of an Internet retailer to describe how this might work for a young, fast growing company. In stage 1, the retailer invests in intangible assets--building its brand, acquiring customers, developing its supply chain, and perfecting its product offering (both its products and the overall customer experience). During this stage, the company has only cash outflows, no inflows. In stage 2, the retailer goes on-line, selling its products to the public. During this stage, the retailer will also probably continue to invest in strengthening its intangible assets. The company's income statement reports losses, however, partly because it has not yet reached the scale necessary to compete effectively, partly because it is still experimenting with its business model and partly because its continued investments in intangibles are accounted for as expenses. In stage 3, profits and cash flow turn positive as growth slows and the need for investments relative to operating profits declines.

To assess the value of this retailer, an investor needs to estimate how much revenue, profit and cash flow the company might be able to earn in the future when it becomes relatively mature and stable (say 5 to 15 years out). Let's focus on revenues for this example. Regardless of what stage the retailer is in, the investor needs to estimate the potential size of market the company is pursuing and the company's potential market share. For a stage 3 company, the current size of the market and retailer's current market share might be reasonable starting points to develop future estimates.

For a stage 2 company, the current size of the market and current market share might not be that relevant. The investor probably needs to look to operating measures such as the number of visitors to the retailer's web site (indicating brand strength), how many visitors make purchases (indicating the attractiveness of the product offering) and how

many customers make repeat purchases (effective is the total customer experience). The investors can use the company's performance on these measures to develop its judgment on the retailer's long term potential.

For a stage 1 company, investors need to rely on more qualitative assessments of intangible assets when forecasting future market share. For example, they might assess brand awareness, the logic of the product offering, the skill and experience of the management team, innovative aspects of the business system.

Of course, investors will be more uncertain about the performance of a stage 1 company than a stage 2 company. Investors may make adjustments for this uncertainty, but in the end, investors still need to get some sense of revenues, profits and cash flow.

The current reporting system works best for stage 3 companies, which is what it was designed for. Until recently, most public companies were stage 3 companies. Now that there are so many listed stage 1 and 2 companies, investors need stage 1 and 2 type information, specifically, they need information about the intangible assets of the company and operational metrics (like number of site visitors, number of repeat customers) to help with their assessment. Current reporting rules do not provide any guidance about this type of information.

Voluntary Supplemental Disclosures Are Not Adequate

Of course, companies voluntarily provide supplemental information to investors to help them assess the value of their company. This information is provided in annual and quarterly reports, press releases, analyst presentations and conference calls. Companies in many industries, not just internet companies, are responding to investor demands for more information that will help them assess the value of companies. A group led by the FASB will issue a report in 2001 that documents many of the voluntary disclosures made by companies in x different industries.

There are many examples in the Internet world where companies provide substantial non-financial information to help investors understand their potential for long term revenues and profits:

- ¶ Amazon.com releases figures for how many new customers it added in the last quarter, number of unique visitors, what percent of customers were repeat buyers, how many new "stores" it opened, and what new partnerships it has formed.
- ¶ E-bay, the on-line auction house releases figures for total transaction volume, number of auctions hosted, and average transaction size.
- ¶ E-trade, the on-line broker, releases figures for new accounts, acquisition costs per account, average number of transactions per day, page views, size of assets held in customer accounts.

These voluntary disclosures tend to evolve over time as companies and investors learn from each other what is important for valuation. A good example of this evolutionary process is the pharmaceutical industry. [This will be filled in with a paragraph based on case material received from David Shedlarz.]

Why should companies voluntarily provide this information? CEOs want a high share value. A higher share value leads to better compensation, higher values for their share options, better press coverage and more flexibility to build their business. So companies compete for investors just like they compete for customers. If a company has a good story to tell, it's to their benefit to provide investors with the data to support their story. Investors, on the other hand, are suspicious of companies that are unwilling to provide adequate data. The logical conclusion is that tight-lipped companies must be hiding some bad news (although in some cases competitive issues favor secrecy).

While applauding the voluntary reporting of supplemental information, the panel believes that these practices are not as consistent and rigorous as they could be. Companies can selectively decide to disclose only information that paints them in a favorable light. They can change the information they report from one period to the next. Companies are not always clear about how they define and calculate these supplemental measures. Finally, disclosures about intangible assets are spotty at best.

RECOMMENDATIONS

One of the principal barriers to moving forward with better reporting is the absence of a framework or language for supplemental reporting that could be immediately implemented. This problem is well recognized. Academics, the accounting firms and other organizations have begun to tackle the problem, but no approach has gained widespread acceptance. Furthermore, there has not been a major coordinated effort to rethink the current reporting model.

In formulating our recommendation, the panel's bias is not to develop an entire replacement for the current reporting system. Rather, the panel believes that a systematic approach to providing supplemental information about intangible assets and operating metrics is what is needed. One example -- and only an example -- would be a framework whereby a company describes those intangible assets that are most critical to its business model. With regard to each intangible identified, the company could provide a description of its "characteristics of value" -- the things that make the asset valuable. Qualitative information about an intangible asset is meaningful especially if it is backed up with quantitative information that support the qualitative assessment. For example, a company's web site domain name, or URL, could be described as having extraordinary brand value based on the quantitative measures of "hits" or visits to the web site. Similarly, customer loyalty is a valuable intangible asset based on measures such as repeat purchases, customer referrals and other operational metrics.

However, the panel urges caution against making sweeping changes that could create more harm than benefit. For example, the panel is concerned about regulated disclosures of supplemental information. Most useful disclosures are specific to the industry and company. It is probably not practical for any regulatory body to define precisely effective disclosures for hundreds of different industries. Even if regulations could be written that covered the multitude of industries, in many industries the pace of change is so rapid that it is unlikely that regulators could actually change the disclosures quickly enough to keep up with the needs of investors.

Considering that there isn't an obvious answer to the problem waiting to be implemented, the panel supports a two-pronged approach:

- ¶ In the near term, create an environment that encourages innovative disclosures by companies.
- ¶ Longer term, establish a formal effort to develop a systematic approach to supplemental disclosures.

Encourage Experimentation in Near-Term

Recognizing that economic change and uncertainty will not go away soon and that it will probably take time for a new disclosure framework to be developed and adopted, companies should be encouraged to experiment with supplemental disclosures. Almost by definition, experimentation must be voluntary. The government cannot, therefore, mandate experimentation by companies, but it can help create an environment that is supportive of disclosure. There is currently a sense among the panel members that the current legal framework discourages companies from experimenting with supplemental disclosures.

Essentially, the panel's view is that a shift in mindset by the government is needed. The traditional mindset is that companies will try to mislead investors unless heavily restrained by detailed regulation and that investors are very naïve. A better presumption might be that in today's economy investors need more information and different types of information that cannot be adequately described by regulation. Companies should be permitted to provide more speculative, hard to measure information, as long as they warn investors that the information is speculative.

There are a number of actions the government can take to improve the environment and encourage experimentation.

1. **Expand safe harbor provisions.** The current safe harbor provisions, as embodied in the Private Securities Litigation Reform Act of 1995, while helping expand the provision of forward looking financial information, are very limited in scope. While the panel members are not lawyers and therefore not in a position to make specific recommendations, the panel supports considering expansion of safe harbor rules to include most

disclosures related to intangible assets and operating metrics made by a company in its annual and quarterly reports, SEC filings, web site and other investor communications. Of course, these should be accompanied by the appropriate warnings.

- 2. Modify SEC enforcement posture.** There is a sense among some of the panel members that the SEC has gone too far in aggressively pursuing cases against companies. The SEC needs to set the tone in its enforcement activities, making it clear that it will not prosecute companies making good faith attempts to provide better information to investors. Unfortunately, the SEC has shown the opposite inclination by filing legal briefs that support a more restrictive view of the safe harbor's availability. For example, the SEC's *Amicus Curie* brief *Harris v. Ivax*, No. 98-4818, (Eleventh Circuit, 1999) where the SEC argued against the circuit court's broad interpretation of the statutory safe harbor.

Pursue Systematic Approach for Longer-Term

For the longer term, the panel encourages the establishment of a formal effort to develop a systematic approach to supplemental disclosures, particularly around intangible assets and related operating metrics. The panel does not envision a wholesale replacement of GAAP, but rather a coherent framework and language for supplemental disclosures to help investors assess the future profit and cash flow potential of companies.

The effort should involve the SEC, the FASB, the AICPA and the accounting firms, as well as investors, academics and key industry groups. Users and preparers should play a particularly important role in ensuring that the proposals are easy to implement and that the information provided will be valued by the investor community.

The panel is wary of many small interim changes to current reporting requirements that could cause more harm than good. Accordingly, we should have patience and only implement a comprehensive approach that has been thoroughly tested.

IMPROVED REPORTING LIKELY TO HAVE LITTLE IMPACT ON VOLATILITY OR LEVELING PLAYING FIELD

Improved reporting, while helping investors value companies will not eliminate market volatility (although some reduction may be achieved), nor will it level the playing field between large institutional investors and small individual investors.

The volatility of the stock market is largely driven by the underlying uncertainty about the future performance of companies and the economy as a whole. The senior managers of most Internet companies cannot accurately predict how their companies will perform over the longer term. Therefore, even if investors had as much

information about companies as their managers did, the uncertainty and volatility in the stock market would not be significantly reduced. Furthermore, the panel believes the boom and bust in Internet shares that we experienced in late 1999 and 2000 was largely driven by factors other than inadequacies in company reporting.

The perceived unlevel playing field is largely unrelated to company disclosures. Professional securities analysts and their clients have a number of advantages over individual investors. While companies can provide raw information to investors, analysis and synthesis that integrates company information with industry knowledge drives informed investment decisions. Professional analysts have the skills, experience, access to management and industry contacts to assemble and critically assess the information from companies to make fully informed investment recommendations. They are also able to assess the management through direct contacts. This costly analysis is typically available to large investors only, those who can hire analysts or purchase outside research.

In addition, professional analysts are “in the information flow” and, therefore are likely to learn about company developments sooner than small investors. They may also be able to better interpret company statements or read between the lines in company statements or press releases.

There is great concern these days about whether securities analysts employed by the leading investment banks are truly unbiased in their recommendations. More and more, analysts are critical in helping the investment banking side of their firms bring in clients. Analysts face two issues when they write unfavorable reports. First, they risk being cut off from access to management. Second, they could risk losing the client for advisory and capital raising fees. As a result, it is well known that analysts rarely issue “sell” recommendations.

All??

These issues around the structure of the stock market are important. However, the panel believes that changes in company disclosure will not eliminate this advantage for large investors. Furthermore, attempts to level the playing field could make the problem worse. It could actually inhibit the free flow of information or it could lead to a deluge of useless boilerplate information that confuses small investors.

Finally, it is not clear that many smaller investors would make use of improved company disclosure. The percentage of trading conducted by individual investors is growing relative to institutional investors. This is more pronounced in Internet shares. [cite statistics]. Yet, many of these individual investors are either unsophisticated (wanting to make some money on the latest sure thing) or technical traders (wanting to make money on the volatility of shares during the day rather than investors for the long term based on the fundamentals of the company). It is not clear that these individual investors will make use of improved disclosure.

OTHER IDEAS EXAMINED

In addition to the conclusions and recommendations above, the panel discussed a number of other ideas related to company reported. In summary, the panel favored more use of the Internet to communicate with investors. We debated the idea of third party verification of non-financial disclosures, but ultimately concluded that the difficulties and substantial costs of third party verification would not outweigh the relatively small improvements expected. We also discussed ideas such as additional disclosures about management and founding investors, but did not achieve consensus.

Using the Internet to Communicate with Investors

The Internet is also changing the way information is supplied to investors. Through their web sites, companies can now, at virtually no cost, make information available to all investors immediately and simultaneously. Furthermore, the elimination of the need to print and mail documents means that companies can easily provide more information to investors at no incremental cost.

Internet technology and the explosion of interest in Internet companies has also led to more information being made available to investors about companies from third parties. In addition to information from companies themselves, investors can learn both facts and opinions about companies from business oriented television networks, investor oriented websites, investor chat rooms, fact oriented web sites (e.g., Bloomberg, Bridge, etc.). The volume of information that investors can access can be overwhelming.

Many companies have moved swiftly ahead in experimenting with ways to use the Internet. The panel hopes that this trend spreads quickly. While there will inevitably be a learning period as companies and investors learn best how to take advantage of the new technologies for investor communications, certain steps can be taken now.

First, the panel supports simultaneous disclosure of key information to all investors via a company's web site. There needs to be a clear dividing line, however, that delineates what must be simultaneously disclosed to all investors over the Internet and private one-to-one conversations. We would favor limiting immediate disclosure to information that will be in the public domain anyway. Simultaneous disclosure would probably include SEC filings, annual and quarterly reports, press releases, transcripts of investor presentations (with more than 10 in attendance), conference call recordings or transcripts.

Second, the panel encourages experimentation with using the Internet for two-way communication between companies and investors. Typically only professional securities analysts and institutional investors have been able to ask managers questions. While it would be infeasible for managers to sit down with every investor, there might be ways that companies could use the Internet to provide two-way communication with investors. For example, the company could post each week or month the 10-20 most frequently asked questions and answers. The company could also commit to posting

frequently asked questions that it did not want to answer and explain why (or not as the case may be).

Third Party Verification

It has been suggested that investors could benefit from some form of third party verification of non-financial information, similar to the way auditing firms provide opinions on financial statements. Currently, information on key operating metrics or market size data is provided voluntarily by companies based on their own internal definitions, with no external verification. While companies today can be penalized for providing fraudulent information to investors, operating data is not standardized and therefore may not be comparable across companies. Furthermore, companies have substantial freedom to report information that while not fraudulent, could be misinterpreted by investors.

The panel did not endorse third party verification of non-financial information. The panel believes that third party verification would not significantly improve the quality of information provided by companies to investors and the costs to companies would be substantial. Furthermore, such a requirement would likely reduce the amount of information that companies disclose.

Additional Disclosures About Management

For most investors and venture capitalists, the quality of management is often the most important determinant of investment decisions. The panel discussed whether additional disclosures about management would be beneficial. These additional disclosures might include: record of past success and failures, how much time they would devote to the company, a summary of employment contracts.

The panel did not reach a consensus on whether additional disclosures would be helpful. Some of the panel members believed that the most important qualities of a management team could not be captured in his/her past record or by information about employment contracts.

Disclosures about Founding Investors

For younger companies, the background and intentions of the founding investors is extremely important to new investors. The founding investors often help management develop the company. Venture capitalists and other founding investors also develop reputations for spotting attractive investments. However, the interests of the founding investors are not always in line with those of the public market investors. Accordingly, the panel members discussed whether the following disclosure should be considered: (1) Track record of founding investors, (2) How long do founding investors typically hold shares after an IPO? (3) What are founding investors' intentions with respect to

selling shares in this company? This information could be disclosed in the IPO prospectus and updated in annual and quarterly reports.

The panel did not reach a consensus on this issue. Some panel members believed that the track record and intentions of founding investors are private matters and should be disclosed on a voluntary basis only. Mandating such disclosure might limit the pool of capital available to some companies, as start-up investors would be less willing to take risks and publicize their investments.

Reporting on Insider Transactions

The panel discussed delays in the disclosure of insider trading activity render the information useless in today's fast paced Internet world. Therefore, insiders should provide full and immediate disclosure of insider trades. The panel did not reach a consensus on this issue. Several panel members believed that current system of insider trading disclosure appropriately balances the needs of public investors and the privacy of insiders.

APPENDIX A -- PANEL MEMBERS

[To come]

APPENDIX B -- ADDITIONAL VIEWS OF PANELISTS

[This is where panelists could submit their views regarding GAAP and the new Fair Disclosure rule or any other issue.]

APPENDIX C -- AN ENVIRONMENT OF RAPID AND PERVASIVE CHANGE

The current wave of innovation centered around the Internet and telecommunications has four critical dimensions: (1) the pace of technology diffusion, (2) the fundamental impact on business models, (3) opportunities for “winner take all” outcomes, and (4) the willingness of the capital markets to finance companies with limited track records.

Pace of technology diffusion. The pace of technological development and diffusion is much faster than in the past. This has resulted in the creation of new markets and new business models at lightning speed. For example, worldwide Internet usage reached 10 million people around the world in only 4 years. Past innovations like the telephone required 38 years and the fax machine required 22 years to reach an equal number of users.

Impact on business models. New technologies are linking businesses to each other and to consumers, thus fundamentally changing the way business is conducted. Past waves of innovations were more narrowly focused on specific products or improvements in manufacturing or back office operations. For example, the computer manufacturer Dell has introduced a business model that links it directly to its end consumers and suppliers, thereby cutting out distributors and retailers and providing much quicker information about its component needs to its suppliers. This approach has helped Dell operate with only 6 days sales in inventory compared with 30-60 days for similar manufacturers. Because it manufactures to order, it also does not incur the costs of obsolete inventories. Its approach has made it the most profitable manufacturer of PCs.

Opportunities for “winner take all” outcomes. In a limited set of cases, new information related products are being developed where “demand side” economies of scale result in “winner take all” economic models. On line auctions are a prominent example. The largest auction house selling a particular category of product is more attractive to both buyers and sellers because of they have the most products to sell (attractive for buyers) and they have most buyers visiting their site (attractive for sellers). As more sellers post their wares on the site, the site becomes more valuable to buyers. More buyers, in turn, attract more sellers. This creates a positive feedback loop, helping the leading auction site accelerate its growth much faster than competitors. While we may see more of these “demand side economies” in Internet related products and services; they are still likely to be rare.

Willingness of capital markets to support very young companies. The opportunities for value creation are so large that the capital markets have been willing to place very high values on companies with no track record or earnings history, only the potential to strike gold. As a result, the capital markets have financed an unprecedented number of companies at earlier stages in their lives, rather than by venture capitalists and other private investors. The willingness of the capital markets to finance these businesses has, in turn, also accelerated their growth.

There is no doubt that these technological changes and resulting new products and services will create substantial value for the economy. Not surprisingly, however, there is tremendous uncertainty about which business models, companies, and industries will capture a large share of the value for their shareholders.

One source of uncertainty is consumer behavior. For example, will consumers prefer to shop in virtual malls or will they prefer specialist retailers? Or perhaps there is room for both? On one hand, the Internet favors companies who can develop strong brands and build customer relationships. On the other hand, the Internet also makes it easy for the consumer to find the best specialist retailer for any product or service or to bypass the retailer completely and go directly to the producer. Despite their early leads, Amazon.com quickly overtook both CDNow and e-Toys in their respective markets once Amazon decided to enter their markets.

Another source of uncertainty is the continued rapid pace of technological innovation. Innovation can turn successful business models obsolete practically overnight. For example, AOL has offered to pay a tremendous premium (and associated drop in its own share price) to purchase Time-Warner to get assured access to broadband distribution of its services.

A final source of uncertainty is competitive behavior itself. It is impossible to predict when the best management team will stumble or when a weak competitor will make a brilliant move (either by keen insight, luck, or desperation).

As in past waves of innovation, most new companies will fail or be swallowed by stronger competitors, and many survivors will pass on most of the benefits from new products and markets to consumers, rather than their shareholders. Only a small number are likely to create substantial shareholder value. A study by Morgan Stanley in 199x showed that, prior to the current wave of Internet related IPOs, of x,xxx technology IPOs, only xx% of them created over xx% of the value for shareholders. The results for the current round of IPOs are unlikely to be substantially different, in fact, more than xx% of Internet related IPOs are trading below their opening prices.