NACD Directorship

Social Media and Compliance

Companies must be cautious that the information disseminated by employees on both company and personal social media pages complies with federal securities laws.

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Despite the SEC's 2008 interpretive admonition that all communications made by or on behalf of a company—even those made by employees on social media, blogs and shareholder forums—are subject to relevant provisions of federal securities laws, widespread corporate adoption of appropriate compliance procedures in that regard remains elusive at small and large public companies alike. In an eye-opening IR Web Report article published in April 2010, Dominic Jones set forth a litany of issues facing investor relations professionals with respect to social issues, arriving at the austere conclusion that at literally hundreds of public companies studied, investor relations professionals are exposing their companies to material compliance risks by failing to suitably monitor the use of social media. One of the principal impediments to widespread boardroom assessment of these risks is that many directors simply don't have substantive experience with social media, its use, misuse and potential legal and regulatory consequences.

To illustrate the potential scope of issues of which directors should be aware in this regard, consider the following hypothetical: XYZ is a public company that manufactures widgets. XYZ has an investor relations manager and several employees throughout the organization who regularly contribute to XYZ's website, XYZ's industry blog, XYZ's Facebook and Twitter accounts, and occasionally to their own Facebook and Twitter accounts. XYZ is planning on releasing its quarterly earnings press release at 1:00 pm ET (during market hours) on its website; the results are far in excess of consensus estimates. At 12:50 pm, a third-party financial blog that follows XYZ posts a note to the financial blog's Facebook page stating that its "channel checks weren't impressive – going to be a tough quarter for XYZ. That said, we love their new ABC 5000 widget which will be a HUGE winner for them." At 12:52 pm, Sally, from XYZ sales and marketing, replies on the financial blog's Facebook page that she "like[s] this posting," and puts a link to that Facebook page on XYZ's industry blog. At 12:54 pm, Jim, an XYZ engineer, responds to a pejorative Tweet about XYZ by a friend who works for XYZ's largest competitor, by posting a link on his personal Twitter page to a summary of a third-party analyst note reiterating that XYZ is a "strong buy." At 12:56 pm, Larry, XYZ's investor relations manager, updates XYZ's official Facebook and Twitter pages to remind people that the earnings release is forthcoming, but erroneously instructs people to look for the release on the wire, instead of at XYZ's website. The earnings release is posted on XYZ's website precisely at 1:00 pm ET, but isn't picked up by the wire services until 1:03 pm. During the three-minute gap, the stock rises 10 percent. Later that afternoon, Margaret and some of her overworked, dissatisfied colleagues in

XYZ’s factory intentionally and untruthfully “tweet” in their personal Twitter accounts that the ABC 5000 is being shipped with a critical design flaw. The next morning, one of the research analysts covering XYZ elects to downgrade the stock due to the prior day’s price increase, but since it’s not good news, Larry decides not to state anything about that on XYZ’s website, Facebook or Twitter accounts.

As fanciful as it might sound to directors who are less social media savvy, fact patterns like these are playing out routinely, and the panoply of issues created in the process can be vexing. Though Sally might not have been intentionally seeking to mislead investors, what does it mean to an XYZ investor when an XYZ employee says they “like” a financial blog posting which predicts, among other things, doom for XYZ’s impending quarter; what if an XYZ investor reasonably relied on that and sold her stock eight minutes before a 10-percent rally? Similarly, Jim might not have intended to mislead his Twitter followers by directing them to a summary of a positive analyst report, but are there ramifications to XYZ for its employee omitting regulatory disclaimers in connection with what can be construed to be investment advice? Larry didn’t intend to misguide investors by directing them away from XYZ’s website for the earnings release, but, having done so, the three-minute news lapse could well have been costly to certain investors given the stock movement. Lastly, the intentionally false and misleading Tweets by Margaret and her colleagues are, per the SEC’s interpretation referenced above, attributable to XYZ. It’s also plausible that Larry’s purposeful omission of the analyst’s downgrade could garner some regulatory attention if XYZ’s website, Facebook and Twitter accounts are, by design, places where the preponderance of XYZ’s investors are induced to get their information about XYZ.

Whether attuned to social media or not, a practical way for directors to start evaluating these risks is by simply providing this hypothetical to a company’s communications managers in advance of the next board meeting, and asking appropriate personnel to make a presentation about how and to what extent there are procedures in place to effectively manage these and associated risks. One thing’s for certain: these are challenges that are going to multiply, not diminish.

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