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Corporate Governance Update: The Board, Social Media and Regulation FD

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The widespread use of social media in today's global marketplace presents opportunities and challenges for all financial market participants, including boards of directors, investors and regulators. While social media outlets provide unprecedented pathways for companies to engage actively with investors, both large and small, as well as with reporters, analysts, customers, suppliers and other members of the corporate community, there are regulatory restrictions that public companies need to heed. Releasing information via Twitter, Facebook, and similar channels must be done with caution to avoid violating Securities and Exchange Commission (SEC) Regulation FD¹ as it currently stands. Moreover, companies are vulnerable to negative publicity that can be quickly and widely disseminated over social media networks, even if they are not active participants in such channels.

As public companies increasingly use and rely upon the new avenues of communication provided by social media, it is correspondingly important for directors to be aware of the manner and extent of their companies' use of social media and have a basic understanding of the risks and benefits of corporate participation. At the same time, it may be incumbent upon the SEC to revisit Regulation FD. The immediacy and availability of communications made through social media suit the purpose of Regulation FD far better than anything available at the time of its passage in 2000; by failing to update Regulation FD, the SEC may find that the rule is impeding rather than furthering its stated goals. Fundamentally, the interests of all market participants are aligned when it comes to encouraging companies to use social media consistently, effectively, and legally, as enhanced transparency and increased engagement generally benefit the market as a whole.

Oversight of Social Media

Though familiar with social media and generally aware of its potential, it appears that directors and senior executives tend to underutilize and perhaps underestimate its power. A 2012 study conducted by The Conference Board and the Rock Center for Corporate Governance

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¹ 17 C.F.R. § 243.100. Regulation FD stands for "Fair Disclosure" although it is often (mistakenly) referred to as "Full Disclosure." For a comprehensive discussion of Regulation FD, see Practical Law Company "Complying with Regulation FD (Fair Disclosure)" available at us.practicallaw.com/1-383-2635 (subscription required).

at Stanford University indicates that, of the “senior-level decision makers” in North American companies—whose average age is in the mid-50s—only slightly more than half believe they have “a good understanding of the impact that social media can have on their business.”² By contrast, about two-thirds of the survey participants use social media for personal purposes or business purposes; in both cases, slightly more than half do so daily.³ Just over three-quarters of the survey respondents said that their companies use social media for business purposes, though the companies overwhelmingly do so to communicate with customers rather than shareholders.⁴

The gradual awakening of corporate America to the possibilities inherent in social media, and the often informal tone of communications made possible through this channel of “casual” communication, perhaps explain in part the general lack of corporate controls in this area. Of the survey respondents, three-quarters said that their companies have no social media guidelines for their board of directors.⁵ Even more concerning is that fewer than half of the survey respondents said that their companies do have formal social media guidelines or policies for employees and senior management.⁶ Only 32 percent of the survey respondents said that their company had ever hired a consultant or expert to present on the subject of social media.⁷

Directors should consider taking steps to close the gap between their general familiarity with social media and the formal and intended use of social media in the corporate context. A startling statistic is that over 90 percent of survey respondents said that their companies do not have a board committee that has responsibility for oversight of social media. While the formation of a committee to oversee social media is not necessary, it appears that, as a general matter, boards are not paying enough attention on a regular basis to corporate use of social media. It is not the directors’ job to institute social media guidelines, but directors should use their oversight function to determine whether management is sufficiently focusing on the risks inherent in social media in the corporate context. In this regard, directors may wish to prompt management to consult with lawyers or other experts to develop formal policies to guide the use of social media at all levels of the corporation.⁸ More broadly, directors would be well advised to study corporate use of social media and have a discussion with senior management as to how the company can most effectively use social media to communicate with various

² David F. Larcker, Sarah M. Larcker & Brian Tayan, “What Do Corporate Directors and Senior Managers Know About Social Media?” Director Notes, The Conference Board, Oct. 2012, at 1, 6.

³ *See id.* at 4.

⁴ *See id.* at 7 (finding that 77 percent use social media to “communicate and interact with customers” while only 14.4 percent use social media to “communicate with shareholders”).

⁵ *See id.* at 10.

⁶ *See id.* at 11.

⁷ *See id.* at 7.

⁸ *See id.* at 13. For example, IBM has instituted guidelines for blogging. IBM Social Computing Guidelines, available at www.ibm.com/blogs/zz/en/guidelines.html.

constituencies, including customers and investors.⁹ The risks, benefits, and contours of social media use will be different for each company based on its strategy, its business model, and many other factors.¹⁰ Moreover, as these factors are constantly changing, directors may determine to revisit the topic from time to time to make sure that management is appropriately considering the impact of these changes.¹¹ It may be useful for the board to conduct a cost-benefit analysis of participating in social media with respect to investors and analysts as opposed to simply customers; such an exercise could involve reaching out to large investors for their views, examining how competitors handle social media, as well as carefully addressing compliance concerns.¹²

Social Media Risks and Rewards

Social media can be a powerful tool in building corporate culture, gaining insight into client and customer sentiments, communicating with investors and analysts, and much more. Unsurprisingly, therefore, the use of social media in the corporate context continues to grow. According to Burson-Marsteller, Fortune Global 100 companies now not only have a presence on social platforms but, as of 2011, are actively engaging with other participants.¹³ In 2012, Burson-Marsteller found that “seventy-nine percent of corporate accounts on Twitter attempt to engage with other users by retweeting and using @mentions, ninety-three percent of Facebook pages are updated weekly, and seventy percent of corporate pages are responding to comments on their walls and timelines.”¹⁴ Furthermore, companies are using various platforms and channels to communicate with different target audiences based on location, topic, or other criteria, and they are adapting quickly as new platforms and channels emerge.¹⁵

Chief executives around the world also are increasing their use of social media and setting the tone for corporate engagement in social media platforms. A 2012 IBM study of over 1,700 CEOs in 64 countries found that CEOs see social media as a tool for collaboration and relationship-building in the service of innovation and the creative exchange of ideas.¹⁶

⁹ See Director Notes, *supra*, at 12.

¹⁰ See *id.*

¹¹ IBM reviews its guidelines “periodically.” See IBM Social Computing Guidelines, *supra*, (In 2008 and again in 2010 IBM turned to employees to re-examine our guidelines in light of ever-evolving technologies and online social tools to ensure they remain current to the needs of employees and the company.”)

¹² See Broc Romanek, “Checklist: Social Media Business Case for Investor & Analyst Engagement,” TheCorporateCounsel.net (subscription required).

¹³ Burson-Marsteller, Global Social Media Checkup 2012, Executive Summary, available at www.burson-marsteller.com/social/Summary.aspx.

¹⁴ *Id.*

¹⁵ See *id.*

¹⁶ “Leading Through Connections: Insights from the Global Chief Executive Officer Study,” IBM Corporation, 2012, at 14, available at www-935.ibm.com/services/us/en/c-suite/ceostudy2012/.

Moreover, they see social media as a rapidly growing force. The IBM study indicated that, though social media is currently the least utilized form of customer interaction, CEOs predict that within five years it will be the number-two way to engage with customers, second only to face-to-face interaction.¹⁷

However, the communicative power of social media is a double-edged sword. One inescapable risk to a company in the age of social media is that of losing control of its reputation. There have been many instances when a disgruntled customer, for example, has “gone public” with a complaint, and the company is instantly, without warning, put on the defensive in front of the virtual world. As the IBM CEO study points out:

[O]penness increases vulnerability. The Internet—especially through social networks—can provide a worldwide stage to any employee interaction, positive or negative. For organizations to operate effectively in this environment, employees must internalize and embody the organization’s values and mission.¹⁸

The board and the CEO are partners in setting the “tone at the top” that permeates any corporation. Social media raises the stakes of doing so successfully, in that any interaction can be widely (and instantly) publicized via social networks and the reach of the Internet. Power over a company’s reputation is being decentralized from the entity to the individual, and thus it becomes even more important for directors and senior executives to build a shared sense of values, loyalty, and open, honest communication within their organization. The board should be apprised of any major incidents involving publicly disseminated complaints, allegations or other negative comments about the company, as these increasingly appear to have an impact on stock price.

Regulation FD

One of the most prominent legal risks of using social media for corporate communications is that of inadvertently violating Regulation FD, which prohibits the selective disclosure of material information to investors. Some companies and chief executives—notably LinkedIn and Alan Meckler of WebMediaBrandINC—have successfully managed to use a wide variety of available social media platforms to communicate with investors and others without running afoul of Regulation FD. Key elements of ensuring that any social media communication is not made selectively include: informing investors (via news releases, posted disclosure policies, SEC filings, and any other relevant method) of the company’s chosen communication channels; providing prominent links on the company website to all such channels; establishing a consistent pattern of communication on the designated channels; and monitoring usage of these

¹⁷ See *id.* at 35.

¹⁸ IBM CEO Study at 19.

channels to ensure that communications are actually being received.¹⁹ The general counsel or chief compliance officer should ensure that the company's Regulation FD policy covers communications made via social media. In this context, it is important to note that Regulation FD is not meant to address communications with the press.

A recent, high-profile example of some of the perils of using social media in the corporate context is the SEC's concern over a Facebook post by Netflix chief executive W. Reed Hastings. In July 2012, Hastings posted on his Facebook page a message including the information that "Netflix monthly viewing exceeded 1 billion hours for the first time ever in June."²⁰ In December 2012, the SEC announced that it would recommend enforcement proceedings against Netflix and its CEO, alleging a violation of Regulation FD. Hastings claimed, in his defense, that the post contained no material information and, moreover, that a Facebook post did not constitute a selective disclosure.²¹ It is possible that the SEC's actions to date in this case already have had a chilling effect on corporate communication through social media, which would be to the detriment of investors;²² moreover, it appears to run contrary to the SEC's prior assertion that "it would not attempt to second-guess reasonable, good-faith judgments by persons who honestly attempt to comply with Regulation FD."²³ It remains to be seen whether the SEC will proceed with an enforcement action, but the Netflix incident already has generated criticism of the SEC and calls for reform of Regulation FD.²⁴

¹⁹ See Dominic Jones, "Can a Tweet Meet the SEC's Fair Disclosure Rules?" IR Web Report, May 11, 2011, available at irwebreport.com/20110511/twitter-regulation-fd-sec/.

²⁰ See Post by Reed Hastings, Facebook.com (July 3, 2012) available at www.facebook.com/reed1960/posts/10150955446914584.

²¹ Netflix, Inc., Current Report on Form 8-K, Dec. 5, 2012, available at [iir.netflix.com/secfiling.cfm?filingID=1065280-12-25&CIK=1065280](http://ir.netflix.com/secfiling.cfm?filingID=1065280-12-25&CIK=1065280).

²² See Joseph A. Grundfest, "Regulation FD in the Age of Facebook and Twitter: Should the SEC Sue Netflix?" Rock Center for Corporate Governance at Stanford University, Working Paper Series No. 131, Jan. 30, 2013, at 33, available at papers.ssrn.com/sol3/papers.cfm?abstract_id=2209525.

²³ *Id.* at 17 (quoting Harvey L. Pitt, SEC Chairman).

²⁴ See, e.g., Christopher Garcia and Melanie Conroy, "Applying Securities Laws to Social Media Communications," Reg FD Alert (December 2012), at 4 ("In short, the circumstances are ripe for guidance from the SEC that will reverberate throughout and shape our entire securities law regime."), available at www.weil.com/files/upload/Weil_Alert_Sec_Lit_Enforcement_Dec_21_2012.pdf; Ning Chiu, "Amicus Submission to SEC Questions Regulation FD Case Against Netflix," DavisPolk Briefing Governance (March 6, 2013), available at www.davispolk.com/briefing/corporategovernance/?entry=273; Neal Hershberg, "Regulation Fair Disclosure: Once Again in Critics' Cross Hairs" BusinessWired (Jan. 3, 2013) ("The warring factions should put their differences aside and join forces in a united effort to bolster disclosure. There is an underlying commonality of interests that everyone can agree to: the need for better and broader disclosure.") available at blog.businesswire.com/2013/01/03/regulation-fair-disclosure-once-again-in-critics-cross-hairs/?blogsub=confirming#blog_subscription-3.

Reforming Regulation FD

Regulation FD was promulgated in 2000 in order to prevent the “game of nods and winks”—in the words of then-SEC Chairman Arthur Levitt²⁵—that was played among corporate managers, auditors, and analysts, in which companies revealed material information only to selected market recipients. The goal of the rule was to ensure that all investors received prompt disclosure of material information. Studies of the effect of Regulation FD have showed mixed results,²⁶ but at this point the societal value placed on transparency and the immediate, widespread communication of material information to all investors is no longer in question; the issue is only how best to implement regulation supporting this value.

At the time of Regulation FD’s enactment, postings on corporate websites and pre-announced conference calls with toll-free dial-in numbers were the most effective ways to communicate to a large audience (along with the required SEC filings).²⁷ As Tom Kim, Chief Counsel of the SEC’s Division of Corporate Finance, has observed, one major technological change since that time is the advent of “push” communications.²⁸ These technologies make it much easier for companies to disseminate information in a manner that makes it available to the securities marketplace at large—a value emphasized in the SEC’s 2008 Guidance on the Use of Company Websites.²⁹

Indeed, social media and push technology serve the SEC’s goal of simultaneous disclosure of material information to all market participants far more effectively than any earlier technology ever has.³⁰ In order for investors to have the full benefit of the communication possibilities of social media, the SEC should find a way to encourage the use of these platforms while still maintaining appropriate regulatory oversight.

²⁵ “The Numbers Game,” Remarks by Chairman Arthur Levitt, Securities and Exchange Commission, NYU Center for Law and Business, Sept. 28, 1998, available at www.sec.gov/news/speech/speecharchive/1998/spch220.txt.

²⁶ See, e.g., Steven M. Davidoff, “In Netflix Case, a Chance to Re-examine Old Rules,” NYT DealBook, Dec. 11, 2012, available at dealbook.nytimes.com/2012/12/11/in-netflix-case-a-chance-for-the-s-e-c-to-re-examine-old-regulation/.

²⁷ See Louis M. Thompson, “The Time Has Come to Revise Regulation FD,” Compliance Week, Feb. 2013, at 48, available at www.complianceweek.com/pages/login.aspx?returl=/the-time-has-come-to-revise-regulation-fd/article/276359/&pagetypeid=28&articleid=276359&accesslevel=2&expiredays=0&accessAndPrice=0 (subscription required).

²⁸ See Jones, *supra*.

²⁹ 17 C.F.R. Parts 241 and 271, Release Nos. 34-58288, IC-28351; File No. S7-23-08, Commission Guidance on the Use of Company Websites, Aug. 7, 2008, available at www.sec.gov/rules/interp/2008/34-58288.pdf.

³⁰ See Joel Don, “Where Does Information Disclosure Start and End in Social Media?” Blog: Social Business Trends, Social Media and the Law (Jan. 15, 2013) (“The difference between a press release issued on a paid newswire service and a posting on Facebook is simply a distribution and search problem. Distribution is easy; just ensure you post the same material disclosure to the widest range of social media channels. That effectively mimics the shotgun blast delivered by paid newswires.”)

In a recent paper, Stanford Law School professor Joseph Grundfest offers two excellent suggestions. The first is that the SEC cease to distinguish among various forms of communication and instead require that any material disclosure by an issuer be promptly filed on a Form 8-K, “without regard to the identities of the recipients of the disclosure or the means by which the disclosure is otherwise disseminated.”³¹ This would put all media on equal footing and ensure that material information is disseminated to the world at large. Second, he proposes that the SEC redesign its EDGAR website along the model of Facebook and Twitter, allowing the public to subscribe to EDGAR postings that could be pushed to the followers of any listed company.³² Taken together, these suggestions would enable the SEC to harness the power of social media to the benefit of investors rather than impeding the rapid flow of information that is now made possible by its very existence. As Professor Grundfest notes, “The Commission would then become part of the social network rather than in tension with the social network.”³³

If the SEC misses the opportunity to adapt the requirements of Regulation FD to modern communication technology, the SEC runs the risk of actually harming the public interest in full and fair disclosure. It would be unfortunate and contrary to Regulation FD’s purpose if fears of violating Regulation FD actually restrained companies from using social media to disseminate information to eager market participants, as some studies suggest is already occurring.³⁴ In this sense, the SEC’s actions in the Netflix case appear to demonstrate a lack of understanding that the communications world is changing, and that it benefits no one for the SEC to remain in the dark ages (before social media).

As social media platforms proliferate and widen, SEC attention to the guidance and rules of Regulation FD will be increasingly important, as will boards of directors’ and managements’ attention to the issues raised by corporate use of these communication channels. As one CEO in the IBM study observed, “From 1995 to 2000, the web went from something only some people used to something almost everyone used to conduct business. I view social media the same way – we’re approaching the stage when almost everyone will have to figure out how to use it to conduct business successfully.”³⁵ The challenge is clear, and all market participants, not least the SEC, boards of directors and management teams, should step forward to meet it.

³¹ Grundfest, *supra*, at 33.

³² *See id.* at 33-34.

³³ *Id.*

³⁴ *See* Thompson, *supra*, at 49.

³⁵ IBM Study at 36.