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REPORT

DISCLOSURE

Social Media and the Federal Securities Laws

BY LOIS HERZECA

Social media has become a key component of corporate communications strategies. These internet sites allow for the creation and exchange of user generated content, and encompass a vast array of social networks, blogs, microblogs, photo and video sharing sites, news aggregation sites and reference sites. Social media sites may have both 'static' content (such as profiles and banner ads), which once posted do not change, and 'interactive' content which involves real time communications. Since social media is generally low cost, instantaneous and widely accessible, many companies have determined that social media is a vital way to connect with customers, employees and shareholders. Currently, a majority of the Fortune 500 companies have either a Twitter or a Facebook account.[1] Since social media, by definition, involves the dissemination of

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[1] NORA GANIM BARNES, CTR. FOR MARKETING RESEARCH, THE FORTUNE 500 AND SOCIAL MEDIA: A LONGITUDINAL STUDY OF BLOGGING, TWITTER AND FACEBOOK USAGE BY AMERICA'S LARGEST COMPANIES 8

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information, it is not surprising that corporate deployment of social media raises potential compliance issues under the federal securities laws and has become the focus of regulators.

Regulation D

Under the Securities Act of 1933, offers and sales of securities must either be registered or qualify for an exemption from registration. Regulation D provides an exemption for issuers in offerings meeting the general conditions set forth in Rule 502. Specifically, Rule 502(c) prohibits an issuer or any person acting on the issuer's behalf from offering or selling ''securities by any form of general solicitation or general advertising'' including: any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and any seminar or meeting whose attendees have been invited by any general solicitation or general advertising.[2] It is reasonable to conclude that social media would be included in the category 'similar media', but it is not so clear what types of conduct on social media would constitute a general solicitation. The Securities and Exchange Commission's (SEC) historical view is that whether a communication is a general solicitation depends on whether the relationship between the parties communicating predated the securities offering and whether a sale of securities was intended by the communication.[3] This becomes an interesting analysis in the context of Facebook 'friends' and Linkedin 'connections', where relationships are more fluid and the purpose of communications more ambiguous. Companies that are in the process of conducting private placements need to be especially vigilant about avoiding social media usage that arguably constitutes a general solicitation.

Regulation FD

Regulation FD prohibits an issuer, or a person acting on its behalf, from selectively disclosing material nonpublic information. If material nonpublic information is selectively disclosed to certain individuals or entities, the issuer must make ''public disclosure'' of that information.[4] Information may be publicly disclosed by either filing or furnishing a Form 8-K or by disseminating the information through ''another method (or combination of methods) of disclosure that is reasonably designed to provide broad, non-exclusionary distribution of the information to the public.''[5] In 2008, the SEC issued guidance as to when content on a company's website is considered ''public'' for purposes of Regulation FD.[6] The three elements to consider in determining whether content posted on a company website will be considered ''public'' for purposes of Regulation FD are (i) whether a company website is a recognized channel of distribution; (ii) whether information posted on a company website is accessible and therefore disseminates information to the marketplace in general; and (iii) whether information is posted for a reasonable enough period for the marketplace to react.[7]

Disclosure of material nonpublic information on social media sites, other than corporate websites that meet the SEC's tests, may subject a company to possible FD violations and the disclosing person to insider trading claims. Under FD, selective disclosure of material nonpublic information on a social media site (such as a blog, or other discussion forum) by a senior company official who is not authorized to make such disclosures would not be an FD violation, but may trigger insider trading liability.

The Antifraud Rules

The SEC has often reiterated the general proposition that ''[t]he antifraud provisions of the federal securities laws apply to company statements made on the Internet in the same way they would apply to any other statement made by, or attributable to, a company.''[8] Further, the SEC explicitly stated that the antifraud provisions apply to blogs and electronic shareholder forums and that companies are responsible for statements made by them or on their behalf on their websites or third party websites.[9] Section 10b and Rule 10b-5 under the Securities Exchange Act of 1934 prohibit material misstatements and omissions of fact in connection with the purchase or sale of securities. To satisfy the materiality standard of Rule 10b-5, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by an investor as significantly altering the 'total mix' of information made available to the investor.[10] This requires a facts and circumstances determination in each case. But the SEC notes that employees acting as representatives of the company on internet sites cannot avoid the antifraud rules by purporting to speak in their individual capacity.[11]

The SEC has affirmed that a company is not responsible for statements that third parties post on a company sponsored website, nor does a company have any obligation to correct a misstatement made by a third party.[12] However, a company can be held liable for third party information to which it hyperlinks from its website and which could be attributable to the company.[13] Whether third party information is attributable

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(2010), *available at* http://wwwl.umassd.edu/cmr/studiesresearch/2010F500.pdf.

[2] 17 C.F.R. § 230.502(c) (2010).

[3] Interpretive Release on Regulation D, Securities Act Release No. 6455, 48 Fed. Reg. 10,045 (Mar. 10, 1983) at III.C. The SEC offered the following guidance regarding Rule 502(c)'s prohibitions:

> The analysis of facts under Rule 502(c) can be divided into two separate inquiries. First, is the communication in question a general solicitation or general advertisement? Second, if it is, is it being used by the issuer or by someone on the issuer's behalf to offer or sell the securities?
>
> A determination of whether there is a pre-existing relationship between the parties has largely driven the first inquiry. *See id.;* Regulation D, Securities Act Release No. 6825 [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,404, at 80,047 (Mar. 14, 1989) (citing a prior relationship between issuer and agent as a reason why an offering would not constitute a general solicitation).

[4] 17 C.F.R. § 243.100(a) (2010).

[5] 17 C.F.R. § 243.101(e) (2010).

[6] Commission Guidance on the Use of Company Websites, Exchange Act Release No. 34-58288, 73 Fed. Reg. 45,862 (Aug. 1, 2008) (''Release No. 34-58288'').

[7] *Id.* at II.A.1.

[8] *Id.* at II.B.

[9] *Id.*

[10] *Basic v. Levinson*, 485 U.S. 224, 231-32 (1988).

[11] Release No. 34-58288 at 11.13.4.

[12] *Id.*

[13] *Id.* at II.B.2.

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to the company depends on whether the company has involved itself in the preparation of the material (the entanglement theory) or explicitly or implicitly endorsed or approved the information (the adoption theory). A disclaimer alone is not sufficient to insulate a company from liability for third party posts.[14]

The Proxy Rules

The proxy rules regulate the form and content of proxy solicitations subject to the rules. Under the proxy rules, a proxy solicitation includes a ''communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy'', subject to limited exceptions.[15] Under Rule 14a-3, a proxy solicitation generally cannot be made until a compliant proxy statement is furnished to security holders. However, Rule 14a-12 provides a limited exception for proxy solicitations prior to the furnishing of a proxy statement if they meet certain conditions, including the following: the communication must contain a prominent legend identifying the participants in the solicitation and their interests; the communication must contain a prominent legend advising security holders to read the proxy statement when it becomes available and advising them where and how to obtain a copy; and the communication must be filed with the SEC no later than the date it is first published or sent to security holders. The limited size of messages communicated on Twitter, for example, and the rapid dissemination of information on social media sites generally, would make compliance with Rule 14a-12 difficult. Moreover, the content of proxy solicitation material is subject to the antifraud rules.

Recommendations made on social media trigger NASD Rule 2310 responsibilities to determine investor suitability.

Care should be taken to comply with these rules if social media is used expressly for the purpose of proxy solicitation or otherwise can be viewed as containing proxy solicitation material. Indeed, employees who contribute to social media sites during a proxy solicitation may, under certain circumstances, be deemed to be participants in the solicitation and required to satisfy the disclosure requirements of the proxy rules.

The Regulation of Securities Firms

Securities firms, because of the interactive nature of their business, are particularly vulnerable to compliance issues involving social media. On January 25, 2010, the Financial Industry Regulatory Authority (FINRA), the largest independent regulator of securities firms in the United States, issued a Regulatory Notice[16] providing guidance, in question and answer format, on the applicability of FINRA rules to social media sites sponsored by securities firms or their registered representatives (i.e., employees who provide securities advice and receive a commission).

The Regulatory Notice stated that firms that communicate, or permit their associated persons to communicate, through social media sites must first ensure that they can retain records of those communications as required by applicable rules and regulations. In addtion, recommendations made on social media trigger NASD Rule 2310 responsibilities to determine investor suitability. The Regulatory Notice suggests that, as a best practice, firms prohibit all interactive electronic communications that recommend specific investment products or link to such recommendations unless a registered principal has previously approved the content. Additionally, static content is considered an ''advertisement'' under NASD Rule 2210 and firms must obtain prior principal approval before posting static content. Real-time interactive communications are considered an ''interactive electronic forum'' and no prior principal approval is necessary, but content must be supervised under NASD Rule 3010. The Regulatory Notice reminds firms that they must have appropriate supervisory policies and procedures to review incoming, outgoing and internal electronic communications, including those that go through social media sites for compliance with SEC and FINRA rules.

Generally, FINRA does not consider posts by third parties as firm communications under Rule 2210, however it has adopted the same entanglement and adoption approach as the SEC. Best practices concerning third party communications would include establishing usage guidelines for customers and third parties; screening third party posts; and disclosing the firm's policy regarding responsibility for third party posts.

Investment advisers need to be particularly careful about social media sites which contain or may be seen as containing personal recommendations.

The Investment Advisers Act, and the rules thereunder, prohibit, among other things, investment advisers from engaging ''in any act, practice, or course of busi-

[14] Use of Electronic Media, Securities Act Release No. 33-7856, Exchange Act Release No. 34-42728, Investment Company Act Release No. 24426 (Apr. 28, 2000) at II.B.1.b.

[15] 17 C.F.R. § 240.14a-1(1)(iii) (2010).

[16] FINRA Regulatory Notice 10-06 (Jan. 2010) (Social Media Web Sites), *available at* http://www.finra.org/web/groups/industry/@ipi@regl@notice/documents/notices/p120779.pdf.

ness which is fraudulent, deceptive, or manipulative.''[17] Specifically, it is unlawful for any investment adviser ''directly or indirectly, to publish, circulate or distribute'' any advertisement which refers to any testimonial concerning the investment adviser or its recommendations.[18]

An ''advertisement'' is defined broadly as any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities.[19] Accordingly, investment advisers need to be particularly careful about social media sites which contain or may be seen as containing personal recommendations.

Regulatory Action

In February 2010, the Financial Services Authority, the regulator of financial services firms in the United Kingdom, conducted a review of the use of new media (including Facebook and Twitter) to communicate financial services promotions. The FSA found that in some cases social media promotions did not comply with the FSA's promotional rules and set forth certain best practices, including regular review of social media sites to ensure that information is up to date and compliant.[20] In February 2011, the SEC conducted an information ''sweep'' of investment advisers seeking documentation relating to the advisers' use of social media. Among other things, the SEC requested information relating to advisers' policies and procedures for monitoring social media, record-keeping of communications made through social media, and training of company employees to use social media.[21] It is not clear whether the SEC will use this information for enforcement proceedings or rulemaking.

Conclusion

Given the relatively recent adoption of social media by the corporate world, it is not surprising that regulators and the courts have not yet provided extensive guidance on the intersection of the federal securities laws and social media. Yet, regulators are beginning to focus on these issues. It is therefore useful to proactively consider the ways in which social media use could run afoul of the federal securities laws. Accordingly, companies would be wise to develop and adopt carefully tailored social media policies in light of the federal securities laws (as well as other applicable laws), carefully monitor their social media sites and educate their employees on the very real risks of social media use. In particular, companies should focus on social media usage that could be construed to offer to sell securities, disclose material non-public information, or solicit stockholder action.

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[17] Investment Advisers Act, 15 U.S.C. § 80b-6 (2010).
[18] 17 C.F.R. § 275.206(4)-1 (2010).
[19] § 275.206(4)-1(b).

[20] Financial Promotions Using Social Media, FIN. PROMOTIONS INDUSTRY UPDATE (Fin. Services Authority), June 2010, at 1, *available at* http://www.fsa.gov.uldpages/Doing/Regulated/Promo/pdf/new_media.pdf.
[21] Jessica Toonkel, *SEC said to 'sweep' advisory firms for social-media info*, INVESTMENTNEWS, Feb. 14, 2011, http://www.investmentnews.com/apps/pbcs.dlllarticle?AID=/20110214/FREE/110219962.

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