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Think before you tweet: Social Media and Securities Law

In September 2018, the U.S. Securities and Exchange Commission (“SEC”) charged Elon Musk, the former Chairman of Tesla, Inc., with securities fraud. A series of Tweets on Musk’s personal page, the first of which read: “Am considering taking Tesla private at \$420. Funding secured”, caused share prices to instantly soar. In reality, the potential transaction was uncertain and subject to a number of contingencies. Market confusion and disruption ensued.

The SEC claimed Musk’s tweets amounted to issuing false and misleading statements and to a failure to properly notify regulators of material events at Tesla. The action quickly settled, with Musk agreeing to step down as Chairman of the Board of Tesla for at least three years, and both Musk and Tesla paying a \$20 million penalty each. Tesla was forced to agree to governance reforms, including the establishment of a new committee of independent directors to oversee the implementation of new policies and procedures regarding Musk and other key players’ communications.

Social media has emerged as an easy, quick, and cost-effective method to connect with the public. Canadian and US regulators have grappled with how to regulate social media in the securities law context developing two distinct approaches.

In the United States, companies are generally permitted to publicly announce material information via social media in lieu of a traditional news release. The SEC’s views were articulated in 2013 after an investigation into Netflix CEO’s Reed Hastings, who posted on his personal Facebook page that Netflix had achieved a corporate milestone (for the first time viewers had watched 1 billion hours in a month). The SEC concluded that social media could be used to announce material information, so long as investors are alerted beforehand about what mediums may be used to disseminate such information (this has since been dubbed the “Reed Hastings Rule”).

In the case of Tesla, filings were made with the SEC informing investors that Mr. Musk’s Twitter account would be used as a means of announcing material company information. The controversy was therefore not about Mr. Musk’s use of Twitter, but rather the substantive content of his tweet.

By contrast, in Canada, companies remain obliged to generally

disclose material information through press releases. Social media may only be used to further disseminate material information that is already generally disclosed, and cannot be used as a medium to make initial public announcements of material information.[1]

Although we have yet to see such a high-profile securities case arising from the use of social media by a board member in Canada, more and more companies are endorsing their social media profiles – and sometimes their executive’s personal social media profiles – as platforms to communicate material information to the public and to their shareholders.

An important take-away from Musk’s experience is that the SEC’s main concern with Tesla was its lack of controls and procedures to oversee the information being shared on Musk’s Twitter account. To protect themselves from investigations by securities regulators, public companies should ensure that proper procedures, policies and control processes are in place when using social media as a means of disclosing material company information.

Canadian public companies and their key player should consider the following precautions:

- setting up a clear and comprehensive procedure and policy for posting company information on social media, including an oversight mechanism. Ensuring these procedures and policies are made readily available to the public;
- limiting or eliminating the number of key players and representatives who may post company information on their personal social media profiles;
- using social media as an additional means of disclosure, but not as a replacement for disclosure through traditional mediums;
- ensuring that social media posts mirror disclosure provided through other means to ensure consistency and to avoid misleading the public;
- creating a clear list of Board-sanctioned social media profiles investors and shareholders can turn to for information about the company and keeping a record of any relevant social media posts;
- establishing a special committee to oversee and approve social media disclosure, and general social media presence, to prevent any potential breach of securities regulations;

- establishing a system whereby an independent committee reviews, vets and approves the content and timing of posts before they appear on social media.

With notes from Julia Flood

[1] CSA Staff Notice 51-348 Staff's Review of Social Media Used by Reporting Issuers

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<https://www.bloomberg.com/news/articles/2018-09-27/elon-musk-is-sued-by-securities-and-exchange-commission-docket-jml0ca0m>