The danger of blogging

The SEC needs to be careful in its encouragement of using the internet to disseminate material information

Innovation is, by its nature, exciting. New approaches based on technological advances are often exhilarating. But when the excitement dies down, we are occasionally left with the uncomfortable suspicion that we are no better off than we were before.

Recently, SEC chairman Chris Cox surprised the public by publishing an official SEC communication in a corporate blog. In a November 2 blog posting, Cox responded to Sun Microsystems CEO Jonathan Schwartz's letter to the chairman requesting that the SEC consider blog postings as widely disseminated information satisfying a public company's Regulation FD disclosure obligations. Cox's means of communication generated more commentary than the substance of his response, and there was little discussion of the implications of using blogs for corporate communications.

The SEC adopted Regulation FD (Selective Disclosure and Insider Trading), or Reg FD, in 2000 to prevent public companies disclosing material non-public information on a selective basis to market professionals (principally research analysts) who might be able to use that information to their own advantage at the expense of the public. The regulation applies to communications on behalf of the issuer with market professionals and with security holders who might trade on the basis of the disclosed information. Reg FD requires that, whenever an issuer intentionally discloses material non-public information, it must do so through a general public disclosure. If it learns that it has made an unintentional selective disclosure, it must make public disclosure promptly. Public disclosure must be made through FD-compliant means, such as distributing a press release through a widely circulated news or wire service or holding a press conference to which the public is granted access. Most companies use pre-announced conference calls and press releases to satisfy these requirements. Although the regulation applies to selective disclosure of material non-public information, Reg FD does not define materiality, leaving it up to case law and other SEC guidance. Consistent with its policy goal of ensuring that market participants receive timely access to information, since adopting Reg FD, the SEC has adopted amendments to the Form 8-K disclosure requirements, mandating that companies disclose the occurrence of additional events by filing a current report. The SEC also has pursued several highly publicized enforcement actions for Reg FD violations.

"Are blogs useful in conveying material information? Conversation and disclosure are, by their nature, different"

Public companies and their advisers struggle with the challenges of communicating responsibly with stockholders and other market participants in light of the dangers associated with corporate communications in a litigious environment. After Reg FD came into force, public companies revisited their corporate communications practices and many adopted Reg FD disclosure policies, training policies or other well-iterated practices relating to their communications – understanding that these communications would be carefully scrutinized.

Since Reg FD was adopted in 2000, there have been continuing advances in communications. More means of electronic communications are available, all of which allow for immediate dissemination of information. Access to the internet and internet use has grown. Companies now use their websites to provide investors with increased access to information about their governance policies, products and other developments. According to news reports, 30 Fortune 500 companies publish corporate blogs.

The SEC recognizes the value of electronic communications and has implemented a number of regulatory changes permitting broader use of electronic means of communication. For example, as part of securities offering reform, the SEC adopted the access-equals-delivery model for prospectus delivery, which presumes that investors have access to a final prospectus once it is filed. The SEC has also proposed the e-proxy rule, which would permit delivery of proxy materials by posting to a company's website and notifying stockholders that the materials are available. Chairman Cox has been championing the interactive data XBRL initiative, requiring electronic tagging of financial data in company filings to make filings easier to use, compare and analyze. All of these changes are intended to bring the securities regulatory scheme, originally conceived in the 1930s, into the internet age.

The SEC has studied Reg FD's effects on public disclosure and considered changes to increase its effectiveness. In a 2001 Reg FD study, a roundtable suggested that the SEC explore additional uses of technology that would satisfy the broad, non-exclusionary standard, including adequately noticed website postings, fully accessible webcasts and electronic email alerts. The study noted that the regulations of securities exchanges, including the NYSE and Nasdaq, should be reviewed, because they require that listed companies make disclosures through press releases.

In his response to Sun's CEO, Cox applauds the use of corporate websites as a source of information to the market and investors. However, the chairman does not take a particular point of view regarding the use of blogs. The letter expresses interest in the idea of web postings being considered widespread information. Cox notes that, among the questions the SEC would need to address is "whether there exist effective means to guarantee that a corporation uses its website in ways that assure broad non-exclusionary access" and that "the extent to which a determination that particular methods are effective in that regard depends on the particular facts". Presumably, for example, corporate websites that require users to register, obtain a password and log on would not satisfy the SEC's broad non-exclusionary access test. Cox concluded by inviting Sun's CEO to discuss the issue further with the SEC.

Using blogs as a Reg FD-compliant means of communication requires more discussion. In many respects, the nature of a blog renders it a highly questionable tool for the disclosure of material information. A blog is, in essence, an electronic forum for conveying information, exchanging ideas, posing and responding to questions, and commenting on specific topics, which might include any topic that comes into a blogger's head. Much of the discussion on the suitability of blogs as a means of satisfying Reg FD obligations has focused on whether use of this technology would constitute wide dissemination of information. It is true that companies cannot presume that their stockholders will regularly read corporate blogs. It is also true that communicating information through blogs could shift the balance and put the onus on an investor to watch for information, as opposed the company bearing an affirmative obligation to disseminate information. Some of these concerns could be alleviated by technology, for example, alerting investors once a blog posting has occurred. It is also

true that some blogs might not be easy to search. That too is a problem that could be addressed by technology.

It's not that simple

These discussions are interesting, but they are not all that important for public companies. We can all agree that websites and blogs have become established and popular means of sharing information. If widespread dissemination were the only issue, we could stop there, congratulate one another for embracing technology and observe that this is what websites and blogs were intended to do – make information broadly available. But the analysis is not so simple.

Reg FD focuses on the broad disclosure of *material* information, not just any information. Reg FD did not provide guidance on which information would be considered material. In its FD release, the SEC noted that information would be material if a reasonable shareholder would find it important in making an investment decision. A number of judicial standards have developed to define information that is material. For example, the Supreme Court has held that information is material if it "would have been viewed by the reasonable investor has having significantly altered the 'total mix' of information made available". Other courts have considered the likely effect of the information disclosure on the issuer's stock price. Undoubtedly, websites and even blogs would be useful in conveying information about a company – but are they useful in conveying material information? A blog encourages conversation and dialogue, but this dialogue is usually informal. Conversation and disclosure are, by their nature, different. In a blog, a high volume of unimportant chatting might obscure important disclosures. An important piece of information could be lost in the flow of a discussion.

If information on a corporate blog is combined with submissions or commentary from stockholders or other third parties (which is the intention of blogs – providing an interactive forum), this poses additional dangers. Blogs encourage one-on-one communications. A corporate official posts information; a blogger responds or poses a question; and a corporate official responds to the blogger's posting. These one-on-one communications might be tricky to handle. At the time Reg FD was promulgated, legal advisers suggested that companies carefully script their communications and refrain from responding to impromptu questions. One objective of this guidance was to avoid miscommunication and avoid introducing variations in the information that was being communicated. These variations might be viewed as qualitatively significant or somehow altering the overall mix of available information. Blog discussions might, due to their informality, prompt company officials to extend beyond the parameters of their script in ways that could have unintended negative consequences. It also might be difficult to establish ground rules for blogs. For example, on an earnings call, a public company may choose not to take questions or may indicate that it has no comment in response to questions. It is quite easy for a company official to be lulled into responding to a blogger's question in the context of a stream-of-consciousness discussion. Individual questions from bloggers might cause a company to deviate from its intended and consistent disclosure pattern. Would it be possible to achieve consistency in blog communications? If so, once a company has established a particular pattern of response, will it be held by investors and others to that standard going forward?

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All of this suggests that public companies and their advisers need to think carefully about the implications of blogs. In particular, it means revisiting many of the best practices for Reg FD communications and investor relations that have developed and thinking about how these might be translated to an online interactive medium. For example, will only a single company official or a handful of officials be responsible for online communications? Will investor relations and in-house legal staff review blog communications before posting? Will public companies set out policies and procedures in connection with their blogs? It also means re-evaluating some principles that have become well accepted. For example, it is widely presumed that public companies have no affirmative duty to correct incorrect information on a website or chat room and no duty to correct or verify marketplace rumours unless those rumours are attributable to the company. Will that change in the blogosphere? If a company official is engaged in a dialogue with third parties, will the company official take on an affirmative duty to correct incorrect information conveyed by the third party? If company-originated blog postings are combined with third-party postings, can the public presume the same standards of accuracy and balance apply to all of the blog communications? Similarly, public companies now include disclaimers, risk disclosures and cautionary notes regarding forward-looking information in their filings and press releases. Will these disclaimers begin appearing in blogs?

Blogs are here to stay. They will continue to address important needs. Whether blogs should serve as the exclusive or a principal means for satisfying Reg FD requirements should only be answered after questions such these are considered and answered with precision and care.

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