

# Corporate and M&A Law

## Mergers & Acquisitions

### Due Diligence

#### Buyer Beware: Social Media Due Diligence in M&A



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Setting precedent.

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Over the last few years, communication has advanced tremendously due in part to new and improved technology. One of the major advancements in electronic communication has been the creation of social media sites (e.g., Facebook, Twitter, MySpace, LinkedIn, YouTube, and various interactive blogs). Through the use of social media, individuals as well as companies disseminate information to a widespread audience instantaneously. As a result of these capabilities, many

companies have incorporated social media into their business strategies to promote their products and services to existing and potential customers.

This was likely a driver in Twitter's acquisition of BackType, a social analytics company that helps brands and agencies understand the business impact of social media in order to make more intelligent business decisions.<sup>1</sup> Moreover, in the spring of 2011, it was reported that 77 percent of the Fortune Global 100 companies use Twitter, 61 percent have a Facebook page, 57 percent use YouTube, and 36 percent use corporate blogs.<sup>2</sup> These numbers will continue to rise as more companies are forced to integrate social media into their businesses to remain competitive within their respective markets.

Along with the benefits of social media in business, there are also pitfalls. Some of the legal issues include trademark infringement, employee misuse, securities law violations, and negative publicity. This article describes some of those pitfalls from the perspective of a buyer seeking to acquire or partner in an M&A transaction with a target company that utilizes social media.

#### Due Diligence Requests

Traditionally, in an M&A transaction, a buyer will conduct a due diligence review of the target. Material information about the target company is disclosed to the potential buyer and examined by the buyer and its hired professionals (e.g., attorneys, investment bankers and accountants) to determine, among other things, the financial stability, obligations and liabilities, value, potential growth, assets, and profitability of the target company. As part of the due diligence review, a target company is generally

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asked to disclose information regarding its marketing strategies and to provide copies of its marketing materials. Specifically, a standard marketing due diligence request may require a target company to disclose “*all press releases issued by the Company during the past five years and any press clippings that refer to the Company, if available.*”<sup>3</sup> Some confusion by the target company’s representatives may arise as to whether the use of social media would fall under the marketing category or under any of the other categories normally set forth in a due diligence request. Although such postings could be considered press releases, it is probably unreasonable to expect a target company to disclose all of its Facebook postings made within the last five years.

Ambiguities in due diligence requests can lead to potential omissions of pertinent information and to potential exposure of unknown obligations and liabilities. To avoid confusion and possible omissions by target companies when disclosing information in response to a due diligence request, potential buyers should specifically request information regarding social media usage by the target company. Buyers should consider incorporating the following information regarding social media into their due diligence request: (1) the names of social media outlets used by the target company, (2) the usernames and passwords to social media accounts of the target company, (3) the names of employees with access to operate such social media accounts on behalf of the target company, and (4) an explanation of the target company’s use of the social media outlets. This requested information should provide buyers with a more in-depth look at the target company’s social media activities.

### Unauthorized Accounts and Postings

In addition to reviewing information disclosed by the target company regarding its official social media accounts, it is equally important for potential buyers to examine unauthorized social media accounts and postings made by third parties regarding the target company’s business. Reviewing third-party social media accounts and postings as part of a potential buyer’s due diligence provides additional information about the target company’s reputation within the market. Potential buyers should pay close attention to negative comments since such comments may also have a damaging effect on the target’s bottom line. The methods used by the target company to address negative comments, including requests to remove negative content, should also be reviewed by potential buyers.

Buyers should also search for misuses of the target company’s intellectual property during their due diligence review. The occurrence of “name-squatting,” a process by which a user registers the name of another company or names associated with another company with the intent to mislead the public as to the ownership of the social media account, is a rising concern among companies using social media sites. For example, CNN had to negotiate an agreement with a CNN fan to obtain ownership of a Twitter account, “@CNNBrk”, set up by the fan to automatically tweet CNN’s Breaking News e-mail alerts.<sup>4</sup> Not wanting to take an aggressive stance against the fan, CNN chose to hire the fan as a consultant to train CNN staffers on how to use Twitter in return

for the ownership rights to “@CNNBrk.”<sup>5</sup> Buyers should ensure that there are no existing social media accounts that have “name-squatted” the target company’s name or logos.

Additionally, buyers should search for more common problems involving intellectual property such as counterfeit sales of goods, trademark and copyright infringements, and false or misleading advertising on various social media sites. Buyers should also review the precautionary steps, if any, taken by the target company to safeguard its intellectual property. Owners of intellectual property are legally required to monitor unauthorized use to effectively assert a claim for infringement.

### Employee Social Media Use

The use of social media by employees, whether for business or personal reasons, is another area of concern for buyers. Since employees are representatives of the company, their misconduct can have a major impact, especially when involving employees in supervisory positions, since it poses a risk of vicarious liability. Buyers should request a copy of the target company’s social media

use policy, if any, to examine whether such policies are being adhered to by the target company’s employees and the efforts made by the target company to enforce their policies. Some of the most common issues faced by companies involving employee use of social media are the following:

- **Litigation Exposure.** Despite policies on the use of social media during work hours, employee use of social media even through a personal account may expose its employer to liability. In one case, a male employee took unauthorized pictures of a female co-worker while at work and posted the pictures on his personal Facebook page.<sup>6</sup> The female co-worker became aware of the posted pictures and filed an EEOC claim for harassment against both the male employee and the employer.<sup>7</sup> Although the actions of the employee did not relate to the employer’s business activities, the employer became a party to the claim because it failed to adequately address the issue.
- **Dissemination of Confidential Information.** The potential for confidential information to appear publicly online is another major concern for employers. According to one IT journal, over the past year, most companies experienced at least nine social media incidents, with 94 percent of the companies surveyed suffering negative consequences such as loss of customer trust, data, and revenue.<sup>8</sup> Two of the top three types of social media incidents identified by the companies surveyed were (1) employees sharing too much information in public forums (46 percent), and (2) the loss or exposure of confidential information (41 percent).<sup>9</sup>
- **Disparaging Comments about the Company.** Another growing concern for employers is monitoring of disparaging comments made by its own employees. In one case, angry employees of a company created

a private Myspace group page to provide past and current employees with an outlet to vent about their experiences at work.<sup>10</sup> The icon for the Myspace group page was the trademarked logo of the company, thus making the page identifiable to its customers.<sup>11</sup> The posts included references to violence and illegal drug use, negative remarks about management and customers, and information relating to the company's business.<sup>12</sup> More recently, George Jensen, founder, Chairman and CEO of USA Technologies Inc. (USA Tech) was suspended after an investigation by an outside consulting firm uncovered that Jensen had posted several comments relating to USA Tech and its stock prices.<sup>13</sup> Jensen also commented on postings which criticized USA Tech. Though it may be difficult to identify individual employees due to privacy protections and the ability to use pseudonyms, potential buyers should still be aware of such postings and request their removal from the social media sites.

### Compliance with Laws

Publicly-traded companies using social media may be subject to certain federal laws. The dissemination of information relating to a proposed M&A transaction by a publicly-traded buyer or seller through a social media outlet would also be subject to various federal securities laws. For example, a company reporting with the U.S. Securities and Exchange Commission that wishes to announce its decision to acquire another company in a stock-for-stock merger using a social media outlet such as LinkedIn or Twitter would be subject to Rule 165 of the Securities Act of 1933.<sup>14</sup> Rule 165 applies to all written communications made in connection with or relating to a business combination such as a merger and requires public companies to make additional disclosures and filings.<sup>15</sup> Additionally, disseminating information about a proposed M&A transaction through a social media outlet may be deemed a "solicitation" of proxies which would subject the acquirer to Rule 14a-12 of the Securities Exchange Act of 1934.<sup>16</sup> Rule 14a-12 requires proxy statements to be furnished to shareholders prior to any solicitation.<sup>17</sup> Thus, public companies may be required to provide shareholders with proxy statements prior to disclosing information on the social media outlets.

Buyers should also be aware of prohibitions against disclosure of "material nonpublic" information, such as the decision to acquire a company. Disclosure of such "material nonpublic" information by employees or representatives of both potential buyers and target companies may be deemed insider trading in violation of Rule 10b-5 of the Exchange Act and may lead to investigations and subsequent penalties by federal authorities. The SEC investigated the CEO of a large grocery store chain for potential securities violations after it discovered that the CEO had posted comments using a pseudonym on a social media site regarding a competitor it was in the process of acquiring.<sup>18</sup> However, the SEC eventually closed its investigation.

Also, the SEC inquired into an internal email written by Groupon CEO Andrew Mason regarding the financial stability of the company that was leaked to a social media outlet for possible

violations of the SEC's pre-IPO "quiet period" rules.<sup>19</sup> While the email leak did not interfere with Groupon's subsequent IPO, it illustrates that companies seeking to go public are under intense scrutiny to comply with the SEC rules. To avoid these potential issues, prospective buyers and target companies should consider educating their employees and representatives regarding federal laws governing disclosure of company information through the use of social media prior to engaging in a transaction.

### Conclusion

With the continued growth and widespread influence of social media, it is a good practice for buyers to review and consider social media issues as a part of their due diligence review. Companies should consult with attorneys to assess potential liability and exposure of a target company, including that occurring as a result of its use of social media.

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<sup>1</sup> Leena Rao, *Twitter Acquires BackType*, Tech Crunch (July 5, 2011).

<sup>2</sup> *77% of Fortune Global 100 Companies Use Twitter*, The Realtime Report (Mar. 18, 2011).

<sup>3</sup> Committee on Negotiated Acquisitions, Section of Business of the American Bar Association, Manual on Acquisition Review, 140 (Ariel Vannier et al. eds., 1995).

<sup>4</sup> Julia Angwin, *Who Owns Your Name on Twitter?*, The Wall Street Journal (May 19, 2009).

<sup>5</sup> *Id.*

<sup>6</sup> *Yancy v. U.S. Airways, Inc.*, No. 10-cv-00983, Order and Reasons, at 1 (E.D. La. filed July 20, 2011).

<sup>7</sup> *Id.*

<sup>8</sup> Symantec, *Social Incident Cost Typical Company \$4M over the Last Year*, TechJournal South (July 26, 2011).

<sup>9</sup> *Id.*

<sup>10</sup> *Pietrylo v. Hillstone Restaurant Group d/b/a Houston's*, No. 06-05754, 2008 BL 306076 (D.N.J. July 24, 2008).

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *USA Technologies Comments on Resignation of Chairman and Chief Executive Officer George Jensen*, Business Wire (Oct. 18, 2011).

<sup>14</sup> 17 C.F.R. § 230.165.

<sup>15</sup> *Id.*

<sup>16</sup> 17 C.F.R. § 240.14a-12.

<sup>17</sup> *Id.*

<sup>18</sup> Joshua Lipton, *Whole Foods Faces SEC Probe*, Forbes Magazine (July 16, 2007).

<sup>19</sup> Cory Johnson, *Douglas MacMillan and Brian Womack, Groupon Chairman Remarks May Require Company to Make New Filing Before IPO*, Bloomberg News (June 7, 2011).