

Corporate and Securities Alert

April 29, 2013

SECURITIES

TRANSACTIONAL

SEC Gives Nod to Use of Social Media Under Regulation FD—If Done Correctly

Key Takeaways:

- The SEC has confirmed that social media can be used to disseminate material information in a manner that satisfies Regulation FD.
- Whether a particular disclosure through social media complies with Regulation FD is assessed using the principles contained in the SEC's 2008 guidance on the use of company websites. Under that guidance, a company must consider whether: (1) the communication is made via a recognized channel of distribution; (2) the information is disseminated in a manner that makes it available to the securities marketplace in general; and (3) there has been a reasonable waiting period for investors and the market to react to the information.
- Companies that want to use social media to disseminate material nonpublic information must inform investors about the specific channels they plan to use and the types of information that may be disclosed through those channels. A company using social media as the sole means of disseminating material information will also need to carefully consider whether and when that dissemination has been sufficiently broad so that the information can be repeated in a private conversation without violating Regulation FD.
- Companies should carefully consider whether using social media as the exclusive means of disseminating material nonpublic information is the best way to communicate with investors. At least for now, as was the case before the new report issued by the SEC, most public companies will continue to be best served by disseminating material information through a press release or a Form 8-K, supplemented by website posting, social media and other means of dissemination targeted at various intended audiences.

On April 2, 2013, the Securities and Exchange Commission (SEC) issued a [Report of Investigation](#) that concluded an investigation by the SEC's Division of Enforcement into whether the CEO of Netflix, Inc. had violated Regulation FD by posting an updated corporate metric on his personal Facebook page, without the company making any other simultaneous public disclosure of that metric.

In the Netflix report, the SEC confirmed something that its staff had been saying for years—public companies can use social media outlets such as Facebook and Twitter to disseminate information in a manner that satisfies Regulation FD, but only if that usage complies with the principles outlined by the SEC in its 2008 [Guidance on the Use of Company Web Sites](#).

While the report reflects the SEC's recognition of the increased use and importance of social media channels, as well as the SEC's willingness to allow companies to explore new ways to communicate with investors, it does not fundamentally change the regulatory framework for analyzing Regulation FD compliance. However, with appropriate groundwork by companies based on the principles outlined in the SEC's 2008 guidance, the report may well contribute to an increased acceptance of social media as an investor communication tool.

Background About Regulation FD and the Netflix CEO's Post

Regulation FD prohibits a public company from intentionally disclosing material nonpublic information to specified types of market professionals, such as securities analysts, broker-dealers and investment advisers, or to security holders, if it is reasonably foreseeable that holders will trade on the basis of the information, unless the company publicly discloses the information simultaneously. In addition, if a company "non-intentionally" discloses material nonpublic information to persons covered by Regulation FD, the company must publicly disclose the information as soon as reasonably practicable after relevant company personnel learn of the disclosure, but in no event after the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange (NYSE). A disclosure is "non-intentional" if the company was not aware (and was not reckless in being unaware) that the information was material or that the information had not previously been publicly disclosed. Regulation FD can always be satisfied by disseminating information through a timely Form 8-K submitted to the SEC. Regulation FD can also be satisfied through dissemination of information by a method or combination of methods "reasonably designed to provide broad, non-exclusionary distribution of the information to the public," such as a press release.

In December 2012, Netflix announced that the company and its CEO had each received a "Wells notice" from the staff of the SEC Division of Enforcement, indicating the staff's intent to recommend that the SEC institute a cease and desist proceeding and/or bring a civil injunctive action against Netflix and its CEO for violating Regulation FD. The notice resulted from the CEO's posting of an updated corporate metric (that Netflix's monthly online viewing had exceeded one billion hours for the first time) on his personal Facebook page, without simultaneously making any other disclosure of the metric. See "Timeline" below for more details regarding disclosures made by Netflix and its CEO about the streaming metric.

The Netflix report, which was issued by the SEC in conclusion of the investigation, notes that neither Netflix nor its CEO had previously used the CEO's personal Facebook page to announce company metrics, and that Netflix had not previously informed investors that the CEO's personal page would be used to disclose information about Netflix. Instead, the report notes, Netflix had consistently directed the public to Netflix's corporate website, Facebook page, Twitter feed and blog for information about Netflix. Stating that it recognized that there has been market uncertainty about the application of Regulation FD to social media, the SEC decided not to initiate an enforcement action or allege wrongdoing by Netflix or its CEO.

Revisiting and Applying the SEC's 2008 Guidance to Social Media

The Netflix report built upon the SEC's August 2008 interpretive guidance regarding the use of company websites under the Exchange Act and the antifraud provisions of the federal securities laws. In issuing the 2008 guidance, the SEC noted that its purpose was to encourage the continued development of company websites as a significant vehicle for the dissemination of important company information to investors. The 2008 guidance focused on use of corporate websites and did not explicitly address social media, though the framework created in the 2008 guidance was intended to be flexible and adaptable to technological changes. The Netflix report confirms that the framework established in the 2008 guidance applies equally to social media communications. As the report says: "[T]he principles outlined in the 2008 Guidance — and specifically the concept that the investing public should be alerted to the channels of distribution a company will use to disseminate material information — apply with equal force to corporate disclosures made through social media channels."

The most significant aspect of the 2008 guidance was its recognition that in certain circumstances disclosure of information on a company website can, by itself, satisfy a company's obligations under Regulation FD.¹ The discussion in the 2008 guidance of whether and when information posted on a company website will be considered "public" for purposes of Regulation FD implicates two important Regulation FD issues:

- Does posting information on a company website satisfy Regulation FD's "public disclosure" requirement?
- Do private discussions of information with Regulation FD-enumerated persons after the information has been posted on a company website violate Regulation FD?

The 2008 guidance adopted, and the Netflix report confirms, a facts-and-circumstances approach rather than a bright-line approach to answer these questions. The 2008 guidance suggests that a company consider whether (1) its website is a "recognized channel of distribution," (2) posting information on the website "disseminates" the information in a manner that makes it available to the securities marketplace in general, and (3) there has been a reasonable waiting period for investors and the market to react to the posted information before the company makes a subsequent disclosure to Regulation FD enumerated persons.

Recognized Channel of Distribution; Dissemination

The 2008 guidance explains that the SEC will consider a company website to be a "recognized channel of distribution" when the company has taken steps to alert the market to its website and its disclosure practices. The SEC will also take into account the extent of investors' use of the company website. For companies whose websites are known by investors as a location of company information, "dissemination" turns on (1) the manner in which the information is posted on the company website, and (2) the timely and ready accessibility of posted information to investors and the markets.

The 2008 guidance provides a non-exclusive list of factors for a company to consider in evaluating whether its website is a "recognized channel of distribution" and whether information posted on the website is adequately "disseminated":

- whether and how the company informs investors that it has a website that they should look at for company information;
- whether the company has notified investors that it will post important information on its website and whether it typically posts important information on its website;
- whether the website directs investors to investor-related information, whether such information is prominently disclosed in a location routinely used for such disclosures and whether the information is posted in a format that is readily-accessible to the general public;
- whether the market and media regularly report on information posted on the website and the extent to which the company has advised newswires or the media about such information;
- the size and market following of the company involved;

¹ The other topics addressed by the 2008 guidance were: (1) company liability for information posted on a company website; (2) the types of controls and procedures advisable with respect to information posted on a company website; and (3) the required format of information posted on a company website. With respect to controls and procedures the 2008 guidance explained that the Exchange Act requirements regarding maintenance of disclosure controls and procedures do apply to information a company posts on its website as an alternative to providing the information in an Exchange Act report, as permitted by certain SEC rules, while the Exchange Act rules relating to disclosure controls and procedures (and the related certification provisions) do not apply to other information posted on a company website. However, because companies are responsible for, and could have liability as a result of, information posted on their websites or social media channels, all companies should have controls and procedures designed to ensure the accuracy and completeness of the information.

- the steps the company has taken to make its website accessible, including the use of “push” technology or releases through other distribution channels either to distribute the information or advise the market of its availability;
- whether the company keeps its website current and accurate;
- whether the company uses other methods (in addition to website posting) to disseminate the information and whether such methods are its predominant methods for dissemination of company information; and
- the nature of the information.

Applying the “Recognized Channel of Distribution” and “Dissemination” Standards to Social Media:

As noted in the Netflix report: “The central focus of this inquiry is whether the company has made investors, the market, and the media aware of the channels of distribution it expects to use, so these parties know where to look for disclosures of material information about the company or what they need to do to be in a position to receive this information.”

The report highlights some factors that may be especially relevant in the social media context. These include providing appropriate notice to investors about:

- the specific social media channels the company will use for the dissemination of information, so that investors are in a position to subscribe, join, register for or otherwise review those particular channels; and
- the types of information that may be disclosed through these channels.

A company that wants to use social media as a means of disseminating material nonpublic information should regularly use multiple methods to inform the public of its plans. Options include: initial announcement via press release and Form 8-K; regular disclosure in the company’s periodic reports, proxy statements and other shareholder communications and press releases; prominent disclosure on the company’s corporate website; inclusion of links to social media on the company’s corporate website and in other communications; and notification to the media about the company’s use of social media.

A company seeking to take advantage of the interpretive guidance should also actually make regular use of the social media channels it identifies, regularly review its practices over time, and update its public disclosure regarding social media as needed to reflect changes. It should be prepared to demonstrate a track record of successfully using its social media channels to disseminate information by maintaining information about the number of subscribers and about the frequency and speed with which posted information has been republished by others and otherwise further disseminated. A company should not try to episodically use an identified social media channel to “quietly” disclose negative information.

Reasonable Waiting Period

Although not a specific area of focus in the Netflix report, companies need to be aware that, under the 2008 guidance, if posting information on a company website is considered to be a valid means of publicly disseminating information for purposes of Regulation FD, the posted information will be deemed to be properly publicly disclosed only after investors have been afforded a reasonable waiting period to react to the information before the company engages in private conversations about that information with people enumerated in Regulation FD. Whether a waiting period is reasonable depends on the particular facts and circumstances of the dissemination. The 2008 guidance provides the following non-exclusive factors for companies to consider:

- the size and market following of the company;
- the extent to which investor-oriented information on the company website is regularly accessed;
- the steps the company has taken to notify investors that it uses its website as a key source of company information;
- whether the company has actively disseminated the information posted on the website, or notice of the availability of this information, including through other channels of distribution; and
- the nature and complexity of the information.

Thus, the duration of a reasonable waiting period will vary across companies and for different types of announcements. The 2008 guidance also suggests that companies consider taking additional steps to alert investors and the market that important information will be posted on their websites—such as posting, filing or furnishing the information to the SEC or issuing a press release—prior to posting the information on the website.

Under the foregoing analysis, if information posted on a company website qualifies as “public,” a subsequent private disclosure of that information—such as to an analyst—would not constitute a “selective disclosure” under Regulation FD (and thus would not violate Regulation FD) because such information, even if material, would not be nonpublic. Moreover, in certain circumstances, posting information on a company website may, in and of itself, be a sufficient method of simultaneous public disclosure of material nonpublic information that is otherwise being disclosed in a nonpublic forum or of curative public disclosure following a non-intentional selective disclosure.

Applying the “Waiting Period” Standard to Social Media:

One of the biggest challenges to using social media as a means of disseminating material nonpublic information will be how to determine when the posted information has been adequately disseminated such that it can be freely repeated in a private conversation without concern that the private statement violates Regulation FD. In contrast to disclosure made via a Form 8-K, which results in the information being deemed to be fully disseminated immediately, companies will need to assess, and be able to demonstrate after the fact, that adequate dissemination has occurred.

In addition to the factors listed above, in the context of social media some of the additional factors that may be relevant to consider are: the time of day when the posting is made; whether the company has previously posted information about the topic it is now addressing; whether the topic of the post was adequately identified in the company’s prior notices about its intent to use social media; whether, after posting, the information has been reported by media outlets; and whether the method of dissemination used “push” technology.

Other Lessons and Reminders

The Netflix report's description of the factual background highlights other items that serve as useful reminders about compliance with Regulation FD:

- The report quotes the CEO's explanation during a January 2012 earnings call of the relevance of the streaming metric that the CEO later updated on his personal Facebook page. **Lesson:** The SEC staff routinely reviews statements made by companies outside of their SEC filings, both in connection with enforcement actions and as part of the staff's regular review of corporate filings. The SEC staff routinely issues comments to companies asking about matters discussed on earnings calls that do not appear in SEC filings. To the extent a company elects to use social media as a means of communicating with investors, the company should expect that the SEC staff may be looking at those posts whenever it reviews the company's filings.
- The report notes that prior to his July 2012 post, the CEO did not receive input from Netflix's CFO, legal department or IR group. **Lesson:** Assessing materiality of information can be hard, so it is best for disclosure decisions to be made with input from others, allowing for consideration of all relevant facts and circumstances. The ease with which information can be posted on social media does not change a company's responsibilities (and liabilities) under the federal securities laws, and in fact may increase the risk of an inadvertent or incomplete communication. Companies must put appropriate procedures in place to vet all information disseminated by or on behalf of the company, regardless of what means of dissemination is used.
- Although the report does not explicitly analyze whether the streaming metric was material, the report states that Netflix's stock price rose from \$70.45 at the time of the CEO's post to \$81.72 at the close of the following trading day. **Lesson:** Although the SEC has consistently said it will not second-guess good faith judgments, enforcement actions over the years have demonstrated that the SEC assesses materiality in hindsight, including focusing on what

TIMELINE

1/4/12 – Netflix issues a press release announcing that Netflix members streamed more than two billion hours of TV shows and movies in the fourth quarter of 2011.

1/25/12 – Netflix features the two billion hours streaming metric as part of its announcement of year-end financial results. Netflix's CEO explains relevance of streaming metric in response to a question during earnings call; states that Netflix expects to update metric "on a milestone basis."

6/4/12 – Posting on Netflix's official company blog references streaming metric: "Around the world, people are enjoying nearly a billion hours per month of movies and TV shows from Netflix."

7/3/12 – CEO posts the following on his personal Facebook page (which has approximately 200,000 subscribers): "Congrats to Ted Sarados, and his amazing content licensing team. Netflix monthly viewing exceeded 1 billion hours for the first time ever in June. When House of Cards and Arrested Development debut, we'll blow these records away. Keep going, Ted, we need even more!" Netflix does not make any other public announcement of the streaming metric.

12/6/12 – Netflix announces in a Form 8-K that the company and its CEO have received Wells notices from the SEC staff in the Division of Enforcement.

4/2/13 – SEC issues Report of Investigation Pursuant to Section 21(a). Stating that it recognizes that there has been market uncertainty about the application of Regulation FD to social media, the SEC decides not to initiate an enforcement action or allege wrongdoing by Netflix or its CEO.

4/10/13 – Netflix states in a Form 8-K that it plans to announce material financial information using its corporate IR website, SEC filings, press releases, public conference calls and webcasts. It states that it plans to use these channels plus specified social media channels to communicate with subscribers and the public about the company, its services and other issues. Netflix states that: "It is possible that the information we post on social media could be deemed to be material information. Therefore, in light of the SEC's guidance, we encourage investors, the media, and others interested in our company to review the information we post on the [identified social media channel]."

happened to the stock price and volume after disclosure of the information. While Netflix pointed to other developments that may have accounted for some or all of the price change, proving a negative is always difficult.

- The report states that information from the CEO's Facebook post reached the securities market incrementally, being picked up by a technology blog in about an hour and by some news outlets within two hours. Approximately one hour after the CEO's post (which was made at 11 a.m.), Netflix sent it to several reporters, but did not disseminate it to the broader mailing list normally used for corporate press releases. **Lesson:** While it is not clear (or even alleged in the report) that the outreach to several reporters was prompted by a concern over Regulation FD compliance, this is a good reminder that Regulation FD mistakes, when discovered, can often be mitigated by making prompt public disclosure.

The Netflix report also makes clear that companies should remain especially vigilant about dissemination of information through executives' personal social media accounts. It warns:

[D]isclosure of material, nonpublic information on the personal social media site of an individual corporate officer, without advance notice to investors that the site may be used for this purpose, is unlikely to qualify as a method 'reasonably designed to provide broad, non-exclusionary distribution of the information to the public' within the meaning of Regulation FD. This is true even if the individual in question has a large number of subscribers, friends, or other social media contacts, such that the information is likely to reach a broader audience over time. Personal social media sites of individuals employed by a public company would not ordinarily be assumed to be channels through which the company would disclose material corporate information.

As indicated in the above quote, the Netflix report expressly rejected the idea that having a large number of followers, in and of itself, makes a forum Regulation FD-compliant. The report also makes clear the SEC's view that a private communication is problematic if any member of the audience is in one of the groups of people covered by Regulation FD, regardless of how many other people receive that communication.

Companies that are listed on a stock exchange must also keep in mind the requirements of the stock exchanges regarding timely public disclosure and notification in advance of disseminating material nonpublic information. Because both the NYSE and NASDAQ require that a listed company quickly release material information by means of any Regulation FD compliant method or combination of methods, companies should be aware that disclosures through social media that are not compliant with Regulation FD may also run afoul of stock exchange listing standards. Absent a change in requirements, social media disclosures would also be subject to NYSE and NASDAQ requirements for notification to the exchange before the release of material information, generally at least ten minutes prior to the release.

Finally, companies need to decide from an investor relations perspective whether use of social media alone is the best approach for disseminating certain types of information. Although posting information via social media may be an efficient and inexpensive means of communication, in many situations, investors may be more comfortable receiving information through more traditional modes of communication. For example, we do not expect that companies will stop issuing quarterly earnings releases or press releases regarding major developments. However, some companies may find that social media dissemination makes sense as a principal means of providing timely information about events or developments that are of general interest to investors, as well as customers, employees and others. These might include regular updates regarding changes in the company's products or the status of product development projects. Each company needs to make its own decision about what makes sense for it, focusing both on technical compliance with legal requirements, including Regulation FD, and investor relations considerations.

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