

CLIENT UPDATE

BLOGS, FACEBOOKING AND TWEETING: PUBLIC ENOUGH FOR REGULATION FD?

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In the age of social media, corporate communications disseminated through non-traditional outlets such as corporate blogs, Facebook and Twitter may face increased scrutiny by the Securities and Exchange Commission. As recently reported in the press, Netflix, Inc. and its CEO, Reed Hastings received “Wells Notices” on December 5 from the Staff of the SEC indicating the Staff’s intent to recommend that the SEC bring suit against Netflix and Mr. Hastings for violations of Regulation Fair Disclosure (“Regulation FD”) and other related provisions of the Federal securities laws. At issue is whether disclosure that Mr. Hastings posted on his Facebook page in July that Netflix exceeded 1 billion hours of video streaming in a month for the first time violated prohibitions on the selective disclosure of material non-public information.

BACKGROUND

In 2000, the SEC enacted Regulation FD to address what it perceived as the growing problem of selective disclosure by issuers of material non-public information to securities analysts, significant investors and other market professionals. Regulation FD requires that whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any member of a specified group of outsiders, the issuer must make “public disclosure” of that information simultaneously (in the case of intentional disclosure) and promptly (in the case of non-intentional disclosure).

Public disclosure may be made by filing or furnishing a Form 8-K with the SEC or disseminating the information through another method reasonably designed to provide broad, non-exclusionary distribution of the information to the public. The most commonly recognized form of broad, non-exclusionary distribution of information to the public is a press release disseminated over a major news wire service.

In 2008, in light of the development and proliferation of company websites since 2000 and an expectation that continued technological advances would further enhance the quality of, and speed with which, information would be delivered and available to investors and the market generally, the SEC issued interpretive guidance that, among other things, provided guidance on when information posted on a company website would be considered “public” for purposes of satisfying Regulation FD. The guidance requires companies evaluating whether information posted on a company website is “public” to consider whether (1) the website is a “recognized channel of distribution,” (2) posting of information on the website disseminates the information in a manner making 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. As satisfaction of these conditions is somewhat subjective, many issuers have continued to use press releases and other time-tested distribution methods as their primary means of complying with Regulation FD.

THE NETFLIX RESPONSE

In response to the SEC’s allegations, Mr. Hastings has publicly offered three arguments in defense of his actions. Mr. Hastings’ first and primary argument is that more traditional public disclosure was not required because, due to his 200,000 followers (many of whom are reporters and bloggers who he asserts republished the information in question), Facebook itself is a “very public” forum (i.e., Facebook constitutes a method of dissemination on par with a traditional press release disseminated over a major news wire service). If successful, this argument would represent both a step beyond the SEC’s 2008 interpretive guidance (which was limited to the use of company websites) and potentially open a Pandora’s box of questions around whether and to what extent other social media platforms are “Facebook equivalents” for purposes of Regulation FD compliance. Mr. Hastings also argues that Netflix had previously disclosed on its corporate blog that it was nearing the 1 billion hours milestone and, as such, his Facebook post did not constitute a selective disclosure of material non-public information. While a corporate blog may be more analogous to a company website than a Facebook post, Mr. Hastings and Netflix would need to demonstrate that the corporate blog itself satisfies the SEC’s 2008 interpretive guidance. Finally, Mr. Hastings argues that, even if the Facebook post was not public for purposes of Regulation FD, statistics related to hours of streaming video are not “material” for purposes of the Federal securities laws. Whether this argument is

ultimately successful is a question best left to another client update, but it is worth noting that whether information is material is a facts and circumstances determination that has, in many cases, been subject to broad interpretation by the SEC, and often with the support of the courts.

Interestingly, though Mr. Hastings responded to the SEC allegations on his Facebook page, Netflix furnished Mr. Hastings' response on Form 8-K, lest his response potentially constitute another violation of Regulation FD.

IMPLICATIONS FOR ISSUERS

It may be that the SEC intends its Netflix action to serve as a warning to issuers and executives that make use of social media platforms and other non-traditional forms of electronic communications to communicate with investors. It is also possible that the Netflix action is a harbinger of future Regulation FD enforcement activities yet to come (in late 2009 and 2010, after a lull in enforcement activity around Regulation FD, the SEC brought a series of high profile Regulation FD enforcement actions, including an October 2010 enforcement action against Office Depot and two of its senior executives). The relatively short time between Mr. Hastings' Facebook post and the SEC's Wells Notices (only approximately 5 months) suggests that the SEC Staff moved quickly through its investigation and viewed at least this Regulation FD matter as a priority. Until the questions raised by the Netflix matter come to rest, we recommend that issuers:

- Review and, if necessary, update their internal Regulation FD policies to address the use of social media platforms and other non-traditional means of communication.
- Update the scope of communications that fall under the oversight of their disclosure committees to include company sponsored communications disseminated through social media platforms and other non-traditional means of communication.
- Refresh Regulation FD training for authorized corporate spokespersons.
- Carefully consider the SEC's 2008 guidance in connection with the dissemination of material non-public information by means other than SEC filings or press releases disseminated over a major news wire service.
- Remind authorized corporate spokespersons that the SEC's general anti-fraud rule, Rule 10b-5, applies to all corporate communications, including those transmitted via blogs, Facebook, Twitter or other non-traditional means of communication.

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Please do not hesitate to contact us with any questions.

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