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REGULATION FD IN THE TWITTER AGE

In its report on the use by the president of Netflix of his personal Facebook page to disclose important company news, the SEC disapproved of what was done, but made clear that companies can use social media channels to disseminate material non-public information to investors. The author discusses the Netflix case and suggests steps companies using such channels should take to avoid running afoul of the SEC and Reg FD.

By William S. Freeman *

Immediacy, spontaneity, and direct engagement with customers have made social media an essential tool for corporate communications. These very qualities, however, are potentially at odds with the SEC's Regulation Fair Disclosure ("Reg FD"), which requires companies discussing material information to use established channels of communication, and to announce such information in as broad and non-discriminatory a manner as possible.

Using social media to disclose material information, therefore, requires issuers to navigate a minefield. Unfortunately, the SEC has not been particularly generous with navigational aids. While it has repeatedly said that it would be "flexible" in interpreting its disclosure rules as new communications technologies emerged, it has also declined to issue bright-line guidance, instead referring to multi-factor tests that leave companies guessing whether particular practices might be acceptable.

The SEC's recent Netflix investigation squarely raised – and partially answered – the question of whether social media posting could be FD-compliant. Soon after Netflix CEO Reed Hastings discussed important company news on his personal Facebook account in July 2012, the company's stock price jumped by 16%. Acknowledging general uncertainty about how the regulation applied to social media, the SEC decided not to sanction Hastings or Netflix, but issued a report suggesting that it disapproved of Hastings' actions, and that it would punish similar conduct in the future.[1]

The Netflix Report did not remove all of the uncertainty surrounding the use of social media for the dissemination of material information. It did, however,

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[1] *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings* ("Netflix Report"), Rel. No. 34-69279 (2013).

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stress the importance to public companies of developing policies and procedures that will insure compliance in a rapidly changing communications environment. In order to do this, it is necessary first to review the background of Reg FD and the SEC's efforts over the years to explain its contours.

THE GENESIS OF REG FD

The background to Reg FD is this: During the 1980s and 1990s, a systematic form of tipping became increasingly common as companies attempted to soften the impact of negative news by "guiding" individual analysts to change their projections of future performance, rather than making simultaneous disclosure to the market as a whole. Companies hoped to "walk the market down" artfully and gradually in order to avoid the kind of sudden stock drop that would invite a shareholder class action. Of course, selective disclosure could, and did, permit the analysts on the receiving end of the information to generate trading profits (or avoid losses) for their favored customers.

The SEC believed that such selective guidance was a form of tipping that eroded investor confidence in the integrity of the capital markets.[2] Some commentators, however, argued that it was not prohibited by Section 10(b).[3] The SEC eventually concluded that a new regulation was required to put an end to selective disclosure; the result was Reg FD, which was promulgated in 2000.

Meanwhile, during the 1990s, internet usage was exploding, and companies increasingly posted important news on their websites. Even at the end of the decade, however, the SEC did not believe that internet access was sufficiently widespread to permit companies to announce material news solely via the web. In 1999, for example, the SEC approved a Nasdaq Stock Market rule change that stated that "dissemination of news over the Internet is appropriate as long as it is *not* made available over the Internet before the same information is transmitted to, and received by, the traditional news services."[4]

REG FD: THE FIRST DECADE

Reg FD set forth the following basic framework for the disclosure of material information:

> 1. When an issuer *intentionally* discloses material, non-public information to investors or market professionals, it must make broad public disclosure of the information simultaneously to all market participants.
>
> 2. When an issuer *unintentionally* discloses material, non-public information (for example, when an officer gives an impromptu answer to an unanticipated question), it must make broad public disclosure "promptly" (generally, within 24 hours) after learning that the disclosure of material information has been made.[5]

In its disclosing release, the SEC made clear that the regulation was intended to restore investor confidence in the fairness of the markets by prohibiting companies from selectively providing "guidance" to favored audiences. If a piece of information, standing alone, was material, it must be disclosed to all market participants at the same time. The SEC took the definition of materiality from established case law: a fact is material if there is a "substantial likelihood" that a reasonable shareholder would consider it important.[6]

The SEC did not dictate what means companies must use to make material announcements. Rather, it placed the burden on the company to determine what method or combination of methods was "reasonably designed" to "effect broad and non-exclusionary distribution of information to the public." It acknowledged that as technology continued to evolve and more investors had

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[2] *Final Rule: Selective Disclosure and Insider Trading*, Rel. No. 34-43154, (2000) ("Reg FD Release") at 2.

[3] *E.g.*, Paul B. Brountas, Jr., *Note: Rule 10b-5 and Voluntary Corporate Disclosures to Securities Analysts*, 92 Colum. L. Rev. 1517, 1529 (1992).

[4] Rel. No. 34-40988 (1999) (emphasis in original).

[5] 17 C.F.R. § 243.100(a)(1)-(2).

[6] *TSC Industries, Inc. v. Northway*, 426 U.S. 438, 448-49 (1976).

access to the internet, website-only posting might one day be a sufficient means of dissemination for some widely followed companies. It made clear, however, that this day was not yet at hand. It strongly suggested a disclosure paradigm that quickly became the industry standard: issue a press release, and if the press release is to be followed by a conference call, make the call generally available and provide adequate notice of it by press release and/or website posting.

When it issued Reg FD, the Commission stated that it would "monitor the impact of the regulation on information flow and assess whether the rule had chilled corporation communication or given rise to any other negative, unintended consequences."[7] One year later, a special study recommended that the Commission "should embrace technology to expand opportunities for issuers to disseminate information online," and "should make clear that options such as adequately noticed website postings, fully accessible webcasts, and electronic mail alerts would satisfy Regulation FD."[8]

Notwithstanding, it would be another seven years before the SEC's next pronouncement about the use of modern technologies to disclose information to investors. An August 2008 release stated that website-only disclosure might be sufficiently public "for some companies in certain circumstances," but still stopped short of an unqualified endorsement of this approach.[9] Whether website-only disclosure was sufficient would be analyzed on the basis of at least 13 non-exclusive factors, most of which dealt with the extent to which a company had designed and used its website to make it a "recognized channel of distribution," to keep important information current, and to make it as readily accessible to the securities marketplace as possible. As with the original dissemination of Reg FD, the key was whether website postings were "reasonably designed to provide broad, non-exclusionary distribution of the information to the public." Because the SEC was still not prepared to give a wholehearted endorsement of website-only posting of information, practitioners continued to recommend that companies use press releases, conference calls, and Forms 8-K as key components of their disclosure regimes.

THE ADVENT OF SOCIAL MEDIA

In 2008, Facebook and Twitter were each only two years old. "Social media" as a corporate communications tool was in its infancy and did not receive a mention in the SEC's August 2008 release. Today, Facebook claims to have in excess of one billion users, and Twitter claims more than 500 million. 97% of all businesses with marketing personnel use social media as part of their marketing platform, and 86% of such businesses consider social media important to their business.[10] Among Fortune 100 companies, 80% are active in one or more social media channels.[11] Consumer-oriented companies use Facebook posts and contests to cultivate fan loyalty, and even companies without a consumer focus create Facebook pages for their businesses that are akin to having a website on Facebook itself. Businesses regularly use Twitter's 140-character tweets to release news, market their products, and direct attention to special offers and new content.

As the landscape continued to evolve after 2008, the SEC's silence about the use of social media again left companies without official guidance. It is for this reason that the Netflix Report was so significant.

THE NETFLIX INVESTIGATION AND REPORT

Background Facts[12]

Netflix is an online entertainment service that provides movies and television programming to subscribers by streaming content through the internet and distributing DVDs through the mail. Recently, it has focused increasingly on its streaming business. In January 2012, it announced in a press release that it had streamed two billion hours of content in the fourth quarter of 2011. During year-end and fourth-quarter earnings calls, Reed Hastings, the CEO of Netflix, commented that this was important as a "measure of engagement and scale in terms of the adoption of our service …." Mr. Hastings also stated that he did not anticipate that Netflix would regularly report the number of hours streamed, but that the company would update

[7] Commissioner Laura S. Unger, *Special Study: Regulation Fair Disclosure Revisited*, December 2001, *available at*: http://www.sec.gov/news/studies/regfdstudy.htm.

[8] *Id.*

[9] *Commission Guidance on the Use of Company Web Sites*, Rel. No. 34-58288 (2008).

[10] Social Media Examiner, *2013 Social Media Marketing Industry Report* 7, *available at*: http://www.socialmediaexaminer.com/social-media-marketing-industry-report-2013/ (last visited Sept. 20, 2013).

[11] Funk, *Social Media Playbook for Business* 3 (2011).

[12] All of the facts in this section are taken from the Netflix Report, note 1 *supra*, except as noted.

that metric "on a milestone basis." Shortly thereafter, in a July 3, 2012 post on Mr. Hastings' personal Facebook page, he disclosed the news that for the first time, Netflix monthly viewing had exceeded one billion hours during the month of June, which was roughly a 50% increase over the streaming hours reported the previous January.

Netflix had not previously used Mr. Hastings' personal Facebook account to announce company information or milestones in the past, and, in fact, Mr. Hastings had previously stated that the company did not use social media to announce material non-public information, preferring instead to use investor letters, press releases, and SEC filings.

Netflix did not immediately distribute Mr. Hastings' comments via a press release, a post on the Netflix website, or a Form 8-K. However, the news contained in Mr. Hastings' personal post quickly reached the market over the next 24 hours, including through references in *The Los Angeles Times*, *Bloomberg News*, *Forbes*, *NBC News Online*, and *PCMag.com.*[13] As investors and news services became aware of the information, Netflix's stock price, which had been trading at $70.45 at the time of the posting, increased to $81.72 at the close of the following day. The SEC's Division of Enforcement opened an investigation.

The SEC's Report

In its report, the SEC acknowledged the emerging importance of social media as a tool for companies to communicate with the public, and public uncertainty over how Reg FD and the Commission's prior guidance would apply to social media disclosures. Ultimately, it stressed that the paradigm it had set forth in its 2008 guidance would continue to apply to any use of new communication technologies under Reg FD. It stated that 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 and what they need to do to be in a position to receive this information."[14] The SEC stressed two fundamental points:

1. Company communications through social media require careful analysis under Reg FD, similar to the analysis applicable to the use of more traditional channels.

2. It is critically important that a company alert the public in advance regarding the social media channels of distribution it intends to use to disseminate material non-public information.

The report thus confirms that Reg FD's goal of ensuring broad, non-exclusionary distribution of material non-public information may be accomplished by the use of social media, so long as certain steps are followed. As with its past guidance, however, the SEC declined to state that any particular practices would or would not be permissible. It left it to companies to determine how to communicate information through social media, based on their own particular facts and circumstances.

HOW TO DISCLOSE VIA SOCIAL MEDIA AFTER *NETFLIX*

In light of the Netflix Report, the challenge for public companies is to take maximum advantage of the flexibility, customer engagement, and market penetration offered by social media, while at the same time disseminating material information in a simultaneous and non-discriminatory manner. This will require careful planning, rigorous training, and periodic re-examination of company policies. Anecdotal evidence suggests that public companies have not rushed to use social media platforms as preferred vehicles for disseminating material information, but there can be little doubt that social media will become an increasingly important part of the disclosure strategies of successful companies. Here are some important guidelines to observe.

- A company using social media as a means of disclosure should periodically review and update its corporate communications and Regulation FD policies. As new technologies emerge and gain market acceptance, companies must adapt to remain competitive. The expectations of investors looking for information will continue to evolve, and so long as companies meet investor expectations thoughtfully, systematically, and fairly, the SEC has indicated that Reg FD is flexible enough to accommodate these changes.

- The company should explicitly inform the marketplace that the company intends to use the selected media channel or channels and how it

[13] Joseph A. Grundfest, "Regulation FD in the Age of Facebook and Twitter: Should the SEC Sue Netflix?," Rock Center for Corporate Governance at Stanford University Working Paper No. 131, January 30, 2013.

[14] Netflix Report at 3.

intends to use those channels. The company should provide this information via traditional disclosure channels, such as press releases, current and periodic SEC reports, and the company's website.

- The company should determine which forms of social media are readily accessible by current or potential investors, and should confirm that any social media channels that are selected are up to date and that members of the public can easily navigate them to find posted company information.

- The company should only use outlets that are explicitly identified with the company. While the personal sites of company officers might be acceptable if the company has explicitly alerted investors in advance, the SEC has made clear that they are not a preferred vehicle for company communications. In any event, if a personal site is used, the content placed there must be subject to company review and control, so there is little advantage to the company in placing company information on a personal site, and there is additional administrative burden to both the company and the individual in doing so.

- If it alerts investors that it will use a particular social media channel, such as a corporate Twitter account, a company should use that channel regularly. If the SEC challenges a social media posting on a channel that has not been regularly used, the company will be hard pressed to show that investors have been alerted to the possibility that material company information will be disclosed through that channel.

- Companies should limit access to corporate social media channels to well-trained personnel only. All personnel who are authorized to communicate on behalf of the company should be comprehensively trained, and periodically retrained, to understand what they can and cannot say via social media. All others must be instructed not to use social media to communicate company information.

- Certain events will require more specific protocols and prohibitions in light of SEC rules and regulations. Among these are proxy contests, securities offerings, tender offers, and acquisitions, where extraneous communications could be viewed as offers or solicitations, or could violate prescribed "quiet periods."

- Companies should exercise caution with respect to spontaneous live-blogging or tweeting during a company event such as an earnings call, limiting access to trained personnel, as live communications could cause a carefully calibrated company message to go off script.

- Social media posts containing material company information should be treated like corporate press releases – that is, they should be circulated among appropriate gatekeepers and vetted by counsel.

- Finally, if, prior to alerting the public that a particular social media channel will be used, an unintentional disclosure of material non-public information has been made on a social media site, the error must be cured by promptly filing a Form 8-K or distributing a press release disclosing the information.

CONCLUSION

Since Reg FD was promulgated in 2000, technological innovation has revolutionized the ways in which companies communicate with their customers, their markets, and their investors. As new technologies continue to emerge, companies will continue to seek new ways to engage with their target audiences. The Netflix Report makes clear that companies can use social media channels to disseminate material non-public information to investors. It also makes clear, however, that doing so will require companies to be thoughtful and systematic. While this may seem antithetical to the seeming spontaneity of social media communications, it is key to staying on the right side of the SEC. ■