

SEC Update

April 11, 2013

Does the SEC Like Social Media? Understanding the Application of Regulation FD to Social Media

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The SEC seldom releases an investigation report under Rule 21(a) of the Exchange Act, but when it does, the information is usually important for all public companies. Last week, the SEC issued an investigation report to clarify that its Regulation FD guidance given in 2008, directed mainly towards disclosure on company websites, is the standard to use for communications made through social media.¹ The investigation report was triggered by the SEC's investigation into whether Netflix and its CEO violated Regulation FD when the CEO posted on his personal Facebook page that Netflix had for the first time streamed 1 billion hours of content in the month of June. During the Netflix investigation, the SEC learned that there is uncertainty concerning how Regulation FD and the SEC's prior guidance on the use of company websites apply to the use of social media. The SEC's investigation report aims to address this uncertainty and provide guidance on how to apply the SEC's rules to disclosures made through social media channels. Although the SEC makes clear that its report "is not aimed at inhibiting corporate communication through evolving social media," at the same time it seeks to "remind" issuers that disclosures made through social media must still be analyzed for Regulation FD compliance.

Regulation FD Overview

The SEC's investigation report makes clear that, for public companies, the broadcast of information through social media is affected by Regulation FD. When the SEC released Regulation FD in 2000, its goal was to address concerns about companies selectively disclosing material information. Although Twitter and Facebook did not exist when the rule was finalized, they have grown to the point where companies may feel that posting announcements through an account with one of these services is an appropriate method for distributing information to the public.

Many companies have been reluctant to abandon the standard methods of disclosure and rely solely on social media or websites for announcing material, nonpublic information. One reason for the reluctance is the SEC has not provided a safe harbor for using websites or social media outlets to disclose material, nonpublic information. While the SEC indicates it is supportive of companies using social media outlets to communicate material, nonpublic information to the public, it has left the onus on each company to determine whether the method complies with the rules. As a result, companies must determine for themselves whether a social media outlet is an acceptable method for disseminating business announcements or financial information. Further, companies must monitor, review, and approve these statements to the extent a company allows its executives and employees to post information regarding the company on social media.

To determine whether any method is appropriate for communication of information, a firm understanding of Regulation FD is essential. Regulation FD requires public companies to disseminate material information broadly rather than to select individuals or groups who could exploit the information unfairly. Generally, under Regulation FD, if a public company (or a person acting on behalf of the company) discloses material, nonpublic information to certain enumerated persons (e.g., brokers, dealers, investment advisors, institutional investment managers, investment companies, or shareholders), the company must:

- . **Promptly** make public disclosure of the information if the initial disclosure was not intentional; or
- . **Simultaneously** make public disclosure of the information if the initial disclosure was intentional.

In practice, the standard form of compliance with Regulation FD has been to file a Form 8-K and issue a press release. But a Form 8-K and press release is not the only way that Regulation FD permits companies to comply. Any other method is allowed if it "is reasonably designed to provide broad, non-exclusionary distribution of the information to the public." When distributing information outside of the

known acceptable methods of a Form 8-K and/or press release, this general rule causes the need for a facts and circumstances analysis of the method of distribution to determine whether it results in a distribution that is “broad” and “non-exclusionary.”

In 2008, the SEC released guidance on the use of company websites as a method of distributing information subject to Regulation FD.² In this guidance, the SEC made clear that websites may be used to deliver material, nonpublic information, but each company would have to analyze its own facts and circumstances to determine whether its website disseminated information in compliance with the Regulation FD standard, *i.e.*, in a broad and non-exclusionary manner. The 2008 Guidance identifies two key conditions for determining whether a company’s website meets this standard:

- . The website must be a recognized distribution channel. Investors should know that the website is the place to look for information about the company’s business, financial condition, and operations.
- . The posting on the website must result in dissemination of the information to the marketplace in general. Once posted, the information should have the effect of reaching the general public on a broad scale.

The 2008 guidance was designed to be a factor-based, flexible framework that could be applied to various technologies. The SEC has now made clear that it is applicable to social media disclosure. To determine whether a social media outlet is a recognized channel of distribution and that the posted information results in dissemination to the marketplace in general, companies should consider the following factors:

- . Whether and how companies make investors and the markets aware of the source of important information (*e.g.* in press releases, proxy statements, website postings, and other public communications);
- . The company’s prior practice for posting such information on the source;
- . Accessibility, readability, and prominence of material information posted on the source;
- . The public’s following of the source and the ability of the source to spread information effectively to investors and market participants;
- . Whether the media regularly reports on information posted at the source;
- . Whether the information posted at the source is current, relevant, and accurate; and
- . Whether other methods are used and whether those methods are the predominant methods used to disseminate information.

The application of Regulation FD is also subject to a determination of whether the relevant information is “material.” Information is material if there is a substantial likelihood that a reasonable shareholder would consider it important in making an investment decision and its disclosure would alter the total mix of information available to the investor. Case law sets forth the standards for materiality, but the Regulation FD adopting release suggests that the following items are likely to be deemed material information:

- . Earnings information;
- . Mergers, acquisitions, tender offers, joint ventures, or changes in assets;
- . New products or discoveries, or developments regarding customers or suppliers (*e.g.*, the acquisition or loss of a contract);
- . Changes in control or in management;
- . Change in auditors or auditor notification that the issuer may no longer rely on an auditor’s audit report;
- . Events regarding the issuer’s securities (*e.g.*, stock splits, repurchase plans, dividends, defaults, public or private sales); and
- . Bankruptcies or receiverships.³

Moreover, SEC Staff Accounting Bulletin No. 99 discusses materiality for purposes of financial reporting and may help a company understand what qualitative factors the SEC considers when making materiality determinations.⁴

Applying Regulation FD to Social Media

Establishing a social media website or account as a recognized distribution channel may take time.

The public needs to be on notice that the website or account is a source of updated information on the company, and the website or account will need to be in existence long enough to gain a broad following before it can be relied upon as a recognized distribution channel. One way of establishing a recognized distribution channel is to regularly disclose its existence and how to access it in the company's SEC filings, press releases, and other communications. In an effort to establish a recognized distribution channel, a company should often repeat in press releases and other communications, such as earnings calls, the methods that it will use under Regulation FD to distribute important announcements. As a distribution channel gains a broader following and the company feels that publishing of information through the medium satisfies the rules, the company may then want to consider whether it is appropriate to exclusively distribute material, non-public information through that medium. Prior to gaining comfort that the medium by itself results in "broad, non-discretionary distribution," we do not advise companies to abandon their traditional methods of disseminating information.⁵

A company also needs to have confidence that the distribution of information through the website or account will be picked up by the media and available to investors. This will be easier for larger companies with a large following than for smaller companies with a limited following. In addition, a reasonable waiting period should be given before making any selective disclosure of the information to ensure that the information has been broadly disseminated.

The 2008 guidance also noted that one of the key ways to let others know where to look for information is by including the website address in periodic filings with the SEC. To establish a public social media account as a means of relaying important information, a company should list the account and how to access it in its periodic filings. The guidance also takes into consideration how the information on a particular site moves through the press and is picked up by the public once posted. Until the company is comfortable that the method has gained a broad following, the website or social media account should not be relied upon as the sole method for disseminating important information. It is also advisable to be certain all information disclosed, and the methods of disclosure, are subject to proper internal review and approval before disseminating any material, non-public information through a website or social media outlet. These methods of review and approval likely should be the same as those used for press releases or Form 8-Ks.

The SEC's Investigation of Netflix

The SEC conducted an investigation of Netflix and its CEO, Reed Hastings, for violations of Regulation FD. The investigation was triggered by Hastings' posting on his personal Facebook page that Netflix had streamed 1 billion hours of content in the month of June 2012. This information had not been previously announced and Netflix had not made public announcements through Hastings' Facebook page prior to the announcement. Netflix did not issue a press release in the normal fashion or file a Form 8-K with the SEC to disclose the information more broadly. Netflix did send Hastings' announcement to several reporters, and a few bloggers and analysts picked up the story. The next trading day Netflix's stock price rose more than \$10. The SEC focused on the fact that Netflix had not previously used Hastings' Facebook page to announce company milestones or metrics. The SEC also noted that Netflix had not made any effort to inform investors that Hastings' Facebook page might be used as a medium to communicate information about Netflix. Furthermore, the SEC report indicates that when the announcement was made, Netflix only informed a few reporters an hour later and did not use its usual methods for sending out new company information. Nevertheless, the SEC determined not to pursue an enforcement action. That decision appears to have been based, at least in part, on the SEC's belief that there was uncertainty concerning how Regulation FD and the Commission's guidance applied to social media channels.⁶

On April 10, 2013, Netflix filed a Form 8-K to inform investors of the five social media channels that it may use for posting material information. These channels include Netflix's blog, its Twitter feed, its Facebook page, and Hastings' public Facebook page. It is unclear how Netflix will use these channels because Netflix also stated that it announces material financial information through its investor relations website, SEC filings, press releases, public conference calls, and webcasts.

Things to Remember on Regulation FD Compliance

In addition to consistent Regulation FD compliance, the recent report released by the SEC highlights the need to address the following items:

- . Make investors and the public aware of the ways in which material information will be communicated. Posting to social media sites like Facebook and Twitter is one way of doing this, but investors need to know where they should look before the information is released. One possible way

of establishing a recognized distribution channel is to regularly disclose its existence and how to access it in SEC filings, press releases and other communications.

- . Avoid selective disclosure. This is the whole point of Regulation FD. If you think that a mistake has been made, and that material, nonpublic information has been released, it is advisable to make full disclosure through approved channels within 24 hours.
- . Clear and pre-established Regulation FD policies are extremely important. Companies should be sure policies are updated to address social media, including personal use by the company's officers, employees, and agents.
- . Ensure proper training of officers, employees, and agents to reduce the likelihood of an unintentional disclosure of material nonpublic information.
- . Even if a Regulation FD violation does not subject a company to antifraud liability, officers, employees, and agents should be made aware that selective disclosure is a breach of a duty of trust and could trigger insider trading liability.

If you have any questions regarding the use of social media or Regulation FD in general, please contact the Venable lawyer with whom you work, one of the authors or a member of our **Corporate Finance and Securities** or **SEC and White Collar Defense Group**.

1 See SEC Press Release No. 2013-51 (Apr. 2, 2013), available at <http://www.sec.gov/news/press/2013/2013-51.htm>.

2 See SEC Release No. 34-58288 (Aug. 7, 2008), available at <http://www.sec.gov/rules/interp/2008/34-58288.pdf>.

3 See SEC Release No. 33-7881 (Oct. 23, 2000), available at <http://www.sec.gov/rules/final/33-7881.htm>.

4 See SEC Staff Accounting Bulletin: No. 99 – Materiality (Aug. 12, 1999), available at <http://www.sec.gov/interps/account/sab99.htm>.

5 Although beyond the scope of this Client Alert, before trading in a company's securities, insiders will also need to be comfortable that information distributed through social media is no longer "non-public information" to avoid making trades that are subject to insider trading penalties.

6 This is not the first time the SEC has addressed uncertainty in the use of social media. Last month, the SEC released an IM Guidance Update to clarify the obligations of mutual funds and other investment companies seeking review of advertising materials posted on their social media sites. The IM Guidance Update provides several examples of social media communications that the SEC would not expect to be filed and a few examples of what they would expect to be filed under Section 24(b) of the 1940 Act or Rule 482 of the 1933 Act. For more information, the IM Guidance Update can be found at <http://www.sec.gov/news/press/2013/2013-40.htm>.