

# ClientAlert

## Capital Markets

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### Netflix SEC Investigation Report Clarifies the Use of Social Media and Regulation FD

*"There's a huge divide between CEOs living in the real world and the financial industry, which lives behind regulatory walls. Reg. FD is built for the old way of communicating from behind these walls."*

– Howard Lindzon, CEO of StockTwits, December 7, 2012.<sup>1</sup>

#### Regulation FD

Regulation FD prohibits US public companies or persons acting on their behalf from selectively disclosing material, nonpublic information to securities professionals or investors when it is reasonably foreseeable that such investors will trade on the basis of the information.<sup>2</sup> Regulation FD requires that when such information is disclosed, it must be filed with the SEC on a Form 8-K or disclosed through a channel that provides for broad and non-exclusionary public dissemination, such as a widely distributed press release.

Recognizing the increased use of corporate websites to disseminate investor information, in 2008 the SEC released guidance (the "2008 Guidance") on the use of company websites as a means of complying with Regulation FD.<sup>3</sup> This guidance, which applied to websites, blogs and RSS feeds, listed several factors for public companies to consider in determining whether their websites and blogs could be considered recognized channels of distribution. Such factors include whether the company regularly posts material information on its website, the extent to which investors rely on the company's website for such information, and the steps that the company has taken to make its website accessible, including whether it uses "push" technology, such as RSS feeds.



Colin Diamond  
Partner, New York  
+ 1 212 819 8754  
[cdiamond@whitecase.com](mailto:cdiamond@whitecase.com)

Gary Kashar  
Partner, New York  
+ 1 212 819 8223  
[gkashar@whitecase.com](mailto:gkashar@whitecase.com)

Joshua Kiernan  
Partner, London  
+ 44 20 7532 1408  
[jkiernan@whitecase.com](mailto:jkiernan@whitecase.com)

Michelle Rutta  
Partner, New York  
+ 1 212 819 7864  
[mrutta@whitecase.com](mailto:mrutta@whitecase.com)

John Vetterli  
Partner, São Paulo  
+ 55 11 3147 5615  
[jvetterli@whitecase.com](mailto:jvetterli@whitecase.com)

<sup>1</sup> Aruna Viswanatha and Sarah N. Lynch, *SEC Wrestles with Internet Age in Netflix Case*, CHICAGO TRIBUNE (Dec. 7, 2012), available at [http://articles.chicagotribune.com/2012-12-07/business/sns-rt-us-netflix-secbre8b51ip-20121206\\_1\\_sec-case-regulation-fair-disclosure-netflix](http://articles.chicagotribune.com/2012-12-07/business/sns-rt-us-netflix-secbre8b51ip-20121206_1_sec-case-regulation-fair-disclosure-netflix).

<sup>2</sup> Regulation FD expressly excludes foreign private issuers from its terms; however, in adopting Regulation FD, the SEC reminded foreign private issuers of their obligation not to violate the antifraud provisions of Rule 10b-5 under the Securities Exchange Act of 1934 which, among other things, prohibits "tipping" of material nonpublic information. Foreign private issues would be advised to comply with Regulation FD as codifying best practices.

<sup>3</sup> See Commission Guidance on the Use of Company Websites, Release Nos. 34-58288, IC-28351 (August 1, 2008), available at <http://www.sec.gov/rules/interp/2008/34-58288.pdf>.

While the 2008 Guidance served as a framework for the use of corporate websites as the sole means of disclosing material nonpublic information, it did not squarely address whether social media channels, which are used by significant numbers of public companies,<sup>4</sup> could also serve as a channel for the distribution of material nonpublic information in a Regulation FD-compliant manner.

## The Netflix Investigation and Report Guidance

On July 3, 2012, Reed Hastings, the CEO of Netflix, Inc., via a post on his personal Facebook page, disclosed that Netflix's monthly viewing had exceeded one billion hours for the first time.<sup>5</sup> On the next trading day, Netflix's stock price increased from US\$70.45 to US\$81.71. On December 5, 2012, Netflix filed a Form 8-K disclosing that it, and its CEO, had received a Wells Notice from the SEC for potential violations of Regulation FD in relation to Mr. Hastings' Facebook post, since it had not been accompanied or preceded by a Form 8-K or a broadly disseminated press release.<sup>6</sup> On April 2, 2013, after a four-month-long investigation, the SEC issued a report stating that it had decided not to pursue an enforcement action against either Netflix, Inc. or Mr. Hastings.

The SEC's report stated that its investigation raised questions regarding the applicability of the SEC's 2008 Guidance to emerging technologies, such as social media and networking sites. The SEC noted that it never explicitly addressed whether the 2008 Guidance applied to disclosures made through social media channels. However, it highlighted that today's social media channels are extensions of the communication tools addressed in the 2008 Guidance, such as the websites and RSS feeds. In this regard, the SEC clarified two points:

- Issuer communications through social media channels require a careful Regulation FD analysis, comparable to the analysis given to press releases and other traditional communication channels. The SEC expects issuers to examine whether channels such as their Facebook pages are "recognized channels of distribution" for investor communication. Such analysis is needed even if their social media pages have a large number of subscribers, "friends" or other contacts.
- The factors outlined in the 2008 Guidance should be applied to disclosures made through social media channels. Specifically, the SEC noted that the most important factor is whether investors are aware of these channels of distribution, and that issuers should take affirmative steps to alert the market about which forms of social media they intend to use to disseminate material, nonpublic information. The SEC encourages issuers to include disclosures on their corporate website identifying the specific social sites they use, and how an investor may access those sites.

## Practical Implications

As the Netflix investigation and report illustrates, the SEC is taking steps towards embracing the use of social media by issuers as a means of communicating with investors. However, issuers interested in disseminating material, nonpublic information via social media channels still need to ensure that they comply with the fundamentals of Regulation FD as interpreted by the 2008 Guidance, and should bear the following points in mind:

- **Is a particular social media channel a recognized channel of distribution?** An issuer seeking to use social media must determine whether its social media outlets are recognized channels of distribution and whether investors are aware that it is using these outlets to disseminate material, nonpublic information. For example, issuers intending to use social media, such as Facebook or Twitter, should place a link to their company's social media channels on their corporate websites' investor information pages.
- **Can investors access a particular social media channel easily?** Issuers should identify the steps necessary for investors to reach their social media channels, which should include instructions on how an investor may subscribe, join or register. Issuers who are already utilizing social media channels for investor information should make sure the links to social media pages are up-to-date, properly working, and that accurate instructions are given on how to access such channels.

4 For example, a Burson-Marsteller study determined that 79% of Fortune 100 companies are using social media platforms such as Facebook, Twitter and YouTube. *Burson-Marsteller Fortune Global 100 Social Media Study*, THE BURSON-MARSTELLER BLOG (Feb. 23, 2010), available at [http://www.burson-marsteller.com/Innovation\\_and\\_insights/blogs\\_and\\_podcasts/BM\\_Blog/Lists/Posts/Post.aspx?ID=160](http://www.burson-marsteller.com/Innovation_and_insights/blogs_and_podcasts/BM_Blog/Lists/Posts/Post.aspx?ID=160).

5 Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings, Release No. 69279 (Apr. 2, 2013), available at <http://www.sec.gov/litigation/investreport/34-69279.pdf>.

6 See Netflix, Inc., Current Report (Form 8-K) (Dec. 5, 2012).

- **Whose social media account?** Although the SEC declined to pursue an enforcement action against the CEO of Netflix, issuers should be particularly cautious in using a corporate officer's social media page as a means to communicate material, nonpublic information. The SEC report states that the social media site of an individual corporate officer would not be considered a sufficient channel of communication under Regulation FD or the 2008 Guidance unless the issuer provided advance notice that the officer's channel was being used for this purpose. Companies are, therefore, advised to disseminate information via their own channel of communication, rather than those of their officers or other employees.
- **What about "traditional" communication channels?** While the SEC report does permit the use of social media sites as a means of communicating with investors in compliance with Regulation FD, the SEC stresses that issuers should engage in continual analysis of the new and evolving forms of social media they use in order to comply with Regulation FD and the 2008 Guidance. Therefore, it initially remains advisable that issuers using social media channels to disseminate information do so in conjunction with other traditional forms of Regulation FD compliance, such as Form 8-Ks or press releases, until practices become more settled and, over time, the use of social media channels by investors of a particular company becomes widespread. Companies that are at the forefront of using social media, such as Dell and eBay, also ensure that the information being communicated through these channels can be found in the public domain via traditional Regulation FD-compliant means of communication and is approved by the companies' legal and investor relations teams.<sup>7</sup>

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### New York

White & Case LLP  
1155 Avenue of the Americas  
New York, New York  
10036-2787  
United States  
+ 1 212 819 8200

### London

White & Case LLP  
5 Old Broad Street  
London EC2N 1DW  
United Kingdom  
+ 44 20 7532 1000

### São Paulo

White & Case LLP  
Av. Brig. Faria Lima, 2.277 – 4th Floor  
01452-000 – São Paulo – SP  
Brazil  
+ 55 11 3147 5600

<sup>7</sup> See e.g., Gamet Roach, *Dell Goes Back to Twitter Monologue for Q4 Results*, INSIDE INVESTOR RELATIONS (Feb. 21, 2013), available at <http://www.insideinvestorrelations.com/articles/earnings-calls-financial-reporting/19329/dell-goes-back-twitter-monologue-q4-results/>.