II. Regulation FD and Social Media

A. Introduction

On July 3, 2012, Netflix, Inc. ("Netflix") CEO, Reed Hastings, triggered a Securities and Exchange Commission ("SEC" or "Commission") inquiry by updating his personal Facebook page.[1] According to SEC staff, Hastings may have made a selective disclosure in violation of Regulation Full Disclosure ("Reg FD") by updating his Facebook status[2] to note that the Netflix online streaming service had recently "exceeded 1 billion hours."[3] On December 5, 2012, the SEC issued Wells Notices to both Netflix and Hastings.[4] The Commission issues a Wells Notice when the agency is interested in potentially pursuing an enforcement action against a party.[5]

The Commission ultimately decided not to pursue an enforcement action against Netflix or Hastings.[6] Instead, the Commission released updated guidance on Reg FD in the social

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[1] *See* Steven M. Davidoff, *In Netflix Case, a Chance for the S.E.C. to Re-examine an Old Regulation*, N.Y. TIMES, Dec. 12, 2012, at B1.

[2] *See* Netflix, Inc., Current Report (Form 8-K) (Dec. 5, 2012) [hereinafter Netflix 8-K].

[3] The full post reads as follows: "Congrats to Ted Sarandos, 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!" Reed Hastings, FACEBOOK (July 23), 2012), www.facebook.com (readers with facebook accounts can retrieve Hastings's Facebook post by following: www.facebook.com/reed1960; then selecting the year 2012 on the right side of the screen; then selecting July).

[4] *See* Netflix 8-K, *supra* note 2 ("On December 5, 2012, Netflix, Inc. ('the Company') and its Chief Executive Officer Reed Hastings each received a 'Wells Notice' from the Staff of the Securities and Exchange Commission ('SEC') indicating its intent to recommend to the SEC that it institute a cease and desist proceeding and/or bring a civil injunctive action against Netflix and Mr. Hastings for violations of Regulation Fair Disclosure, Section 13(a) of the Securities Exchange Act and Rules 13a-11 and 13a-15 thereunder.").

[5] *See id.*

[6] Press Release, SEC, SEC Says Social Media OK For Company Announcements If Investors Are Alerted (Apr. 2, 2013), *available at* http://www.sec.gov/news/press/2013/2013-51.htm.

media context.[7] This article will consider whether an enforcement action would have been consistent with the Commission's previous enforcement actions under Reg FD and how the SEC's new guidance will affect companies' future use of social media. Part B will examine the history and policy behind Reg FD. Part C will then consider how past enforcement actions under Reg FD have assessed standards for materiality and public disclosures. Next, Part D will consider whether the SEC should have brought an enforcement action against Hastings and Netflix. Finally, Part E will analyze the recent SEC guidance on social media disclosures.

B. History and Policy Behind Reg FD

In August 2000, the SEC adopted Reg FD as a response to securities issuers' widespread practice of disclosing certain material information directly to industry analysts or institutional investors.[8] During the dot-com era, retail investors often complained that these selective disclosures placed them at a disadvantage.[9] Reg FD sought to alleviate this problem by forcing issuers to make material disclosures available to all investors simultaneously.[10] In light of this purpose and the public nature of Facebook posts, the Netflix Wells Notices surprised many industry professionals who felt that Hastings's Facebook post did not violate Reg FD.[11]

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[7] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc. and Reed Hastings, Exchange Act Release No. 69729 (Apr. 2, 2013) [hereinafter 2013 Guidance], *available at* http://www.sec.gov/litigation/investreport/34-69279.pdf.

[8] For example, companies make selective disclosures by providing "earnings guidance", reviewing draft analyst reports or communicating directly with an analyst instead of to the entire public. John P. Jennings, *Regulation FD: Sec Reestablishes Enforcement Capabilities over Selective Disclosure*, 32 ST. MARY'S L.J. 543, 552 (2001); *See* Final Rule: Selective Disclosure and Insider Trading, Securities Act Release No. 33-7881, Exchange Act Release No. 34-43154, 65 Fed. Reg. 51,716 (Aug. 15, 2000) [hereinafter Adopting Release].

[9] *Id.* at 51,717.

[10] *Id.* at 51,726 ("The purpose of Regulation FD is to discourage selective disclosure of material nonpublic information by imposing a requirement to make the information available to the markets generally when it has been made available to a select few.").

[11] Joseph Grundfest, *Regulation FD in the Age of Facebook and Twitter: Should the SEC Sue Netflix?* (Rock Ctr. For Corporate Governance at

Under Reg FD, when an issuer or its agent intentionally discloses material nonpublic information regarding that issuer or its securities, the issuer or agent must simultaneously disclose that information to the public.[12] Selective disclosures are intentional when the disclosing issuer, or issuer's agent, either knows or is reckless in not knowing that the disclosure contains material and nonpublic information.[13]

C. Enforcement Actions Under Reg FD

1. Nonpublic Material Information

While Reg FD does not expressly define "material information," the SEC has adopted the common law standard that "information is material if 'there is a substantial likelihood that a reasonable shareholder would consider it important' in making an investment decision."[14] The SEC has also issued limited guidance regarding what disclosures might be considered material.[15] Nevertheless, members of the Commission initially commented that an issuer's incorrect judgment regarding materiality would not typically draw the Enforcement Division's ire unless that miscalculation was "egregious."[16]

Stanford Univ., Working Paper No. 131, 2013), *available at* http://ssrn.com/abstract=2209525.

[12] 17 C.F.R. § 243.100 (2012).

[13] *Id.* § 243.101.

[14] Adopting Release, *supra* note 8, at 51,731.

[15] *Id.* at 51,721 (setting forth a non-exclusive list of disclosures, which are likely to be material, including "(1) [e]arnings information; (2) mergers, acquisitions, tender offers, joint ventures, or changes in assets; (3) new products or discoveries, or developments regarding customers or suppliers (e.g., the acquisition or loss of a contract); (4) changes in control or in management; (5) change in auditors or auditor notification that the issuer may no longer rely on an auditor's audit report; (6) events regarding the issuer's securities—e.g., defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of security holders, public or private sales of additional securities; and (7) bankruptcies or receiverships").

[16] *See House Sub Committee Seeks Views on Impact of Regulation FD*, SEC TODAY, Vol. 2001-98, May 21, 2001, *available at* 2013 WL 40715 ("Hunt said he would not support an enforcement action involving Regulation FD unless the violation was particularly egregious."); Richard W. Walker,

In *SEC v. Siebel Systems, Inc.*, the SEC attempted to change course and vigorously enforce the materiality standard. The court pushed back against this attempt to change the status quo and maintained a standard more in keeping with Reg FD's purpose and policies.[17] *Siebel* involved private statements made by the Siebel Systems' CFO, Kenneth Goldman, which the SEC alleged were materially different from Siebel's previous public disclosures.[18] Speaking at private events attended by institutional investors, Goldman mentioned that Siebel had an active pipeline of new deals in the works.[19] According to the SEC, these statements contrasted with public statements of Siebel CEO Thomas Siebel that conditioned the company's prospects on the state of the economy.[20] Although the SEC focused on the predictive nature of Goldman's statements, the court found the same statements to be a vague characterization of the company's financial outlook, which was consistent with previously publicly disclosed information.[21] Therefore, the statements were immaterial because they did not alter the "total mix of information already available to the reasonable investor."[22]

Additionally, the *Siebel* Court noted that whether information is material may depend on how investors use that

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Director, SEC Div. of Enforcement, Address Before the Compliance & Legal Division of the Securities Industry Association: Regulation FD—An Enforcement Perspective (Nov. 1, 2000), *available at* http://www.sec.gov/news/speech/spch415.htm (commenting that the Commission was merely interested in pursuing egregious or intentional violations of Reg FD).

[17] SEC v. Siebel Sys., Inc., 384 F. Supp. 2d 694, 708 (S.D.N.Y. 2005) ("Applying Regulation FD in an overly aggressive manner cannot effectively encourage full and complete public disclosure of facts reasonably deemed relevant to investment decisionmaking. It provides no clear guidance for companies to conform their conduct in compliance with Regulation FD. Instead, the enforcement of Regulation FD by excessively scrutinizing vague general comments has a potential chilling effect which can discourage, rather than, encourage public disclosure of material information.").

[18] *See id.* at 697–98.

[19] *See id.* at 697.

[20] *Id.*

[21] *Id.* at 706.

[22] *Id.*

information.[23] In this way, insignificant information could be transformed into material information should investors value and act upon it.[24] Nevertheless, the court held that Siebel's stock movement in the wake of Goldman's disclosures, by itself, was not dispositive of whether Goldman's disclosures were material.[25] In reaching its decision, the Court cautioned against too low a standard for materiality, lest it chill issuer disclosures or inundate investors with trivial information that undermines "informed decisionmaking."[26] As a result, post-*Siebel* enforcement actions have reflected a higher standard for what constitutes material information.[27]

Based on these facts, an enforcement action targeting Hastings's Facebook post may be inconsistent with the *Siebel* holding. Commentators have argued that Hastings's post did not contain nonpublic information because public disclosures, containing similar statements about total Netflix viewing hours, had already appeared in the weeks prior to Hastings's post.[28] Even absent these disclosures, the information is arguably immaterial since viewing hours are not directly tied to new customers, profits, or any other specifically enumerated category of material information.[29]

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[23] *See id.* at 707.

[24] *See id.*

[25] *Id.* ("Although stock movement is a relevant factor to be considered in making the determination as to materiality, it is not, however, a sufficient factor alone to establish materiality.").

[26] *Id.* at 703.

[27] *See In re* Christopher A. Black, Admin. Proc. File No. 3-13625, Exchange Act Release No. 60715, 2009 WL 3047553 (Sept. 24, 2009) [hereinafter *In re* Christopher A. Black] (new statements were materially different from previous public disclosures where the new statements reflected a significant downward revision of earnings estimates based on an updated, undisclosed internal analysis).

[28] Grundfest, *supra* note 11, at 5–6.

[29] *Id.* at 6 ("There is no indication that the billion-hour threshold triggered any incentive compensation arrangement for any named executive officer, or that it would have any effect on the company's valuation. There is no indication that the billion-hour threshold was referenced in any covenant of any debt instrument, or in any other document material to the market. The very concept of crossing the billion-hour threshold is instead entirely arbitrary from a valuation perspective. Its objective significance to the market is no greater or less than disclosing 950 million hours viewed per month or 1.05 billion hours viewed per month.").

On the other hand, Hastings himself commented that the 1 billion hour metric was significant as a "'measure of engagement and scale in terms of the adoption of [the] service and use of [the service].'"[30] Analysts also reported that this metric reflected a drop in the rate at which Netflix was losing customers.[31] Moreover, the Netflix stock price jumped by nearly 20% in the days following Hastings's post.[32] While this movement in stock price is not by itself dispositive, it may still be a factor in assessing the post's materiality.[33] Nevertheless, what relationship, if any, this stock movement had on the post's materiality is further complicated by (a) the fact that Netflix stock was on the upswing before Hastings posted the information;[34] and (b) the release of a Citigroup analyst report that might have also affected the stock price.[35] All things considered, the effect this post had on the market may be difficult to parse.

2. Public Disclosure

Even if an issuer releases material, nonpublic information, that issuer does not violate Reg FD as long as the issuer publicly discloses the information.[36] Disclosures are public when they take the form of an 8-K filing, or when the issuer "disseminates the information through another method (or combination of methods) of disclosure that is reasonably designed to provide broad, non-exclusionary distribution of the information to the public."[37]

When it passed Reg FD, the SEC sought to make this standard flexible, in order to accommodate the needs and circumstances of each issuer.[38] According to the SEC, the gold standards of public disclosure include "press releases distributed to a widely circulated news or wire service" and press conferences and

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[30] 2013 Guidance, *supra* note 7, at 4.
[31] *See id.* at 5.
[32] Davidoff, *supra* note 1.
[33] *See* SEC v. Siebel Sys., Inc., 384 F. Supp. 2d 694, 707 (S.D.N.Y. 2005).
[34] Davidoff, *supra* note 1.
[35] *Id.*
[36] 17 C.F.R. § 243.101(e) (2012).
[37] *Id.*
[38] Adopting Release, *supra* note 8, at 51,736 (Aug. 15, 2000) ("[B]y allowing an issuer to use a method ''or combination of methods'' of disclosure, Regulation FD recognizes that it may not always be possible for an issuer to rely on a single method of disclosure as reasonably designed to effect broad non- exclusionary public disclosure.").

conference calls, which the public can monitor in person, over the phone, or over the Internet.[39]

In the early days of Reg FD, posting information on a company's website did not by itself satisfy the public disclosure requirement.[40] Nevertheless, in 2008 the SEC updated its guidance to reflect investors' increasing reliance on company websites as a source of material information.[41] Accordingly, the SEC stated that when companies seek to make disclosures via the company website, they must evaluate

> whether and when: (i) a company web site is a recognized channel of distribution, (ii) posting of information on a company web site disseminates the information in a manner making it available to the securities marketplace in general,[42] and (iii) there has been a reasonable waiting period for investors and the market to react to the posted information.[43]

Hastings's Facebook post does not fall within the strict letter of the 2008 guidelines for web disclosures. Although companies are increasingly capitalizing on the social networking potential of Facebook and Twitter, companies do not traditionally use these forums to make material public disclosures.[44] In fact, Hastings admitted that, "while Facebook was 'very public,' it was not where the company regularly released information."[45] Moreover, because

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[39] *Id. at* 51,725.

[40] *Id.* (contemplating that postings on an Issuer's website might constitute *part* of a broad public disclosure but were not, by themselves, sufficient).

[41] Commission Guidance on the Use of Company Websites, Investment Company Act Release No. 28351, 73 Fed. Reg. 45862-01 (Aug. 7, 2008).

[42] *Id.* at 18. The SEC went on to note some of the factors it would consider when evaluating prongs one and two, these include: whether the company has made investors aware that it will disclose information on its website and whether it had a regular practice of doing so, whether the website is designed to efficiently lead investors to relevant information, the extent to which information on the company's website is regularly picked up by the media and market, whether the company keeps its website up-to-date etc. *Id.* at 18–19.

[43] *Id.* at 18.

[44] Michael J. De La Merced, *S.E.C. Warns Netflix Over a Post on Facebook*, N.Y. TIMES, Dec. 7, 2012, at B1.

[45] *See* Davidoff, *supra* note 1.

Netflix already qualifies to release certain material information on its website,[46] posting different information in different locations thwarts disclosure by forcing investors to monitor multiple information channels.[47]

On the other hand, many commentators have noted that few investors read 8-Ks and that information is actually more widely disseminated through Facebook than through the process Reg FD contemplates.[48] Furthermore, because Hastings maintains an open Facebook page that is followed by over 200,000 subscribers, his disclosure is significantly more public than most Reg FD targets.[49] Finally, because larger news outlets picked up Hastings's post, the post subsequently achieved the broad dissemination Reg FD contemplates.[50]

D. Should the SEC Have Brought an Enforcement Action Against Netflix?

An enforcement action against Netflix and Hastings would have represented only the fourteenth enforcement action in Reg FD's history.[51] While the SEC passed Reg FD in order to stop companies from leaking information to market analysts or institutional investors,[52] updated guidance has clarified that Reg FD violations do not turn on "an intent or motive of favoritism."[53] Moreover, although Reg FD enforcement actions typically targeted disclosures made directly to small numbers of industry professionals,[54] the SEC

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[46] *See Investor Relations*, NETFLIX, http://ir.netflix.com/ (last visited Mar. 3, 2013) (collecting Netflix's earnings data, press releases etc.).

[47] *See* Dan Primack, *Netflix CEO Hastings Deserves SEC scrutiny***,** CNN MONEY (Dec. 7, 2012, 2:55 PM), http://finance.fortune.cnn.com/2012/12/07/netflix-hastings-sec/.

[48] Grundfest, *supra* note 9 at 13.

[49] *See id.* at 35–36 (collecting Reg FD cases and finding that they have historically involved disclosures to fewer than 200 individuals).

[50] *See id.* at 11.

[51] *See id.* at 37–38.

[52] Adopting Release, *supra* note 8, at 51,716.

[53] 2013 Guidance, *supra* note 7, at 6.

[54] *See In re* Edward J. Marino, Admin. Proc. File No. 3-14879, Exchange Act Release No. 66990, 2012 WL 1681308 (May 15, 2012) (dealing with a knowing disclosure to a single investment advisor who was also an institutional investor); *In re* Christopher A. Black, *supra* note 27 (dealing with a selective disclosure to eight buy-side investors).

clarified that Reg FD is still applicable to disclosures made to a broader group.[55] Therefore, while Hastings's post failed to reflect an intention to subvert individual investor interests for the sake of institutional investors, the post still falls within the strict letter of a Reg FD violation.

Nevertheless, the Commission has acknowledged the confusion surrounding Reg FD in the changing social media landscape.[56] Furthermore, the decision to pursue an enforcement action has tended to rely on the Commission's policy of enforcing this rule under a general "good faith" compliance standard.[57] Since the SEC has failed to allege that Netflix suffered from a lack of internal controls that place the company at risk of continued Reg FD violations, Netflix was arguably acting in good faith. Therefore, there was little specific deterrence to be found by prosecuting this case.

E. Looking Forward: Social Media and Reg FD in the Future

The Commission's new guidance contemplates that social media outlets like Facebook and Twitter may serve as "recognized channels of distribution."[58] Nevertheless, the issuer is responsible for providing investors with adequate notice regarding the mode of disclosure.[59] Since issuers are still responsible for ensuring that their outlet conforms with the 2008 guidance, this does not represent a dramatic change to the Reg FD framework.[60] Therefore, even in light of the new guidance, Hastings's post does not conform with Reg FD.[61]

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[55] 2013 Guidance, *supra* note 7, at 6.
[56] *Id.* at 1. *But see id.* at 5 (reaffirming that the 2008 Guidance applies with "equal force" to social media disclosures).
[57] *See In re* Christopher A. Black, *supra* note 27 (weighing prompt remedial efforts of the violator including self-reporting and filing an 8-K in decision to settle action); SEC v. Presstek, Inc., Litigation Release No. 21443, 97 S.E.C. Docket 3432, 2010 WL 784231 (Mar. 9, 2010) ("The Commission took into account certain remedial measures taken by Presstek, including revising its corporate communications policies and corporate governance principles, replacing its management team and appointing new independent board members, and creating a whistleblower's hotline.").
[58] 2013 Guidance, *supra* note 7, at 7.
[59] *Id.*
[60] *See id.*; *supra* note 43 and accompanying text.
[61] *See supra* notes 40–47 and accompanying text.

Commentators have also expressed concern that the new guidance does not go far enough.[62] For example, issuers might choose to distribute information on different social media platforms (e.g., Facebook, Twitter, LinkedIn, Google Plus), thereby forcing investors to monitor any and all designated channels.[63] Instead, asking issuers to maintain a centralized website where Tweets, Facebook posts, and press releases all appear would relieve investors of this burden.[64]

Additionally, the SEC has failed to provide significant guidance regarding social media content's materiality. Hastings's post falls somewhere between an advertisement and a traditional material disclosure.[65] Since the Facebook controversy began, issuers have questioned their use of social media. For example, a Twitter post by Zipcar, Inc.'s CEO forced the company to immediately file an 8-K for fear of inciting regulators' scrutiny.[66] The post, which referred to the publicly disclosed sale of Zipcar to Avis Budget Group, arguably revealed no new or material information.[67] Nevertheless, the new guidance does not clarify whether such a disclosure is benign social media puffery or a material disclosure that warrants compliance with Reg FD.

F. Conclusion

While companies may circumvent liability under Reg FD by simultaneously filing an 8-K form with every Facebook update or Tweet,[68] such a scheme is inconsistent with the manner in which companies and individuals use social media. Avoiding liability by designating each of these platforms as a channel for distributing material information is also cumbersome and counterproductive for

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[62] *See* Cyrus Sanati, *Investors Respond to SEC on Social with a Definitive 'Dislike'*, CNN MONEY (Apr. 4, 2013, 12:29 PM), http://finance.fortune.cnn.com/2013/04/04/sec-social-twitter/.

[63] *See id.*

[64] *Id.*

[65] *See Id.*; *supra* Part C.1.

[66] Peter Lattman, *Zipcar Makes S.E.C. Filing After C.E.O.'s Twitter Message*, N.Y. DEALBOOK (Jan. 4, 2013, 6:49 PM), http://dealbook.nytimes.com/2013/01/04/zipcar-makes-s-e-c-filing-after-executives-twitter-message/.

[67] *See id.* (describing the Tweet as reading "@bostonglobe weighs in on the revolution we started at @zipcar http://b.globe.com/130ybZW").

[68] 17 C.F.R. § 243.101(e) (2012).

investors. With new technology, the landscape of disclosures implicating Reg FD is rapidly changing. In the face of this, the SEC needs to reflect on the best way to balance Reg FD's policies with companies' desire to capitalize on technology that connects them with their stakeholders. Recognizing that social media outlets may serve as effective means of distributing material information is a positive start. Increased guidance and opportunity for notice and comment will allow for a workable solution that accounts for the manner in which companies seek to utilize social media, while furthering the intentions of Reg FD.

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