

# Reg FD Alert

## Applying Securities Laws To Social Media Communications

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This month marked an important milestone in the development of securities law at its newest frontier: social media. For the first time, the Enforcement Division of the U.S. Securities and Exchange Commission ("SEC") issued a Wells Notice based on a social media communication. This Wells Notice, which notified Netflix, Inc. and its CEO of the Enforcement Division's intent to recommend an enforcement case to the Commission, demonstrates the potential for liability arising from disclosures by corporate officers through social media. Although the SEC itself uses social media to disclose important information,<sup>1</sup> the agency has yet to offer formal guidance concerning the use of social media to communicate with the investing public. For this reason, the outcome of the SEC's investigation into Netflix and its CEO's social media usage will prove instructive to issuers, directors, corporate officers, investors, and members of the securities and white collar bars.

### Expanding Social Media Usage by Issuers and Executives Intensifies the Need for Clear SEC Guidance

With communication channels that include Facebook, Twitter, YouTube, Google Plus, LinkedIn, and corporate blogs, social media has become a critical tool for companies competing in today's marketplace. Although business leaders are urged to harness the power of social media with greater depth and frequency than ever before, serious questions remain as to whether these social media outlets can give rise to liability under securities laws, especially Regulation Fair Disclosure ("Reg FD").<sup>2</sup> Under Reg FD, adopted in 2000, an issuer may not disclose material nonpublic information to certain groups, either intentionally or unintentionally, without disclosing the same information to the entire marketplace.<sup>3</sup> This market disclosure must either be made through "filing or furnishing a Form 8-K, or by another method or combination of methods that is reasonably designed to effect broad, non-exclusionary distribution of the information to the public."<sup>4</sup> Failure to comply can result in injunctive relief against and monetary penalties for companies and individuals. To date, the SEC has issued no guidance on whether social media channels can satisfy the disclosure requirements of Reg FD, although its Staff has suggested that companies look to a 2008 SEC interpretive release when considering the FD issues raised by social media (as discussed further below).

This lack of guidance from the SEC on whether and when disclosures made through social media are Reg FD-compliant has created a risk for companies and corporate officers using these methods to communicate with consumers and investors. And SEC guidance on Reg FD and social media will only become more pressing given current trends on the use of social media among Fortune 500 companies and their leadership. In 2010, a study of the 100 largest companies in the Fortune 500 found that

79 percent were using at least one of the four most popular social media platforms.<sup>5</sup> Earlier this year, *Forbes* cited an IBM study of 1,709 CEOs, which found that although only 16 percent of surveyed CEOs currently participated in social media, this percentage was likely to grow to 57 percent by 2017.<sup>6</sup>

With this backdrop, the issuance of a Wells Notice based on the disclosure of information through social media marks an important moment in this area of law.

### **The SEC Enforcement Staff Issues a Wells Notice Based on the Disclosure of Information Through Social Media Channels**

On December 5, 2012, Netflix filed a Form 8-K, disclosing that it and its CEO, Reed Hastings, had each received a Wells Notice from the SEC Enforcement staff for potential violations of Reg FD relating to certain statements made by Hastings in a Facebook post.<sup>7</sup> Specifically, on July 3, 2012, Mr. Hastings announced through a Facebook post that “Netflix monthly viewing exceeded 1 billion hours for the first time ever in June [2012].”<sup>8</sup>

Mr. Hastings, who also has Twitter and LinkedIn accounts,<sup>9</sup> defended his actions, arguing “posting to over 200,000 people is very public,” “the fact of 1 billion hours of viewing in June was not ‘material’ to investors,” and Netflix’s stock increases on the day of his post “started well before [the] mid-morning post was out.”<sup>10</sup> Although he did not explicitly make the argument that the information in the Facebook post was previously disclosed (and therefore already

public), Mr. Hastings noted: “In June we posted on our blog that our members were enjoying ‘nearly a billion hours per month’ of Netflix, and people wrote about this.”<sup>11</sup>

### **Not the First Social Media Incident of the Year**

Mr. Hastings’ Facebook post is not an anomaly in a business landscape where corporate executives are increasingly accessing social media for personal and business uses. On May 14, 2012, Francesca’s Holdings Corporation, a fashion retailer, announced the firing of its CFO, Gene Morphis.<sup>12</sup> The company terminated Mr. Morphis after an internal investigation concerning the CFO’s comment on Twitter concerning a board meeting.

The March 7, 2012 Tweet, now deleted from Mr. Morphis’ page,<sup>13</sup> read: “Board meeting. Good numbers = Happy Board.”

Mr. Morphis, who was active on other social media outlets that included Facebook and his personal blog,<sup>14</sup> had a history of posting work-related updates to Twitter.<sup>15</sup> These Tweets covered topics such as earnings calls and roadshows.<sup>16</sup> Although Mr. Morphis’ social media usage and subsequent termination did not result in SEC action, they highlighted, in dramatic relief, the risks of social media use by corporate executives.

### **The Landscape of SEC Guidance that Likely Applies to Social Media Disclosures**

In 2008, the SEC published guidance concerning the use of company websites to disseminate

information to investors.<sup>17</sup> This guidance noted that “[i]nvestors are turning increasingly to electronic media and to company and third-party web sites as sources of information to aid in their investment decisions,” necessitating greater SEC guidance on the application of Reg FD and the antifraud provisions of the federal securities laws to company websites.<sup>18</sup> In its 2008 guidance, the SEC addressed the critical question of when the disclosure of information on a company website might be deemed “public” under Reg FD and the 1934 Act. The SEC explained that the “public” nature of company website disclosures would turn on “whether and when: (1) a company web site is a recognized channel of distribution, (2) posting of information on a company web site 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.”<sup>19</sup> The SEC further expressed its view that, “for some companies in certain circumstances, posting of the information on the company’s web site, in and of itself, may be a sufficient method of public disclosure under Rule 101(e) of Regulation FD.”<sup>20</sup>

During a May 2011 panel discussion for TheCorporateCounsel.net, Tom Kim, Chief Counsel of the SEC’s Division of Corporate Finance, expressed his personal view that the SEC’s 2008 guidance is equally applicable in determining whether social media communications are sufficiently public under securities laws.<sup>21</sup> This analysis makes good

sense, however, there are likely special considerations that will emerge as the SEC, issuers, and corporate executives alike consider whether social media communications meet the three prongs set out in the 2008 guidance.

First, as the SEC's 2008 guidance recognized, company websites have become a common, authoritative, and well-accepted repository for the posting of issuer information.<sup>22</sup> For many years, companies have established prominent investor relations website pages, with repositories of SEC-filed disclosures and supplemental information.<sup>23</sup> It is rare to read an Annual Report filed with the SEC that does not direct investors to company websites for further company information. The same, however, cannot be said of Twitter and Facebook accounts.

The first element of the SEC's analysis will turn on whether the company has sufficiently alerted the market to its disclosure practices.<sup>24</sup> This question rests on the regularity, prominence, accuracy, accessibility, and media coverage of its disclosure methods.<sup>25</sup> Reg FD-compliant social media practices (if they exist) will likely require: notes in all SEC filings and news releases that the issuer discloses information through social media avenues; prominent links and website explanations for social media accounts; and a regular pattern of accurate and accessible usage.

Under the first prong of the SEC's analysis, a regular pattern of social media disclosure, understood and anticipated by investors, may be a bar that few companies or

executives can meet. However, certain CEOs, like Alan Meckler of WebMediaBrands Inc. (who regularly discloses company information through his frequent social media usage), may present a strong argument that they meet this standard.<sup>26</sup> Mr. Meckler, through his Twitter postings that appear on a blog linked to his company's website, has already drawn the attention of the SEC.<sup>27</sup> In December 2010, the SEC's Division of Corporation Finance questioned WebMediaBrands about Mr. Meckler's Tweets, asking "whether these updates conveyed information in compliance with Regulation FD."<sup>28</sup> In its inquiry, the SEC referred the company to its 2008 guidance on company websites.<sup>29</sup> Responding to the SEC, WebMediaBrands first argued that Mr. Meckler's posts did not contain material nonpublic information.<sup>30</sup> However, the company alternatively explained its position that "Mr. Meckler's posts might qualify as 'public disclosures' under Regulation FD and Release 34-58288 [the SEC's 2008 guidance on company websites]."<sup>31</sup> WebMediaBrands explained that it was an internet company, its website was an obvious and recognized source of investor information, and investors are directed to the company website on its public filings.<sup>32</sup> Because Mr. Meckler's blog is "clearly displayed and readily accessible and readable on WMB's public website, and his tweets are widely distributed," the response noted, Mr. Meckler's posts could be considered publicly disseminated through a recognized channel of distribution.<sup>33</sup> To date, the SEC has taken no further action.

## Why Greater Guidance on Social Media Disclosures Matters

In an environment where 16 percent of CEOs already use social media<sup>35</sup> and market leaders are urging more to join their ranks,<sup>36</sup> SEC guidance on social media disclosures is more important than ever. Given the increasing importance and prevalence of social media, a lack of official guidance threatens to compromise the interests that Reg FD was created to protect – the effective, rapid, and equal dissemination of important market information. The Netflix Wells Notice, and the attention and debate it has already drawn,<sup>37</sup> demonstrates the need for further clarity in this area. Issuers, corporate executives, investor relations professionals, and attorneys will be watching closely as the SEC considers whether Netflix and Mr. Hastings' social media communications complied with Reg FD. In the meantime, company officers and directors would be well advised to study their companies' use of social media. For example, boards of directors should familiarize themselves with how their companies use social media, including whether social media is used for marketing, customer relations, or any other purpose, and ask senior management whether the company has updated or adapted its Reg FD compliance policy to address such usage.

Finally, the implications of critical guidance on social media communications will reach further than shaping how companies communicate with their investors and customers. A key defense to a charge of insider trading is

that the material information in question was sufficiently disseminated to the investors through “appropriate public media.”<sup>38</sup> It is possible, should the SEC determine that certain social media communications are Reg FD-compliant disclosures, insider trading defendants will have another category of media through which they may argue material information was made public before they traded on the basis of that information. In short, the circumstances are ripe for guidance from the SEC that will reverberate throughout and shape our entire securities law regime.

1 Through two of its four Twitter accounts ([https://twitter.com/SEC\\_News](https://twitter.com/SEC_News) and [https://twitter.com/SEC\\_Enforcement](https://twitter.com/SEC_Enforcement)), the SEC discloses press releases, speeches, trading suspensions, litigation releases, and administrative proceedings.

2 17 CFR §§ 243.100-243.103.

3 17 CFR § 243.100.

4 17 CFR § 243.101(e); SEC Release Nos. 33-7881, 34-43154.

5 See Burson-Marsteller Fortune Global 100 Social Media Study, 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).

6 Mark Fidelman, IBM Study: If You Don't Have a Social CEO, You're Going to be Less Competitive, *Forbes*, May 22, 2012, available at <http://www.forbes.com/sites/markfidelman/2012/05/22/ibm-study-if-you-dont-have-a-social-ceo-youre-going-to-be-less-competitive/>.

7 See Netflix Current Report on Form 8-K, filed Dec. 5, 2012.

8 Eric Savitz, Netflix Tops 1B Streaming Hours In June; Citi Stays Bullish,

*Forbes*, July 3, 2012, available at <http://www.forbes.com/sites/ericsavitz/2012/07/03/netflix-tops-1b-streaming-hours-in-june-citi-stays-bullish/>; see also <http://www.facebook.com/reed1960>.

9 <https://twitter.com/reedhastings>; <http://www.linkedin.com/in/reedhastings>.

10 Ex. 99.1 to Netflix Current Report on Form 8-K, filed Dec. 5, 2012.

11 *Id.*

12 Rachel Emma Silverman, Facebook and Twitter Postings Cost CFO His Job, *Wall Street Journal*, May 14, 2012, available at <http://online.wsj.com/article/SB10001424052702303505504577404542168061590.html>.

13 <https://twitter.com/theoldco>.

14 <http://www.facebook.com/gene.morphis>; <http://morphview.blogspot.com/>.

15 Rachel Emma Silverman, Facebook and Twitter Postings Cost CFO His Job, *Wall Street Journal*, May 14, 2012, available at <http://online.wsj.com/article/SB10001424052702303505504577404542168061590.html>.

16 *Id.*

17 SEC Release No. 34-58288 (Aug. 7, 2008).

18 *Id.* at 6-7.

19 *Id.* at 18.

20 *Id.* at 25.

21 Dominic Jones, Can a tweet meet the SEC's Fair Disclosure rules?, IR Web Report, May 11, 2011, <http://irwebreport.com/20110511/twitter-regulation-fd-sec/>.

22 SEC Release No. 34-58288, at 12-14 (Aug. 7, 2008).

23 *Id.*

24 *Id.* at 18.

25 *Id.* at 20-21.

26 <https://twitter.com/alanmeckler>.

27 Dominic Jones, CEO pushes Reg FD limits on Twitter, IR Web Report, Sep. 15, 2011, <http://irwebreport.com/20110915/ceo-pushes-reg-fd-limits-on-twitter/>.

28 <http://www.sec.gov/Archives/edgar/data/1083712/000000000010074073/filename1.pdf>.

29 *Id.*

30 <http://www.sec.gov/Archives/edgar/data/1083712/000101968711000062/filename1.htm>.

31 *Id.*

32 *Id.*

33 *Id.*

34 Dominic Jones, CEO pushes Reg FD limits on Twitter, IR Web Report, Sep. 15, 2011, <http://irwebreport.com/20110915/ceo-pushes-reg-fd-limits-on-twitter/>.

35 2012 IBM Global CEO Study, How will CEOs change their use of social media?, available at <http://www-935.ibm.com/services/us/en/c-suite/ceostudy2012/infographic-01.html>.

36 In the past three months alone, the *Wall Street Journal* has quoted Harvard Business School professors and prominent former CEOs that “CEOs should accept that social media is part of their job description” and *Forbes* is urging bank CEOs to “Take the Social Media Plunge.” See Leslie Kwoh and Melissa Korn, 140 Characters of Risk: Some CEOs Fear Twitter, *Wall Street Journal*, Sep. 26, 2012, available at <http://online.wsj.com/article/SB10000872396390444083304578018423363962886.html>; Frank Sorrentino, Dear Bank CEOs: Take the Social Media Plunge, *Forbes*, Oct. 16, 2012, available at <http://www.forbes.com/sites/franksorrentino/2012/10/16/dear-bank-ceos-take-the-social-media-plunge/>.

## Reg FD Alert

- 37 Wall Street Journal Law Blog, Murky Waters Under Facebook Disclosure, Dec. 9, 2012, [http://online.wsj.com/article/SB10001424127887324339204578169530440384400.html?mod=googlenews\\_wsj](http://online.wsj.com/article/SB10001424127887324339204578169530440384400.html?mod=googlenews_wsj).
- 38 *In re Faberge, Inc.*, 45 S.E.C. 249, 256 (May 25, 1973).
- 39 The adopting release for Reg FD cites the 10b-5 analysis in *Securities and Exchange Commission v. Texas Gulf Sulphur*, 401 F.2d 833 (August 13, 1968), concerning when information is deemed "public" as a template for Reg FD's "non-public" element.

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