Advisory

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SECURITIES AND CAPITAL MARKETS

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Netflix Encounters SEC Inquiry for Social Media Communications

This time last year, Wiggin and Dana's Securities and Capital Markets Group summarized many of the legal considerations and best practices involving social media communications by reporting companies. As we begin the new year, many public companies look to update internal controls and procedures. A recent encounter with the SEC by Netflix CEO, Reed Hastings, emphasizes the increasing importance of social media policies.

Last month, Netflix, Inc. disclosed in a Form 8-K filing that the SEC sent it a "Wells Notice" with regard to certain statements made by Mr. Hastings on his Facebook page. Mr. Hastings' July 2012 statements highlighted that Netflix viewing had exceeded 1 billion hours in a month for the first time. At that time, Mr. Hastings' Facebook page had over 200,000 followers. According to company filings, the Wells Notice indicated that SEC Staff are recommending an action or proceeding for violations of Regulation FD (regarding disclosure of material information in a non-public manner), Section 13(a) of the Exchange Act (regarding general disclosure requirements of reporting companies), and Rules 13a-11 and 13a-15 (regarding Form 8-K reports and disclosure controls and procedures).

Mr. Hastings responded to the Wells Notice early last month with another Facebook post, indicating optimism that the matter will be cleared up through an SEC review. As those of us involved in the securities industry await further guidance arising from the SEC's review, we are reminded that internal controls and procedures are especially important as company officials increasingly utilize social media channels, such as Facebook, YouTube, Twitter, and LinkedIn, to communicate with customers, stockholders, potential investors, and other stakeholders.

REGULATION FD AND THE NETFLIX COMMUNICATIONS

Regulation FD prohibits a company (or a person acting on behalf of the company) from disclosing material, non-public information in a selective manner to specified market participants. Regulation FD was adopted in 2000 to address increasing concerns with respect to selective disclosures (i.e., disclosures that are not made to the general public, but rather made to a select group) that advantaged "market insiders" to the detriment of others. The conventional methods for general public disclosures include widely disseminated press releases, public conference calls, and filings with the SEC via Form 8-K.

However, the speed and ease by which information can be disseminated across the Internet continues to challenge the application of Regulation FD. In 2008, the SEC provided guidance on the use of company websites for disclosure of material company information. For such information to be considered "public," it must be disseminated in a way that is designed

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to "reach the securities market place in general through recognized channels of distribution."

In the past, the SEC has recognized a company website as a "recognized channel of distribution" where the company has taken steps to alert the market to its online disclosure practices, and the use by investors and the market demonstrate recognition of such practices. In our January 2012 Advisory, we referenced a comment letter to WebMediaBrands Inc. In that scenario, WebMediaBrands' CEO was tweeting company information via a Twitter account. WebMediaBrands argued that the postings were in compliance with Regulation FD, in part because the CEO's Twitter account was also publicly available via the company's website. The company responded to the SEC's inquiry, stating in part, "its website [which had links to the CEO's account] was the most obvious and recognized source and channel of distribution of company information," and, "is widely known and visited by people who follow the Company." In that case, the SEC eventually replied with no further comment.

Applying this analysis to the Netflix scenario leads to some central questions for the SEC going forward:

- Have any types of social media risen to the level of "recognized channels of distribution"?
- When are social media communications broad enough to be considered "public" disclosure?

Until further guidance by the SEC provides better answers, public companies are well advised to take precautions when utilizing social media to disclose material information. Our current general view is that social media should never be the only channel for disclosing material company information. Social media can be extremely useful for repeating, re-posting, or linking to published information, but should always be preceded or accompanied by traditional disclosure methods. Here are some best practices for compliance going forward.

BEST PRACTICES FOR SOCIAL MEDIA DISCLOSURES

- Develop a written company policy on public disclosures that includes social media considerations.
- Company policies should ensure that only specified individuals are authorized to post or tweet on behalf of the company.
- Appoint an individual at the company or from an outside firm who understands the technology of social media and the limitations of federal securities laws to field questions from authorized individuals that communicate on behalf of the company.
- Social media posts regarding the financial condition or results of the company should include a link to a relevant public filing or release highlighting the same.
- Refrain from linking to analyst reports without appropriate disclaimers. It is better to link to a company web page containing all such disclaimers in addition to the link to the report.
- Extend your company's quarter-end information blackout periods to include prohibitions on social media posts.
- Establish special rules for "fundamental" corporate events. For example, you might enforce a blanket prohibition on social media posts during a proxy contest, a material acquisition, a securities offering, or a tender offer.
- Although tweeting or posting live from annual shareholder meetings may help disseminate information to shareholders who are not present at the meetings, caution should be taken to ensure that such tweeting or posting only takes place subsequent to or simultaneously with the meeting being made available to the public (e.g., through streaming via the company website).
- In any post or tweet, limit the subject matter to what is already publicly disclosed, or coordinate a concurrent disclosure through a conventional channel. When coordinating a concurrent disclosure, take into consideration the speed of the respective channels. For example, a social media post that loads instantly should not precede the quarterly earnings release even if the release is publicly available just moments later.
- Remember that posts, tweets, and other social media communications may be instant and permanent.
