

Pitfalls of Social Media: Facebook Post Could Lead to SEC Enforcement Action

Social media postings by officers of public companies can form the basis of Securities and Exchange Commission (SEC) enforcement actions. Last week, the SEC issued a Wells notice to Netflix, Inc. and its CEO related to a Facebook post made by the CEO in July that may have violated Regulation Fair Disclosure (FD). The SEC said that the company may face a cease and desist proceeding or civil injunctive suit.

Background: Netflix and the Facebook Post

Netflix, Inc. (Netflix) is a publicly traded company that provides DVD rental by mail and on-demand Internet streaming of movies and television shows. Its CEO, Reed Hastings, was one of the company's founders.

In July 2012, Hastings posted on his Facebook page that "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." At the time, Hastings had approximately 200,000 followers on Facebook. On the day of the posting, Netflix stock rose 13 percent.

Wells Notice Sent to Netflix and Hastings

Last Friday, Netflix received a Wells notice indicating the SEC Enforcement Division's intent to recommend that the SEC institute a cease and desist proceeding and/or bring a civil injunctive action against Netflix and Hastings for violations of Regulation FD, Section 13(a) of the Securities Exchange Act and Rules 13a-11 and 13a-15. A Wells notice is a notification from a securities regulator stating that it intends to recommend enforcement action and affords the respondent an opportunity to explain why such an action is not appropriate.

Regulation FD requires that a public company disclosing material nonpublic information regarding itself or its securities to investment professionals or holders of the securities must also publicly disclose the information. The public disclosure of material information is usually done via an SEC filing such as a Form 8-K or by issuing a press release. Regulation FD is intended to ensure that individual investors have equal access to information by prohibiting selective disclosure of material information.

Hastings Response to the Wells Notice

In a very unusual step, Hastings issued a public response to the Wells notice. He stated that Netflix uses blogging and social media, including Facebook, to communicate effectively with the public and its members. Hastings pointed out that:

- In June, Netflix stated on its blog that members were enjoying "nearly a billion hours per month."
- His Facebook subscribers include numerous reporters and bloggers.
- He believes that "posting to over 200,000 people is very public."
- He did not believe the information regarding viewing hours was material to investors.
- While Netflix stock rose the day of his post, the increase started before the post and may have been driven by a positive report released by Citigroup the previous evening.

Companies Should Exercise Discretion

While it remains to be seen whether Hastings' post was material information that should have been disclosed by other means, the Wells notice demonstrates the SEC's willingness to bring enforcement actions in the social media realm. Public companies should use discretion in making social media posts, and strong company policies regarding the use of social media among executives are

advised. Executives who interact directly with the public through social media should be cautious in answering questions spontaneously. This matter shows how an executive's judgment of what information is not material may differ from the SEC's interpretation.

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