

Regulation FD in the Age of Facebook and Twitter: Should the SEC Sue Netflix?

Joseph A. Grundfest

Stanford Law School and The Rock Center for Corporate Governance

January 30, 2013

Copyright © 2013 by Joseph A. Grundfest

Working papers are in draft form. This working paper is distributed for purposes of comment and discussion only. It may not be reproduced without permission of the copyright holder. Copies of workingpapers are available from the author. Crown

Quadrangle • 559 Nathan Abbott Way • Stanford, CA 94305
rockcenterinfo@law.stanford.edu • <http://www.law.stanford.edu/>

Electronic copy available at: <http://ssrn.com/abstract=2209525>

Regulation FD in the Age of Facebook and Twitter:
Should the SEC Sue Netflix?

Joseph A. Grundfest

Stanford Law School and
The Rock Center for Corporate Governance

January 30, 2013

This paper can be downloaded from the Social Science Research Network at

Regulation FD in the Age of Facebook and Twitter:
Should the SEC Sue Netflix?

Joseph A. Grundfest

Stanford Law School and
The Rock Center for Corporate Governance

January 30, 2013

Abstract: The Staff of the Securities and Exchange Commission has announced its intention to recommend to the Commission that enforcement proceedings alleging a violation of Regulation FD be instituted against Netflix, Inc. and its CEO, Reed Hastings, because of a posting on Mr. Hastings' personal Facebook page. Mr. Hastings' webpage had more than 200,00 followers, including reporters who covered the posting in the traditional press. The posting was also the subject of a tweet by TechCrunch, which has approximately 2.5 million followers on Twitter.

This article is in the form of an amicus Wells Submission suggesting that the Commission would, for nine distinct reasons, be prudent not to initiate an action on the facts of the Netflix posting. In particular, the public record suggests that the posting did not contain material information, was not a selective disclosure, and because of its spread through social media constituted a "broad non-exclusionary distribution" that did not violate Regulation FD. A prosecution would also diverge dramatically from all prior Regulation FD enforcement proceedings, and would violate the Commission's prior representations not to "second guess" good faith efforts to comply with Regulation FD. In addition, the posting is not inconsistent with the Commission's 2008 Guidance on the Use of Company Webpages - - guidance that is seriously outdated because of the emergence of social media.

The enforcement action on the facts of the Netflix posting would, moreover, raise serious constitutional questions. Regulation FD is a restraint on truthful speech and, as applied on the facts of a Netflix prosecution, would involve discrimination against social media and in favor of more traditional media channels. There is also doubt that Regulation FD would pass muster as a restraint on commercial speech, particularly in light of the Supreme Court's recent decision in *Sorrell* and the Second Circuit's decision in *Caronia*. A loss on constitutional grounds would also call into question a large panoply of Commission regulations that act as restraints on truthful speech, including, without limitation, quiet period restrictions and restriction on communications with analysts.

Further, the issuance of the Wells Notice has already chilled the use of social media as a form of corporate communication absent the filing of a Form 8-K with the Commission. It also constitutes a questionable allocation of scarce Commission resources and raises questions that should be addressed through rulemaking and not through prosecution. The submission closes with suggestion for a reformulated Regulation FD that should be better able to pass constitutional muster and that would embrace social media technology rather than confront it.

Keywords: Regulation FD, First Amendment, Social Media, Materiality, Enforcement

JEL Classification: K22 K42

January 29, 2013

The Honorable Elisse B. Walter, Chairman
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
Robert S. Khuzami, Director, Division of Enforcement
United States Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

In Re: Wells Notice to Netflix, Inc. and to Mr. W. Reed Hastings Relating to a Regulation FD Investigation¹

Madam Chairman, Commissioners, and Division Director:

The rapid growth of social media presents the Commission with significant challenges.² These challenges are particularly profound when the Commission seeks to control the dissemination of truthful speech through prosecution or regulation.

¹ This submission is not prepared on behalf of Netflix or Mr. Hastings. I represent no one involved in these proceedings, and have no access to testimony or documents that the Commission's Staff may have gathered in the course of its investigation. This letter relies entirely on the accuracy of information that can be gleaned from publicly available sources. If the confidential record generated differs in any respect from the public record, it may become appropriate to amend the views expressed in this letter, and I respectfully reserve the right to do so. This letter is submitted because, if the Commission institutes enforcement proceedings based on the facts and circumstances described in the public record, the Commission faces a significant risk of a litigation loss that could do broader damage to its regulatory agenda. It makes little or no sense, in my view, for the agency to assume this litigation risk when the legitimate questions posed by the emergence of social media can be better addressed through the rulemaking process.

² See, e.g., C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 Colum. Bus. L. Rev. 1, 1-2 (2012) (considering the costs and benefits of crowdfunding and proposing "an exemption that would free crowdfunding from the registration requirements, but not the antifraud provisions, of federal securities law"); Carolyn Elefant, *The "Power" of Social Media: Legal Issues & Best Practices for Utilities Engaging Social Media*, 32 Energy L.J. 1 (2011) ("provid[ing] an exhaustive summary of the legal and regulatory issues potentially implicated by utility engagement in social media, and propos[ing] best practices and guidelines for development of a social media policy that reduce the risks of social media for utilities"); Thomas Lee Hazen, *Crowdfunding Or Fraudfunding? Social Networks And The Securities Laws--Why The Specially Tailored Exemption Must Be Conditioned On Meaningful Disclosure*, 90 N.C. L. REV. 1735 (2012) (provides an overview of the securities laws that apply to crowdfunding and considers possible exemptions); Jill E. Fisch, *Regulation FD: An Alternative Approach to Addressing Information Asymmetry* 1 (U of Penn. Inst. for Law & Econ., Research Paper No. 12-19, 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2042696 ("highlighting current areas of particular importance, including the implications of technological innovations such as the internet and social media"); 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/> (concluding that "Twitter and StockTwits clearly are capable of disseminating material, non-public information in a manner 'reasonably designed to provide broad non-exclusionary distribution of the information to the public.'" (quoting 17 C.F.R. § 243.101(e)(2))).

Public reports suggest that the Staff of the Commission's Division of Enforcement intends to recommend that the Commission initiate enforcement proceedings against Netflix, Inc. and its Chief Executive Officer, Mr. W. Reed Hastings, alleging a violation of the Commission's Regulation FD³ because of the following July 3, 2012, posting to Mr. Hastings' Facebook page (the "Posting"):⁴

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!⁵

There is no indication in the public record that the Posting was other than truthful. Public reports indicate that Mr. Hastings' Facebook page had approximately 205,000 followers.⁶ The Posting would have been rapidly disseminated to each of these 205,000 followers through Facebook's news feed feature.⁷ These followers include reporters from *The New York Times*, *The Wall Street Journal*, *Forbes*, CNNMoney.com, MarketWatch, and *The Huffington Post*.⁸ The Posting was also rapidly disseminated through Twitter. For example, TechCrunch, which has more than 2.5 million Twitter followers, tweeted about the Posting within an hour of the Posting's first appearance.⁹ The Posting was also broadly covered in the traditional press and

³ 17 C.F.R. § 243.100.

⁴ See, e.g., David Goldman, *Netflix faces SEC probe over Facebook post*, CNN Money (Dec. 7, 2012), <http://money.cnn.com/2012/12/07/technology/netflix-facebook-sec/index.html>; Michael J. de la Merced, *S.E.C. Warns Netflix Over a Post on Facebook*, N.Y. Times DealBook (Dec. 6, 2012), <http://dealbook.nytimes.com/2012/12/06/s-e-c-weighs-suit-against-netflix-over-improper-disclosure/>; Larry Popelka, *SEC doesn't understand social media*, S.F. Gate (Dec. 16, 2012), <http://www.sfgate.com/technology/article/SEC-doesn-t-understand-social-media-4122676.php>.

⁵ See, e.g., Posting by Reed Hastings, Facebook (July 3, 2012) <https://www.facebook.com/reed1960/posts/10150955446914584>; Kirsten Salyer, *The Facebook Post That Got Netflix CEO Reed Hastings in Trouble With the SEC*, Bus. Wk. (Dec. 7, 2012), <http://www.businessweek.com/articles/2012-12-07/the-facebook-post-that-got-netflix-ceo-reed-hastings-in-trouble-with-the-sec>.

⁶ See Eric Savitz, *Netflix Tops 1B Streaming Hours in June; Citi Stays Bullish*, Forbes (July 3, 2012), <http://www.forbes.com/sites/ericsavitz/2012/07/03/netflix-tops-1b-streaming-hours-in-june-citi-stays-bullish/> (revealing that on July 3, 2012, Mr. Hastings had 204,990 followers).

⁷ See *infra* note 47.

⁸ See Anders Bylund, *Netflix Exposes Reg FD Flaws*, The Motley Fool (Dec. 8, 2012), <http://www.fool.com/investing/general/2012/12/08/netflix-exposes-reg-fd-flaws.aspx> (noting that Mr. Hastings' followers include reporters from MarketWatch, The New York Times, Forbes, and The Wall Street Journal); Aruna Viswanatha & Sarah N. Lynch, *SEC wrestles with Internet age in Netflix case*, Chi. Trib. (Dec. 7, 2012), http://articles.chicagotribune.com/2012-12-07/business/sns-rt-us-netflix-secbre8b51ip-20121206_1_sec-case-regulation-fair-disclosure-netflix. See also *Reed Hastings Followers*, Facebook, <https://www.facebook.com/reed1960/followers> (last visited Jan. 28, 2013) (listing followers).

⁹ See Tweet from Ryan Lawler, TechCrunch (July 3, 2012 8:46 a.m.), <https://twitter.com/TechCrunch/status/220181750968623104> ("Netflix Subscribers Watched 1 Billion Hours Of Video In June, Or More Than An Hour A Day On Average"); *TechCrunch home page*, Twitter, <https://twitter.com/TechCrunch> (last visited Jan. 24, 2013) (revealing that as of January 24, 2013, TechCrunch had 2,564,950 followers on Twitter).

was referenced within twenty four hours by the *Los Angeles Times*,¹⁰ Bloomberg News,¹¹ *Forbes*,¹² NBC News Online,¹³ and PCMag.com,¹⁴ among others.¹⁵ The Posting was further available to all members of the public with Internet access.¹⁶

The suggestion that the Commission might institute enforcement proceedings based on these facts and circumstances, rather than proceed by rulemaking to address issues raised by the evolution of social media, should be rejected for at least nine distinct reasons.

First, the Posting contains no material information.

Second, the Posting, even if material, does not violate Regulation FD because it was reasonably designed to provide “broad non-exclusionary distribution.”¹⁷

Third, the Posting was not a selective disclosure.

Fourth, any prosecution on these facts would constitute a dramatic divergence from precedent and would violate the Commission’s commitments not to “second guess” good faith attempts to comply with Regulation FD.

Fifth, the Posting is not inconsistent with the Commission's 2008 Guidance regarding the implementation of Regulation FD and the use of company websites, and that guidance is, in any event, outdated because it fails to account for the evolution of social media.

Sixth, Regulation FD is vulnerable as an unconstitutional restraint on truthful speech, particularly as applied on the facts of this case.

Seventh, the Staff’s Wells Notice has already had a chilling effect on the use of social media without a contemporaneous Form 8-K filing. The Staff has thus obtained much of the remedy it seeks without subjecting its action to Commission review.

¹⁰ Ben Fritz, *Netflix streams more than 1 billion hours in June*, Los Angeles Times (July 3, 2012), <http://articles.latimes.com/2012/jul/03/entertainment/la-et-ct-netflix-billion-hours-20120703>.

¹¹ Samantha Zee & Cliff Edwards, *Netflix Gains as Online Viewing Surges: San Francisco Mover*, Bloomberg (July 3, 2012), <http://www.bloomberg.com/news/2012-07-03/netflix-june-online-viewing-topped-record-1-billion-hours.html>.

¹² Eric Savitz, *Netflix Tops 1B Streaming Hours In June; Citi Stays Bullish*, Forbes (July 3, 2012), <http://www.forbes.com/sites/ericsavitz/2012/07/03/netflix-tops-1b-streaming-hours-in-june-citi-stays-bullish/>.

¹³ Michael Liedtke, *Netflix's monthly video streaming tops 1 billion hours*, NBC News (July 3, 2012), http://www.msnbc.msn.com/id/48064919/ns/technology_and_science-wireless/t/netflixs-monthly-video-streaming-tops-billion-hours/#.UQGvJfJrRRc.

¹⁴ Angela Moscaritolo, *Netflix Streaming Tops 1 Billion Hours in June*, PCMag (July 3, 2012), <http://www.pcmag.com/article2/0,2817,2406679,00.asp>.

¹⁵ See *infra* note 58.

¹⁶ A simple Google search for “Reed Hastings Facebook” will retrieve Mr. Hastings’ personal Facebook page and all of his public postings. Facebook subscribers, even those who are not followers of Mr. Hastings, can also retrieve Mr. Hastings’ public postings by searching for “Reed Hastings” in the Facebook search box.

¹⁷ 17 C.F.R. § 243.101(e) (West, Westlaw through 2013).

Eighth, the proposed enforcement action is a questionable allocation of limited agency resources.

Ninth, if the Commission believes that social media presents a challenge to the operation of Regulation FD then the appropriate response is through the administrative process, and not through a prosecution that would be subject to the infirmities already described. Indeed, there is a simpler regulatory solution to the concerns that led the Commission to adopt regulation FD, and that solution would have the Commission emulate many practices that are now common in the social media rather than challenge information dissemination through the social media.

The remainder of this letter expands on these considerations in greater detail.

I. The Posting Was Not Material.

Regulation FD applies only to disclosures of material information.¹⁸ Information is material only if “there is a substantial likelihood that the [information] ... would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”¹⁹ The determination as to whether information is material is a mixed question of law and fact²⁰ and the test is objective, relying as it does on the views of the “reasonable investor.”²¹

The Posting did not significantly alter the total mix of information because the market already knew that Netflix was close to or had actually achieved a billion hours of viewing per month. On June 4, 2012, a month prior to the Posting, Netflix disclosed on its official blog that its subscribers were “enjoying **nearly a billion hours per month** of movies and tv shows from Netflix.”²² On June 18, 2012, two weeks prior to the Posting, Nginx, Inc., a company working

¹⁸ See 17 C.F.R. § 243.100 (West, Westlaw through 2013) (“Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer. . .”).

¹⁹ Final Rule: Selective Disclosure and Insider Trading, Securities Act Release No. 33-7881 and Exchange Act Release No. 34-43154, 65 Fed. Reg. 51,716, 51,721 (Aug. 15, 2000), 2000 SEC LEXIS 1672, at *32 (hereafter cited as “Adopting Release”) (citing *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *Basic, Inc. v. Levinson*, 485 U.S. 224, 231 (1988); U.S. Sec. & Exch. Comm’n, Staff Accounting Bulletin No. 99 (Aug. 12, 1999), <http://www.sec.gov/interps/account/sab99.htm>).

²⁰ *TSC Indus.*, 426 U.S. at 450. See also *Basic*, 485 U.S. at 231-32 (applying the standard of materiality enunciated in *TSC Industries* to the § 10(b) and Rule 10b-5 context).

²¹ See, e.g., *SEC v. Siebel Sys., Inc.*, 384 F. Supp. 2d 694, 704 (S.D.N.Y. 2005) (“The test of materiality is, however, an objective one, involving the significance of the information to the reasonable investor.”). See also Brief for the United States as Amicus Curiae Supporting Respondent at 20, *Amgen, Inc. v. Conn. Ret. Plans & Trust Funds*, No. 11-1085 (S. Ct. Sept. 2012) (“materiality does not depend on any ... subjective reaction to information....”). Therefore, even if a person who discloses information believes, subjectively but incorrectly, that the disclosure is important, the information remains immaterial as long as it does not significantly alter the total mix of information from the perspective of the reasonable investor.

²² See, e.g., Ken Florance, *Announcing the Netflix Open Connect Network*, Netflix Blog (June 4, 2012, 2:48 p.m.), <http://blog.netflix.com/2012/06/announcing-netflix-open-connect-network.html> (emphasis supplied.) See also Chloe Albanesius, *Netflix Launches ‘Open Connect’ Content Delivery Network*, PCMag (June 5, 2012), <http://www.pcmag.com/article2/0,2817,2405326,00.asp>; David Goldman, *Netflix builds its own delivery network*, CNN Money (June 5, 2012), <http://money.cnn.com/2012/06/05/technology/netflix-open-connect-network/index.htm> (“Netflix serves up just under 1 billion hours of streaming video per month”); Jennifer LeClaire, *Netflix Beefs Up Customer Experience with Open Connect*, News Factor (June 5, 2012),

with Netflix to develop a faster, scalable, and cost-efficient solution for streaming video delivery, announced in a press release that “Netflix has been delivering **a billion hours** of movies and TV shows per month.”²³ On June 27, 2012, a week prior to the Posting, in testimony before the House of Representatives’ Subcommittee on Communications and Technology, Netflix’s General Counsel stated that “Netflix delivers **close to a billion hours** of streaming movies and TV shows to its consumers every month.”²⁴

The “total mix” of information in the market as of the date of the Posting thus included the fact that Netflix was already delivering “nearly a billion” hours, “close to a billion hours,” or had actually already delivered a billion hours of viewing per month. The Commission would therefore face a very significant burden when forced to demonstrate that the Posting contained any material information whatsoever, particularly in light of precedent holding that the repetition of information already known to the market is not material.²⁵

There is also no *a priori* reason to believe that crossing the billion-hour threshold constitutes material information even if that information had not been previously disclosed. 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. The measure is not even a metric of financial performance and does not, in and of itself, convey any information regarding the

http://www.newsfactor.com/story.xhtml?story_id=032003A26LK0 (“Netflix reports streaming nearly 1 billion hours of television and movies per month.”); Todd Spangler, *Netflix Rolls Its Own CDN*, Broadcasting & Cable (June 5, 2012), http://www.broadcastingcable.com/article/485528-Netflix_Rolls_Its_Own_CDN.php (“Netflix, which streams nearly 1 billion hours of video monthly over the Internet. . .”).

²³ Press Release: Nginx, Inc., *Nginx, Inc. Consulted for Netflix “Open Connect” Initiative*, Yahoo News (June 18, 2012), <http://finance.yahoo.com/news/nginx-inc-consulted-netflix-open-170000009.html>.

²⁴ Hearing of the Energy and Commerce Committee, Subcommittee on Communications and Technology, U.S. House of Representatives, at 1 (2012) (testimony of David Hyman, Gen. Counsel of Netflix, Inc.), available at <http://energycommerce.house.gov/sites/republicans.energycommerce.house.gov/files/Hearings/CT/20120627/HHRG-112-IF16-WState-HymanD-20120627.pdf>.

²⁵ See, e.g., *SEC v. Siebel Sys. Inc.*, 384 F. Supp. 2d 694, 703-704 (S.D.N.Y. 2005). See also *Provenz v. Miller*, 102 F.3d 1478, 1492 (9th Cir.1996) (under “truth-on-the-market” doctrine, a misrepresentation is immaterial if the information is already known to the market because the misrepresentation cannot then defraud the market); *United Paperworkers Int’l Union v. Int’l Paper Co.*, 985 F.2d 1190, 1199 (2d Cir. 1993) (“Thus, when the subject of a proxy solicitation has been widely reported in readily available media, shareholders may be deemed to have constructive notice of the facts reported, and the court may take this into consideration in determining whether representations in or omissions from the proxy statement are materially misleading.”); *GAF Corp. v. Heyman*, 724 F.2d 727, 729 (2d Cir. 1983) (“‘total mix’ of information available ... included the many news stories that the closely watched contest had generated”); *Elkind v. Liggett & Myers, Inc.*, 635 F.2d 156, 166 (2d Cir. 1980) (holding that a tip stating that an upcoming earnings report would reflect lower sales was not material where that fact was already common knowledge among analysts and the company had previously stated that a decline in sales was expected), *superseded by statute on other grounds as stated in Acticon AG v. China Ne. Petroleum Holdings Ltd.*, 692 F.3d 34 (2d Cir. 2012); *Seibert v. Sperry Rand Corp.*, 586 F.2d 949, 952 (2d Cir. 1979) (material in “public domain” and therefore readily available included information “reported countrywide in the press and on radio and television,” and “a nationwide consumer boycott ... accompanied by massive media advertising”).

profitability of the enterprise. It is a classic form of an “eyeball” metric that the market knows how to discount when it comes to valuation.²⁶

When the Commission adopted Regulation FD it was sensitive to the fact that its enforcement could implicate subtle questions of materiality. To assuage these concerns, the Adopting Release committed that “[l]iability will arise only when an issuer’s personnel knows or is reckless in not knowing that the information selectively disclosed is both material and non-public. This will provide additional assurance that issuers will not be second-guessed on close materiality judgments.”²⁷ The proposed enforcement action violates this commitment inasmuch as it proposes to re-characterize the disclosure of immaterial information that was already known to the market as material.

The wording of the Posting also indicates that it was not directed to investors. The Posting begins by congratulating employees responsible for content licensing. It then repeats public information regarding new programming. It exhorts employees to do even more to promote further viewing. There is no reference to the company’s stock, to the implications of these developments for investors, or to any other market-related factors. Congratulatory statements of this sort, even when they exaggerate reality, are commonly viewed as immaterial, non-actionable forms of puffery.²⁸ The Posting, which is truthful and repeats information already in the public domain, is *a fortiori* immaterial.

The Commission might also profitably review its experience in the only litigated Regulation FD enforcement proceeding to date, *SEC v. Siebel Systems, Inc.*²⁹ There, the Commission lost on a motion to dismiss in a case litigated in the pre-*Twombly*, pre-*Iqbal* era when the chance of a complaint surviving such a motion was greater than it is today.³⁰ The “gravamen” of the Commission’s *Siebel* complaint was that the issuer’s CFO “made positive comments about the company’s business activity levels and sales transactions pipeline at two

²⁶ The Posting also does not fall into any of the seven categories of material information that the Commission identified as particularly significant in the context of Regulation FD: (1) earnings information, (2) mergers and acquisitions, (3) new products or discoveries, (4) change in control or management, (5) change in auditors, (6) events regarding the issuer’s securities, such as a default or stock split, and (7) bankruptcies or receiverships. *See* Adopting Release, at *37-*38.

²⁷ Adopting Release, at *18.

²⁸ *See, e.g., City of Monroe Emp. Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 670-71 (6th Cir. 2005) (holding that statements of self-praise and confidence amount to immaterial opinions that are not actionable); *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 410 (5th Cir. 2001) (“it is well-established that generalized positive statements about a company’s progress are not a basis for liability”); *Longman v. Food Lion, Inc.*, 197 F.3d 675, 684 & n. 2 (4th Cir. 1999) (concluding that the statements that “Food Lion is one of the best-managed high growth operators in the food retailing industry” and that it provided its employees with “some of the best benefits in the supermarket industry” were “immaterial puffery”); *Lasker v. N.Y. State Elec. & Gas Corp.*, 85 F.3d 55, 58 (2d Cir. 1996) (corporation’s self-praise about its business strategy is “not considered seriously by the marketplace and investors in assessing a potential investment”); *In re Royal Appliance Sec. Litig.*, No. 94-3284, 1995 WL 490131, at *3 (6th Cir. Aug. 15, 1995) (ruling that misrepresentation claims based on statements such as “Royal [is] on track to have a terrific year” were properly dismissed).

²⁹ 384 F. Supp. 2d 694.

³⁰ *See, e.g., Jonah B. Gelbach, Locking the Doors to Discovery? Assessing the Effects of Twombly and Iqbal on Access to Discovery*, Yale L. J. (forthcoming 2013) (concluding that *Twombly* and *Iqbal* have negatively affected plaintiffs in at least 15% to 21% of cases that faced Rule 12(b)(6) motions in the post-*Iqbal* data window).

private events”³¹ that were attended exclusively by analysts and that were not open to the public. The Commission alleged that these statements “materially contrasted with public statements”³² by the CEO who had previously painted a more negative picture of the company’s situation.³³

In dismissing the Commission’s complaint, the court observed that the Commission had improperly attempted to narrow the factual information that the court could review when adjudicating a motion to dismiss.³⁴ The court, over the Commission’s objection, took into account the full public record, including prior statements by the company and its CEO, and concluded that the three statements at issue were each immaterial because they were either “equivalent in substance”³⁵ to a prior disclosure by the CEO, or “provided no material additional information that was not previously publicly discussed by the company,”³⁶ or “imparted no greater information to the private audience than Siebel Systems had already disclosed to the public at large.”³⁷

The court further observed that

[i]t would appear that in examining publicly and privately disclosed information, the SEC has scrutinized, at an extremely heightened level, every particular word used in the statement, including the tense of verbs and the general syntax of each sentence. No support for such an approach can be found in Regulation FD itself, or in the Proposing and Adopting Releases. Such an approach places an unreasonable burden on a company’s management and spokespersons to become linguistic experts, or otherwise live in fear of violating Regulation FD should the words they use later be interpreted by the SEC as connoting even the slightest variance from the company’s public statements. Regulation FD does not require that corporate officials only utter verbatim statements that were previously publicly made. . . . ‘There is no requirement that a material fact be expressed in certain words or in a certain form of language. Fair accuracy, not perfection, is the appropriate standard.’ [Citation] To require a more demanding standard, in the context of Regulation FD, could compel companies to discontinue any spontaneous communications so that the content of any intended communication may be examined by a lexicologist to ensure that the proposed statement discloses the exact information in the same form as was publicly disclosed. If Regulation FD is applied in such a manner, the very purpose of the

³¹ *Siebel Sys.*, 384 F. Supp. 2d at 697.

³² *Id.* at 697-698.

³³ *Id.*

³⁴ *Id.* at 700 (“A plaintiff cannot prevent the Court from examining a [document’s] contents simply by failing to attach the documents to the complaint or even by failing to explicitly cite to them in the complaint.”).

³⁵ *Id.* at 704.

³⁶ *Id.* at 705.

³⁷ *Id.* at 706.

regulation, *i.e.*, to provide the public with a broad flow of relevant investment information, would be thwarted.³⁸

The same conclusion follows on the facts of the Netflix Posting. It is “equivalent in substance” to prior disclosures and “provided no additional material information” beyond that which had already been disclosed “to the public at large.” If Regulation FD is applied to these facts, “the very purpose of the regulation. . . would be thwarted.”

II. The Posting Did Not Violate Regulation FD Because It Was Reasonably Designed to Provide Broad, Non-Exclusionary Distribution of the Information to the Public.

Regulation FD was adopted in response to concern over “selective disclosure of material information by issuers.”³⁹ Selective disclosure occurs when issuers disclose “important public information, such as advance warnings of earnings results, to securities analysts or selected institutional investors or both, before making full disclosure of the same information to the general public.”⁴⁰ Selective disclosure, allows persons “privy to the information beforehand . . . to make a profit or avoid a loss at the expense of those kept in the dark.”⁴¹ The prototypical setting for a selective disclosure arises, for example, in the context of a private gathering of Wall Street analysts or insiders at an event that is closed to the public, or through private phone calls or email, that are not further disseminated to the public.⁴² Simply put, Regulation FD was designed to avoid many of the market effects of insider trading, even if there was no technical violation of the insider trading laws because of a lack of personal benefit or other reason.⁴³

As is apparent from the Proposing Release, Adopting Release, and comment letters to the file, the Commission struggled mightily with the task of crafting a regulation that would define “selective disclosure” without being over or under inclusive. The Commission ultimately settled on a formulation that prohibits disclosures to “any” person within any of four enumerated categories of recipients: “(1) brokers and dealers; (2) investment advisors and certain institutional investment managers; (3) investment companies and hedge funds; and (4) holders of the issuer’s securities in circumstances in which it is reasonably foreseeable that the holder will purchase or sell the issuer’s securities on the basis on the information.”⁴⁴ Regulation FD also provides that, in the event of a disclosure to any person in any of the four enumerated categories, the issuer must make a “public disclosure” either by filing or furnishing that information to the Commission on a Form 8-K, or by disseminating that 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.”⁴⁵

³⁸ *Id.* at 704-705 (quoting *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, 584 F.2d 1195, 1200 (2d Cir. 1978)).

³⁹ Adopting Release, at *4.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² See *infra* Table 1 and Section IV.

⁴³ See Adopting Release, at *4-*7 (noting that Regulation FD was intended to prevent insider trading, loss of investor confidence in the integrity of the markets, and selective disclosure of information to analysts).

⁴⁴ 17 C.F.R. § 243.100(a)-(b)(1).

⁴⁵ Regulation FD provides that “(a) Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any person described in paragraph (b)(1) of this section, the issuer shall make public disclosure of that information as provided in § 243.101(e).” 17 C.F.R. §243.100(a). Section 243.101(e) provides that “(1) Except as provided in paragraph (e)(2) of this section, an issuer

Given the text and intent of Regulation FD, the Posting, even if material, does not violate the regulation for two distinct reasons: it was “reasonably designed to provide broad non-exclusionary distribution of the information to the public,” and it does not constitute a selective disclosure.

Regulation FD does not require that the dissemination actually result in a “broad, non-exclusionary distribution of the information to the public.” It requires only that the dissemination be “reasonably designed” to achieve that result. Here, the Posting was reasonably designed to achieve broad non-exclusionary distribution, and did in fact achieve that objective.

As already indicated, the Posting was⁴⁶ pushed to 205,000 Facebook followers, including, investors, analysts, reporters, and lay persons, through Facebook’s “news feed”⁴⁷ functionality. Almost a quarter of a million people could then almost instantly view the Posting in their news feed without having to visit Mr. Hastings’ home page.⁴⁸ More than one billion Facebook users around the world⁴⁹ – whether followers of Mr. Hastings or not – could then also have viewed the Posting by searching for “Reed Hastings” in the Facebook search box.⁵⁰ Once a viewer accessed Mr. Hastings’ Facebook page, no further searching would have been required – the Posting would have been prominently displayed on Mr. Hastings’ home screen.

It was also reasonably foreseeable that the Posting would be further disseminated through Twitter, and such broad non-exclusionary re-dissemination did in fact occur. To offer but one example, TechCrunch is a widely followed website that covers the technology sector. It has more than 2.5 million Twitter followers.⁵¹ TechCrunch tweeted about the Posting within an hour of its appearance, thereby rapidly and broadly further disseminating the news to the public.⁵²

shall make the ‘public disclosure’ of information required by § 243.100(a) by furnishing to or filing with the Commission a Form 8-K (17 CFR 249.308) disclosing that information”; and “(2) An issuer shall be exempt from the requirement to furnish or file a Form 8-K if it instead 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.”

⁴⁶ I use the past tense because the Posting in question appears to have been removed from Mr. Hastings’ public Facebook page, although it is still retrievable through a Google search.

⁴⁷ “News feed” – the center column of a Facebook user’s home page — is a constantly updating list of stories from people and Pages that a user follows on Facebook. *See News feed*, Facebook Help Center, <http://www.facebook.com/help/327131014036297/> (last visited Jan. 24, 2013). Users who follow Mr. Hastings on Facebook receive his public postings in their news feed. Ruchi Sanghvi, *Facebook Gets a Facelift*, The Facebook Blog (Sept. 5, 2006 1:03 a.m.), <https://blog.facebook.com/blog.php?post=2207967130>.

⁴⁸ *See, e.g.,* Bianca Bosker, *Facebook Unveils ‘Subscribe Button,’ Giving Users An Entirely New Way To Connect*, Huffington Post (Sept. 14, 2011), http://www.huffingtonpost.com/2011/09/14/facebook-unveils-subscribe-button_n_962314.html.

⁴⁹ *See* Barbara Ortutay, *Facebook Tops 1 Billion Users*, USA Today (Oct. 4, 2012), <http://www.usatoday.com/story/tech/2012/10/04/facebook-tops-1-billion-users/1612613/>. Notably, Facebook CEO Mark Zuckerberg announced that his company had hit the one billion-user threshold by posting a status update on his Facebook page. *Id.*

⁵⁰ *See Data Use Policy*, Facebook, <https://www.facebook.com/about/privacy/your-info#public-info> (last visited Jan. 24, 2013) (noting that information a Facebook user chooses to make public “can show up when someone does a search on Facebook or on a public search engine”).

⁵¹ *See TechCrunch home page*, Twitter, <https://twitter.com/TechCrunch> (last visited Jan. 24, 2012) (revealing that as of January 24, 2013, TechCrunch had 2,564,950 followers on Twitter).

⁵² *See* Tweet from Ryan Lawler, TechCrunch (July 3, 2012 8:46 a.m.), <https://twitter.com/TechCrunch/status/220181750968623104> (“Netflix Subscribers Watched 1 Billion Hours Of

Dissemination of the Posting was not limited to users of Facebook or Twitter. Approximately 2.4 billion people around the world have Internet access.⁵³ Any of them, whether Facebook users or not,⁵⁴ could have used any search engine to search for, by way of example, “Reed Hastings Facebook” or “Reed Hastings Facebook posts.” This search would have retrieved all of Mr. Hastings’ postings, including the Posting in question.⁵⁵ In the United States alone, more than 245 million persons, almost 78% of the population, use the Internet.⁵⁶ More than three-quarters of the American public could thus have accessed the Posting on the Internet very shortly after it first appeared.

Further re-dissemination occurred through the traditional media. Among the followers to Mr. Hastings’ Facebook profile are several reporters affiliated with both print and online news sources.⁵⁷ Within hours of Mr. Hastings’ Posting, a number of traditional media outlet, including the Los Angeles Times, Bloomberg News, Forbes, NBC News Online, and PCMag.com, re-published the news that “*Netflix streams more than 1 billion hours in June.*”⁵⁸

Video In June, Or More Than An Hour A Day On Average”). The TechCrunch Tweet was then re-Tweeted 84 times. *See id.*

⁵³ *See* Internet World Stats, <http://www.internetworldstats.com/stats14.htm> (last updated Dec. 16, 2012).

⁵⁴ Similarly, a Twitter account is not required to access company messages on Twitter. A user can simply visit the URL of the company’s account and gain access to its messages. *See* 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/>.

⁵⁵ *See Data Use Policy*, Facebook, <https://www.facebook.com/about/privacy/your-info> (last visited Jan. 24, 2013) (noting that when a user chooses to make information public on Facebook, “anyone, including people off of Facebook, will be able to see it,” and the information “can show up when someone does a search on Facebook or on a public search engine”). A user can turn his or her public search setting off, *see id.*, but it is unlikely that a public figure with an interest in attracting a broad audience would do so.

⁵⁶ 245,203,319 users divided by a total population of 314,929,359 equals 77.86%. *See* Internet World Stats, <http://www.internetworldstats.com/stats14.htm> (last updated Dec. 16, 2012) (total number of Internet users in the U.S.); *U.S. & World Population Clocks*, U.S. Census Bureau, <http://www.census.gov/main/www/popclock.html> (last visited Dec. 2012) (total population of U.S.). In 2011, 91 percent of U.S. households owning mutual funds had Internet access. *See Characteristics of Mutual Fund Owners*, 2012 Investment Company Fact Book, Inv. Co. Inst., http://www.icifactbook.org/fb_ch6.html (last visited Jan. 24, 2013).

⁵⁷ Anders Bylund, *Netflix Exposes Reg FD Flaws*, The Motley Fool (Dec. 8, 2012), <http://www.fool.com/investing/general/2012/12/08/netflix-exposes-reg-fd-flaws.aspx>; Aruna Viswanatha & Sarah N. Lynch, *SEC wrestles with Internet age in Netflix case*, Chi. Trib. (Dec. 7, 2012), http://articles.chicagotribune.com/2012-12-07/business/sns-rt-us-netflix-secbre8b51ip-20121206_1_sec-case-regulation-fair-disclosure-netflix. *See also* list of Mr. Hastings’ followers, which is publicly available on his personal Facebook page, at <https://www.facebook.com/reed1960/followers>.

⁵⁸ *See* Ben Fritz, *Netflix streams more than 1 billion hours in June*, Los Angeles Times (July 3, 2012), <http://articles.latimes.com/2012/jul/03/entertainment/la-et-ct-netflix-billion-hours-20120703>. *See also* John Koetsier, *Netflix: 1 billion hours watched in June is the most ever*, Venture Beat (July 3, 2012), <http://venturebeat.com/2012/07/03/netflix-1-billion-hours-watched-in-june-is-the-most-ever/>; Ryan Lawler, *Netflix Subscribers Watched 1 Billion Hours Of Video In June, Or More Than An Hour A Day On Average*, TechCrunch (July 3, 2012), <http://techcrunch.com/2012/07/03/netflix-subscribers-1-billion-hours/>; Michael Liedtke, *Netflix Subscribers Watched Over 1 Billion Hours Of Online Video In June*, Huffington Post (July 3, 2012), http://www.huffingtonpost.com/2012/07/03/netflix-subscribers-watch-hours-of-online-video_n_1647350.html; Michael Liedtke, *Netflix’s monthly video streaming tops 1 billion hours*, NBC News (July 3, 2012), http://www.msnbc.msn.com/id/48064919/ns/technology_and_science-wireless/t/netflixs-monthly-video-streaming-tops-billion-hours/#.UQHHWPJrRRc; Angela Moscaritolo, *Netflix Streaming Tops 1 Billion Hours in June*, PCMag (July 3, 2012), <http://www.pcmag.com/article2/0,2817,2406679,00.asp>; Eric Savitz, *Netflix Tops 1B Streaming Hours In June; Citi Stays Bullish*, Forbes (July 3, 2012), <http://www.forbes.com/sites/ericsavitz/2012/07/03/netflix-tops-1b-streaming-hours-in-june-citi-stays-bullish/>; Sophie A. Schillaci, *Netflix Monthly Viewing Tops 1 Billion*

Mr. Hastings' Posting to Facebook is thus quite arguably a more effective means of achieving a broad non-exclusionary distribution than an article or advertisement in the *Wall Street Journal*. *The Wall Street Journal* has 2.29 million subscribers, the largest weekday circulation of any newspaper in the United States.⁵⁹ *Wall Street Journal* subscribers, however, represent less than 1.4 percent of all Facebook users in the United States,⁶⁰ and less than 0.23 percent of the total number of Facebook users worldwide.⁶¹ The Journal's subscriber base also represents less than one percent of all United States Internet users⁶² and less than .095 percent of global Internet users.⁶³

Access to a print edition of *The Wall Street Journal* requires payment. On-line access has to cross the Journal's pay-wall. In stark contrast, the Posting was available to all members of the public, immediately, and at no cost. The news-feed features of Facebook and Twitter also pushed the information directly to millions of persons who had indicated a previous interest in Mr. Hastings' activities or in the area of technology implicated by the Posting. Print newspapers, however, have no push technology. A person who buys a print copy of *The Wall Street Journal* would have to search through the entire newspaper to find the information contained in the

Hours in June, *The Hollywood Reporter* (July 3, 2012), <http://www.hollywoodreporter.com/news/netflix-billion-hours-viewing-record-344673>; Samantha Zee & Cliff Edwards, *Netflix Gains as Online Viewing Surges: San Francisco Mover*, *Bloomberg* (July 3, 2012), <http://www.bloomberg.com/news/2012-07-03/netflix-june-online-viewing-topped-record-1-billion-hours.html>.

Information from the Posting continued to be re-published by print and online news sources in the following days. See, e.g., Matt Cantor, *We Spent 1 Billion Hours Watching Netflix Last Month*, *Newser* (July 4, 2012), <http://www.newser.com/story/149455/we-spent-1b-hours-watching-netflix-last-month.html>; Lesley Lanir, *Netflix exceeds 1 billion monthly hours of video viewing*, *Digital J.* (July 4, 2012), <http://digitaljournal.com/article/327922>; Ryan Lawler, *Over 1 Billion (Hours) Served: Netflix, Big Cable, And The Innovator's Dilemma*, *TechCrunch* (July 4, 2012), <http://techcrunch.com/2012/07/04/netflix-youtube-innovators-dilemma/>; Michael Liedtke, *Netflix users watched a billion hours last month*, *USA Today* (July 4, 2012), <http://usatoday30.usatoday.com/tech/news/story/2012-07-03/netflix-online-video/56009322/1>; Paul Lilly, *Netflix Customers Charged Past 1 Billion Hours of Streaming Video in June*, *MaximumPC* (July 4, 2012), http://www.maximumpc.com/article/news/netflix_customers_charged_past_1_billion_hours_streaming_video_june; Connor Simpson, *Congratulations, We Wasted a Billion Hours on Netflix in June*, *The Atlantic Wire* (July 4, 2012), <http://www.theatlanticwire.com/entertainment/2012/07/congratulations-we-wasted-billion-hours-netflix-june/54185/>; *A billion hours and counting for Netflix*, *The Boston Globe* (July 4, 2012), <http://www.bostonglobe.com/business/markets/2012/07/03/netflix-stock-gains-online-viewing-surges/jA93DUIjvaQNdScNJR6DwL/story.html>.

⁵⁹ See Edmund Lee, *New York Times Digital Readers Help Boost Circulation by 40%*, *Bloomberg* (October 30, 2012), <http://www.businessweek.com/news/2012-10-30/new-york-times-weekday-circulation-jumps-40-percent-on-digital-readers>.

⁶⁰ As of September 30, 2012, there were 166,029,240 Facebook users in the United States. See Internet World Stats, <http://www.internetworldstats.com/stats2.htm> (last updated Dec. 21, 2012). $2,290,000$ (*Wall St. Journal* subscribers) / $166,029,240$ (Facebook users in the United States) = $0.01379 \times 100 = 1.38\%$.

⁶¹ As of October 2012, there were over 1 billion Facebook users worldwide. See Barbara Ortutay, *Facebook Tops 1 Billion Users*, *USA Today* (Oct. 4, 2012), <http://www.usatoday.com/story/tech/2012/10/04/facebook-tops-1-billion-users/1612613/>. $2,290,000$ (*Wall St. Journal* subscribers) / $1,000,000,000$ (Facebook users worldwide) = $0.00229 \times 100 = 0.23\%$.

⁶² In the United States, more than 245 million people use the Internet. See Internet World Stats, <http://www.internetworldstats.com/stats14.htm> (last updated Dec. 21, 2012). $2,290,000$ (*Wall St. Journal* subscribers) / $245,203,319$ (Internet users in the U.S.) = $0.0093 \times 100 = 0.93\%$.

⁶³ More than 2.4 billion people use the Internet around the world. See Internet World Stats, <http://www.internetworldstats.com/stats14.htm> (last updated Dec. 21, 2012). $2,290,000$ (*Wall St. Journal* subscribers) / $2,405,518,376$ (Internet users worldwide) = $0.00095 \times 100 = 0.095\%$.

Posting, assuming that the Journal's editors thought that coverage of the Posting was warranted. In addition, there is no guarantee that every reader interested in the Posting would be able to find the Journal's coverage of the Posting. A print newspaper with no "push" technology and that charges for access is thus arguably inferior, from a public dissemination perspective, to an Internet-based mechanism that has the ability to highlight potentially important information to a user base and then to direct that information to that user base, all at no cost.

The Adopting Release expressly observes that acceptable methods of public disclosure for purposes of Regulation FD include "press releases distributed through a widely circulated news or wire service."⁶⁴ An empirical examination of the coverage obtained by press releases issued through traditional news or wire services could well establish that the Posting achieved a level of dissemination broader than that attained by a large number of press releases issued through traditional channels. Such a finding would prove problematic to the Commission in the event of litigation: it would suggest that the enforcement action was animated by the use of a particular medium and not, as the regulation requires, the degree of dissemination that was reasonably foreseeable without regard to the medium employed. This type of discrimination would also raise distinct constitutional issues because it would suggest governmental favoritism for some forms of media over others in clear violation of the First Amendment.⁶⁵

A *New York Times* columnist also suggests that the Posting on Facebook achieved a broader dissemination than would have resulted from filing the information with the Commission on Form 8-K.⁶⁶ The simple observation that registrants commonly issue press releases that are also filed with the Commission on Form 8-K suggests that the issuer community does not have confidence that a Form 8-K filing is, in and of itself, sufficient to provide the broad dissemination that issuers seek independent of any Commission requirements. Notwithstanding this obvious fact and without regard to any empirical finding by the Commission that Form 8-K filings are at all superior or inferior to other forms of information dissemination, Regulation FD provides that a Form 8-K filing is sufficient to demonstrate adequate public dissemination. Litigation would provide the parties with an opportunity to compare the degree of dissemination achieved through Form 8-K filings and postings of the sort employed by Mr. Hastings. Evidence that social media can achieve broader dissemination than filings on a Form 8-K would again raise the question of whether the Commission, through litigation, is discriminating against a particular form of communication in violation of both Regulation FD and the First Amendment.

The Commission's litigation posture would be further complicated by the fact that the Commission has two Facebook pages,⁶⁷ a LinkedIn page,⁶⁸ a YouTube page,⁶⁹ and four Twitter

⁶⁴ Adopting Release at *53.

⁶⁵ For further discussion of the First Amendment issues that would be raised in any enforcement proceeding, *see infra* Section VI.

⁶⁶ *See, e.g.,* Steven M. Davidoff, *In Netflix Case, a Chance to Re-examine Old Rules*, N.Y. Times DealBook (Dec. 11, 2012), <http://dealbook.nytimes.com/2012/12/11/in-netflix-case-a-chance-for-the-s-e-c-to-re-examine-old-regulation/> ("It is certain that more people read this comment on Facebook than if it had been in an S.E.C. filing.")

⁶⁶ The disparity in treatment of social media publications and traditional printed publications makes no sense in the current digital era, and underscores the need for new Commission guidance on the use of social media.

⁶⁷ *See U.S. Sec. & Exch. Comm'n home page*, Facebook, <https://www.facebook.com/UnitedStatesSEC> (last visited Jan. 24, 2013); *SEC Career Opportunities*, Facebook, <https://www.facebook.com/SECJobs> (last visited Jan. 24, 2013).

accounts.⁷⁰ To be sure, the Commission may not be getting as much action on its social media sites as Mr. Hastings has on his Facebook page,⁷¹ and it may not have as many Twitter followers as TechCrunch,⁷² but the simple fact that the agency uses social media suggests that the agency is aware of the potential for broad non-exclusionary dissemination of information through social media. Again, litigation will give the parties an opportunity to explore the Commission's internal processes and expectations in connection with establishing its own social media accounts. Evidence that the Commission was well aware of the opportunities provided by social media for broad, non-exclusionary communication could prove problematic for an enforcement proceeding.

In sum, these observations raise a profound concern that the Staff's interest in pursuing this litigation is animated by the use of social media rather than by the extent of dissemination that resulted from the use of social media. Putting aside for the moment the constitutional questions raised by this form of discrimination, the simple wording of Regulation FD provides no basis for such a distinction.

III. The Posting Was Not a Selective Disclosure.

The Posting was an undifferentiated dissemination to the world at large. It was quickly and broadly redistributed through the Internet and through traditional media. Neither the Company nor its CEO controlled the identity of the Posting's recipients or the mechanisms of retransmission. The dissemination cannot be characterized as generating any of the harms that Registration FD was designed to prevent. The Posting was thus not a selective disclosure.

Only an overly formalistic reading of the text of Regulation FD could support an assertion that the Posting was a selective disclosure. Such a reading would, however, conflict with established Supreme Court precedent central to the interpretation of the federal securities laws, and would therefore fail.

The suggestion that the Posting violates Regulation FD hinges on the interpretation of the word "any" as that word is used in Regulation FD. The text of the regulation provides that "any" disclosure of material information to "any" member of four enumerated categories of individuals violates Regulation FD unless the information is filed or furnished on a Form 8-K or is disseminated "through another method (or combination of methods) of disclosure that is

⁶⁸ See *U.S. Sec. & Exch. Comm'n home page*, LinkedIn, http://www.linkedin.com/company/us-securities-and-exchange-commission?trk=hb_tab_compy_id_166718 (last visited Jan. 24, 2013).

⁶⁹ See *U.S. Sec. & Exch. Comm'n home page*, YouTube, <http://www.youtube.com/SECViews> (last visited Jan. 24, 2013).

⁷⁰ See *U.S. Sec. & Exch. Comm'n Office of Investor Educ. & Advocacy*, Twitter, https://twitter.com/SEC_Investor_Ed (last visited Jan. 24, 2013); SEC Enforcement, Twitter, https://twitter.com/SEC_Enforcement (last visited Jan. 24, 2013); SEC News, Twitter, https://twitter.com/SEC_news (last visited Jan. 24, 2013); SEC Jobs, Twitter, https://twitter.com/SEC_Jobs (last visited Jan. 24, 2013).

⁷¹ The SEC's Facebook page has received 12 likes, see <https://www.facebook.com/UnitedStatesSEC> (last visited Jan. 24, 2013), while a single posting on Mr. Hastings' Facebook page has received 918 likes, see Apr. 15, 2012 Posting, <https://www.facebook.com/reed1960> (last visited Jan. 24, 2013).

⁷² SEC News has 186,999 Twitter followers, see https://twitter.com/SEC_news (last visited Jan. 24, 2013), while TechCrunch has over 2.5 million Twitter followers, see <https://twitter.com/TechCrunch> (last visited Jan. 24, 2013).

reasonably designed to provide broad, non-exclusionary distribution of the information to the public.”⁷³ Assuming without deciding that the Posting was material, and that it did not result in a broad, non-exclusionary distribution, then if the Posting reached even a single member of any enumerated class - - *i.e.*, any analyst, any broker, any hedge fund, or any holder of the issuer’s securities “under circumstances in which it is reasonably foreseeable that the person will purchase or sell the issuer’s securities on the basis of the information” - - Regulation FD was arguably violated.

The problem with this reading of the text is that it contravenes Supreme Court guidance regarding the interpretation of the word “any” as that term is applied in the federal securities laws. In particular, the Securities Act of 1933 and the Exchange Act of 1934 state that the definition of the term “security” includes “any” stock and “any” note.⁷⁴ In *United Housing Foundation v. Forman*,⁷⁵ however, the Supreme Court explained that stock in a housing co-operative, which was clearly a form of stock for purposes of the federal securities laws, nonetheless did not qualify as a “security.” The court explained that the stock at issue did “not fall within the ordinary concept of a security”⁷⁶ and emphasized that “ ‘form should be disregarded for substance and the emphasis should be on economic reality’ ” when interpreting the federal securities laws.⁷⁷ Reliance on a “literal approach” to defining the term was rejected as misplaced,⁷⁸ and the Court observed that “common sense” suggested that people who purchased the stock solely as a means of acquiring “a residential apartment in a state-subsidized cooperative” were not engaged in the sort of transaction that Congress intended to be subject to Commission regulation.⁷⁹ Thus, the word “any” in this context could not support a dictionary definition of the term.

Similarly, in *Reves v. Ernst & Young*,⁸⁰ the Supreme Court held that, notwithstanding statutory text defining “any” note as a security subject to Commission regulation, it did not follow that “any” note was a “security” subject to the Commission’s regulation. Again, the Court explained that the interpretation of the term “security” was governed “not by legal formalisms, but instead [by] ... the economics of the transaction under investigation.”⁸¹ Accordingly, “the phrase ‘any note’ should not be interpreted to mean literally ‘any note,’ but must be understood against the backdrop of what Congress was attempting to accomplish in enacting the Securities Acts.”⁸²

⁷³ 17 C.F.R. §§ 243.100, 243.101(e).

⁷⁴ See 15 U.S.C.A. § 77b(a)(1) (West, Westlaw through P.L. 112-207 approved 12-7-12) (“The term ‘security’ means any note, stock. . . .”); 15 U.S.C.A. § 78c (a)(10) (West, Westlaw through P.L. 112-207 approved 12-7-12) (same).

⁷⁵ 421 U.S. 837 (1975).

⁷⁶ *Id.* at 848.

⁷⁷ *Id.* (quoting *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967)). See also *SEC v. W. J. Howey Co.*, 328 U.S. 293, 298 (1946).

⁷⁸ *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 849-50 (1975).

⁷⁹ *Id.* at 851.

⁸⁰ 494 U.S. 56 (1990).

⁸¹ *Id.* at 61.

⁸² *Id.* at 63.

The same logic governs the interpretation of Regulation FD. The Commission's 2008 Guidance on the Use of Company Web Sites⁸³ states that

Regulation FD was adopted to address the problem of selective disclosure of material information by companies, in which 'a privileged few gain an informational edge - and the ability to use that edge to profit - from their superior access to corporate insiders, rather than from their skill, acumen, or diligence.' We must, therefore, keep that in mind when providing guidance on when information is considered public for purposes of assessing whether a subsequent selective disclosure may implicate Regulation FD.⁸⁴

The phrase "any" as used in the regulation's text thus "must be understood against the backdrop of what [the Commission] was attempting to accomplish in" adopting Regulation FD. Nowhere in the record is there the slightest indication that the Commission intended to regulate situations in which issuers had no control over the identity of the recipients of the information and in which hundreds of thousands or millions of persons would quickly and simultaneously have access to the information at no cost. It follows that Regulation FD was never intended to prohibit a communication in the form of the Posting. The text of the regulation, and its reliance on the word "any," thus cannot be interpreted to suggest that the Posting violates the regulation.

This conclusion is further buttressed by the Supreme Court's decision in *Securities and Exchange Commission v. Ralston Purina*.⁸⁵ There, the Court defined the meaning of the term "public distribution" in order to set the bounds of an exemption from the registration requirements of the federal securities laws. The Court observed that "manifestly, an offering of securities to all redheaded men, to all residents of Chicago or San Francisco, to all existing stockholders of the General Motors Corporation ... is no less 'public', in every realistic sense of the word, than an unrestricted offering to the world at large," even though, as a technical matter, not every member of the public is a recipient of the offering.⁸⁶ Thus, "to determine the distinction between 'public' and 'private' in any particular context, it is essential to examine the circumstances in which the distinction is sought to be established and to consider the purposes sought to be achieved by the distinction."⁸⁷ The Court thus concluded that "the natural way to interpret the private offering exemption is in light of the statutory purpose," which here turned on "whether the particular class of persons affected needs the protection of the Act."⁸⁸

So too in the case of Regulation FD, the natural way to interpret the scope of the potential violation is to ask whether the dissemination at issue implicates the reasons for the adoption of the regulation in the first instance. There being no evidence that the Commission had any concern over a dissemination that was not selective in the sense that the issuer could not control the identity of any of the recipients, it follows that the Posting does not violate the regulation.

⁸³ U.S. Sec. & Exch. Comm'n, *Commission Guidance on the Use of Company Web Sites* (2008), available at <http://www.sec.gov/rules/interp/2008/34-58288.pdf> (hereafter cited as "2008 Guidance").

⁸⁴ *Id.* at 17-18 (quoting Adopting Release at 5).

⁸⁵ 346 U.S. 119 (1953).

⁸⁶ *Id.* at 123-24.

⁸⁷ *Id.* at 124.

⁸⁸ *Id.* at 124-25.

The fact that the Posting occurred in the context of a broadly-based social network dissemination that was not in the form of quiet, back room behavior contemplated by the regulation only further underscores the conclusion that the Posting cannot be fairly read as violating Regulation FD.

IV. An Enforcement Action Would Mark a Dramatic and Unwarranted Extension of Regulation FD in Violation of Prior Agency Commitments.

The Commission has, to date, brought thirteen enforcement actions under Regulation FD. Table 1, attached as an appendix to this letter, lists each of these enforcement actions and summarizes the facts underlying each proceeding. As is apparent from Table 1, an enforcement action on the Netflix facts would dramatically extend Regulation FD far beyond any prior claims filed by the Commission. In particular:

- In each of the preceding thirteen enforcement actions, the mode of dissemination allowed the issuer to control the identity of the recipients by either placing a telephone call, deciding to attend a closed meeting, sending an email, or requiring paid subscription to a controlled website. Here, the issuer did not control the identities of the recipients.
- The largest identified number of recipients of an allegedly selective disclosure in any preceding action is 200. Here, the Commission will have to argue that a disclosure to almost 205,000 persons is selective.
- In each preceding enforcement action, the recipients of the information were exclusively investment industry insiders, such as analysts, portfolio managers, brokerage personnel, or, in a single case, subscribers to an obscure data base service who were likely market professionals. In no case is there any indication that the general public had even a remote chance of obtaining access to the information at issue. Here, however, the information was disclosed simultaneously to hundreds of thousands of members of the general public.
- In none of preceding enforcement actions is there any indication that even a single member of the press was among the recipients of the selective disclosure. Here, in stark contrast, the public record suggests that members of the press actually received the allegedly selective disclosure contemporaneously with all other recipients, and that the press disseminated the information quickly. Put another way, the Posting operated like a press release that was visible to all members of the public and that required no fee for access.

Such a dramatic extension of Regulation FD's reach beyond all precedent is particularly unwarranted in light of evidence that the Posting contained no material information, was reasonably designed to achieve a broad dissemination, and was not a selective disclosure. Indeed, such a dramatic extension would directly abrogate the Staff's prior representation and Chairman Pitt's commitment that "the Commission's Enforcement Staff has stated that it will not attempt to second-guess reasonable, good faith judgments by persons who honestly attempt to comply

with Regulation FD. I agree with that approach.”⁸⁹ An enforcement action here would also conflict with the Adopting Release’s representation that “[l]iability will arise only when an issuer’s personnel knows or is reckless in not knowing that the information selectively disclosed is both material and non-public. This will provide additional assurance that issuers will not be second-guessed on close materiality judgments.”⁹⁰ The facts of this case do not present auspicious circumstances for the Staff and for the Commission to renege on its prior representations regarding the enforcement of Regulation FD.

V. The Commission's 2008 Guidance Regarding Web Sites and the Implementation of Regulation FD Has Not Been Violated and Is Outdated.

The Commission’s 2008 Guidance on the Use of Company Web Sites provides observations on the circumstances under which Internet-based disclosures might not violate Regulation FD.⁹¹ The Staff’s interest in pursuing an enforcement action on the facts of this case might be animated, in part, by the observation that the Posting appeared on Mr. Hastings’ personal Facebook page, not the Company’s webpage or Facebook page. Further, the public record appears to contain no indication that investors received prior notification that they should be looking to Mr. Hastings’ personal Facebook page for company information. The Staff might therefore contemplate arguing that the Posting fails to comply with the 2008 Guidance and thus violates Regulation FD. This logic, however, fails on at least three distinct grounds.

First, the 2008 Guidance does not amend Regulation FD. “SEC positions announced in interpretive releases necessarily provide less precedential and predictive value than do rules that are promulgated as a result of the more formal interpretive rulemaking process.”⁹² Interpretive releases, no action letters, and other administrative actions that do not comply with the Administrative Procedures Act, cannot expand the scope of liability under the federal securities laws. They can instead create *de facto* safe harbors and clarify strategies that the agency might follow in enforcing validity adopted regulations. A failure to comply with the 2008 Guidance thus cannot constitute a violation of Regulation FD. Accordingly, because the Posting was not material, did not constitute a selective disclosure, and was reasonably designed to provide broad, non-exclusionary distribution of the information to the public, there is no violation of Regulation FD even if the Posting did not comply with the 2008 Guidance.

Second, “[w]hether a company’s website is a recognized channel of distribution of information will depend on the steps that the company has taken to alert the market to its web site and its disclosure practices, *as well as the use by investors and the market of the company’s web site.*”⁹³ One factor that is relevant to this analysis is “[t]he extent to which information posted on the web site is regularly picked up by the market and readily available media, and reported in, such media.”⁹⁴ The 2008 Guidance thus accepts the notion of functional equivalence - - that actual use by investors and the market can substitute for steps taken to alert the market to a

⁸⁹ Fisch, *supra* note 2, at 9 n.45 (quoting letter from Harvey L. Pitt, Chairman, U.S. Sec. and Exch. Comm’n, to the Chief Clerk, U.S. Senate, Comm. on Banking, Hous. & Urban Affairs (July 23, 2001)).

⁹⁰ Adopting Release, at *18.

⁹¹ See generally 2008 Guidance.

⁹² 6 Thomas L. Hazen, *Treatise on the Law of Securities Regulation* §16.32[3], p. 329 (6th ed. 2009).

⁹³ 2008 Guidance at 18-19 (emphasis supplied).

⁹⁴ 2008 Guidance at 20-21.

website. This notion of functional equivalence logically extends to the idea that there are forms of Internet distribution, other than the use of static web pages advertised as sources of company information, that are entirely acceptable forms of public dissemination. Therefore, if actual access to Mr. Hastings' Facebook page, with more than 200,000 followers, combined with reasonably foreseeable retransmission of the Posting through Facebook, Twitter, and traditional media, leads to public dissemination that is functionally comparable to that resulting from posting and publicity on a static company webpage, then the Facebook Posting is not inconsistent with the 2008 Guidance. Any other interpretation leads to the illogical conclusion that the 2008 Guidance was intended to chill the use of advanced technologies that would lead to superior forms of public dissemination.⁹⁵

Third, the 2008 Guidance itself observes that Internet technology has been rapidly changing,⁹⁶ but it fails adequately to anticipate the growth of social media and the implications of this growth for Regulation FD. In particular, the central theme of the 2008 Guidance rests on the assumption that information transmission through the Internet is dominated by passive company-sponsored webpages, and that corporations have to actively advertise to attract investors to visit those webpages. This vision of the Internet might have been true in 2008, but it fails to account for the evolution of social media, the pervasive use of push technology,⁹⁷ the ability of the traditional press to follow a wide number of data feeds at very low cost, and the capacity of information to "go viral" as a function of the significance of the information's substance rather than as a function of the advertising or promotion of the information's location. Put another way, the Internet of 2012 is a very different medium from the Internet of 2000, when Regulation FD was adopted, or the Internet that existed at the time of the 2008 Guidance.

⁹⁵ This is clearly not the case. See 2008 Guidance at 5 (noting "our expectation that continued technological advances will further enhance the quality, not just the quantity, of information delivered and available to investors on such web sites, as well as the speed at which such information reaches the market"); *id.* at 6 ("We have long recognized the vital role of the Internet and electronic communications in modernizing the disclosure system under the federal securities laws and in promoting transparency, liquidity and efficiency in our trading markets"); *id.* at 7 ("Through the years, we have taken a number of steps to encourage the dissemination of information electronically via the Internet, as we believe that widespread access to company information is a key component of our integrated disclosure scheme, the efficient functioning of the markets, and investor protection"); *id.* at 9-10 ("We recognize that allowing companies to present data in formats different from those dictated by our forms or more technologically advanced than EDGAR may be beneficial to investors. Indeed, because we recognize the enormous potential for the Internet to promote the goals of the federal securities laws, we wish to continue to encourage companies to develop their web sites in compliance with the federal securities laws so that they can serve as effective information and analytical tools for investors.").

⁹⁶ 2008 Guidance at 4 (noting "the speed at which technological advances are developing, and the translation of those technologies into investor tools"); *id.* at 5 (noting "the development and proliferation of company web sites since 2000, and our expectation that continued technological advances will further enhance the quality, not just the quantity, of information delivered and available to investors on such web sites, as well as the speed at which such information reaches the market"); *id.* at 6 ("Ongoing technological advances in electronic communications have increased both the markets' and investors' demand for more timely company disclosure and the ability of companies to capture, process and disseminate this information to market participants.").

⁹⁷ See 2008 Guidance at 21 n.51 (describing "push technology" as "a type of Internet-based communication where the request for the transmission of information originates with the publisher or central server. It is contrasted with pull technology, where the request for the transmission of information originates with the receiver or client."). In fact, the 2008 Guidance identifies a company's use of "push technology" as a factor relevant to evaluating whether the company's website is a recognized channel of distribution and whether information posted thereon is "disseminated." See *id.* at 21.

Regulation FD was adopted in August 2000. The Internet was then far smaller than it is today.⁹⁸ Social media were in their infancy, and Mark Zuckerberg, Facebook's founder, was in high school. The leading social networking site in 2000 was the now defunct SixDegrees.com.⁹⁹ Friendster launched in 2002; MySpace and LinkedIn did not appear until 2003;¹⁰⁰ and the current leaders in the space, Facebook and Twitter, did not come along until 2006.¹⁰¹ Not surprisingly, the Adopting Release did not contemplate the implications of the Internet in general or of social media in particular.

The Commission's 2008 Guidance on the Use of Company Web Sites appeared when Facebook and Twitter were only two years old.¹⁰² In 2008, Facebook had 100 million active users.¹⁰³ Today, Facebook is ten times larger with more than one billion active users.¹⁰⁴ In 2008, Twitter recorded 100 million tweets per quarter, or just over 1.1 million tweets per day. Today Twitter logs approximately 340 million Tweets per day.¹⁰⁵ By that metric, Twitter is today about 309 times larger than it was in 2008.

In the four years since the Commission's 2008 Guidance, businesses have increasingly come to rely on social media as a means of broad, non-exclusionary communication with current and potential customers and investors.¹⁰⁶ Today, more than 11 million businesses have Facebook

⁹⁸ In 2000, there were estimated to be 361 million Internet users worldwide. See Raphael Cohen-Almagor, *Internet History*, 2 Int'l J. of Technoethics 45, 56 (2011). Today, Facebook alone has more than one billion users, and there are more than 2.4 billion persons with Internet access around the world. See *supra* notes 49 & 53.

⁹⁹ See Danah M. Boyd, *Social Network Sites: Definition, History, and Scholarship*, 13 J. of Computer-Mediated Commc'n 210, 211 Fig. 1 (2008) (timeline of the launch dates of many major SNSs and dates when community sites re-launched with SNS features); Anders Bylund, *Netflix Exposes Reg FD Flaws*, The Motley Fool (Dec. 8, 2012), <http://www.fool.com/investing/general/2012/12/08/netflix-exposes-reg-fd-flaws.aspx>.

¹⁰⁰ See Boyd, *supra* note 99, at 211 Fig. 1.

¹⁰¹ See Boyd, *supra* note 99, at 211 Fig. 1. Facebook did not become a public social networking site until 2006, although it was available to Harvard students in 2004 and to high school students in 2005.

¹⁰² See Boyd, *supra* note 99, at 211 Fig. 1 (observing that Twitter and Facebook launched in 2006, two years before the SEC issued the 2008 Guidance).

¹⁰³ See Sentiment Metrics, <http://oursocialtimes.com/wp-content/uploads/2012/08/Sentiment-Metrics-Olympics-infographic.jpg> (last visited Jan. 24, 2013).

¹⁰⁴ See Barbara Ortutay, *Facebook Tops 1 Billion Users*, USA Today (Oct. 4, 2012), <http://www.usatoday.com/story/tech/2012/10/04/facebook-tops-1-billion-users/1612613/>.

¹⁰⁵ See Sentiment Metrics, <http://oursocialtimes.com/wp-content/uploads/2012/08/Sentiment-Metrics-Olympics-infographic.jpg> (last visited Jan. 24, 2013).

¹⁰⁶ See, e.g., Cliff Edwards, *Netflix CEO Hastings Faces SEC Action Over Facebook Post*, Bloomberg (Dec. 7, 2012), <http://www.bloomberg.com/news/2012-12-06/netflix-ceo-hastings-faces-sec-action-over-facebook-post.html> (noting that on Dec. 4, Elon Musk, chairman and CEO of Tesla Motors Inc., said on Twitter that his electric-vehicle company was cash-flow positive); Sharon Gaudin, *Business Use of Facebook, Twitter Exploding*, Computerworld (Nov. 9, 2009), http://www.computerworld.com/s/article/9140579/Business_use_of_Twitter_Facebook_exploding ("The use of social networking sites like Twitter and Facebook to promote businesses has exploded over the past six months"); Dominic Jones, *Google Moves to Web Disclosure for Reg FD*, IR Web Report (Apr. 16, 2010), <http://irwebreport.com/20100416/google-moves-to-web-disclosure-for-reg-fd/> (noting that Google will begin making announcements about its financial performance solely through its investors relations website); Brian Wassom, *Public Companies, Social Media, and SEC Regulation FD*, Wassom.com (May 31, 2012), <http://www.wassom.com/public-companies-social-media-and-sec-regulation-fd.html> (noting that companies are "live tweeting" their earnings calls and annual meetings). In growing numbers, registered investment advisers are also "using social media to communicate with existing and potential clients, promote services, educate investors and recruit new employees." See Office of Compliance Inspection and Examinations, *Investment Adviser Use of Social*

pages,¹⁰⁷ 73 percent of Fortune 500 companies have a corporate Twitter account that they have used within the past month, and 66 percent have a Facebook account.¹⁰⁸ The numbers are even higher for small businesses.¹⁰⁹ In addition, an increasing number of people are engaging with businesses through social media. On Twitter, the number of users following Fortune 500 companies increased exponentially between 2011 and 2012: Walt Disney's Twitter following increased by 523 percent, and Nike's following increased by 257 percent.¹¹⁰

Since 2008, the manner in which users receive information through social media has also changed dramatically. Social media sites now commonly "push" real-time information directly to the public. On Facebook, for example, users can "follow"¹¹¹ corporate executives to receive the executives' public postings directly in their news feed.¹¹² Similarly, users can elect to receive real-time information from corporate executives and businesses by "following" them on Twitter.¹¹³ Businesses also create "Facebook Pages" designed specifically for brands such as companies, organizations, and celebrities, in order to tap into the Facebook market and interact and communicate with thousands of users.¹¹⁴ These were not broadly established features of the social media landscape in 2008.

Media, at 1, Nat'l Examination Risk Alert, Vol. II, Issue 1 (2012), available at <http://www.sec.gov/about/offices/ocie/riskalert-socialmedia.pdf>.

¹⁰⁷ See Eric Jackson, *Why Do Some Advertisers Believe That 90% Of Facebook Ad Clicks Are From Bots?*, Forbes (July 31, 2012), <http://www.forbes.com/sites/ericjackson/2012/07/31/why-do-some-advertisers-believe-that-90-of-facebook-ad-clicks-are-from-bots/>.

¹⁰⁸ See Nora Ganim Barnes, Ava M. Lescault, & Justina Andonian, *Social Media Surge by the 2012 Fortune 500: Increase Use of Blogs, Facebook, Twitter and More*, University of Massachusetts Dartmouth (2012), <http://www.umassd.edu/cmr/socialmedia/2012fortune500/> (a study of Fortune 500 companies in 2012 found that 28% have a corporate blog, 90% of the blogs allowed comments and subscriptions, 73% have a corporate Twitter account and have tweeted within the last 30 days, 66% have a Facebook presence, and 2% have a Pinterest account).

¹⁰⁹ Eileen Garrity, *The Shift in Small Business Behavior: 90 Percent Networking Online, According to New Manta Survey*, Manta (Sept. 12, 2012), http://www.manta.com/media/marketing_3D_091212; Carol Tice, *Small Businesses Don't Have Time for Social Media -- and Don't Track Results*, Forbes (Oct. 31, 2012), <http://www.forbes.com/sites/caroltice/2012/10/31/small-businesses-dont-have-time-for-social-media-and-dont-track-results/> (discussing study from online marketing firm, Virtual Response, which found that two thirds of small businesses regularly use Facebook, half regularly use Twitter, and sixty-six percent of small businesses are spending more time on social media compared to a year ago).

¹¹⁰ Barnes, et al., *supra* note 108.

¹¹¹ On September 14, 2011, Facebook launched a "Subscribe" button (now referred to as "Follow") which allows users to follow public updates from companies, journalists, politicians, or other bloggers of interest. When a user "follows" a blogger's profile, the blogger's public postings and status updates are automatically "pushed" to the user's news feed. See *Manage Your Followers*, Facebook Help Center, <https://www.facebook.com/help/382751108453953/> (last visited Jan. 28, 2013); Jason Kincaid, *Facebook Launches Twitter-Like 'Subscriptions', Lets You Share With Unlimited Users*, TechCrunch (Sept. 14, 2011), <http://techcrunch.com/2011/09/14/facebook-launches-twitter-like-subscriptions-lets-you-share-with-unlimited-users/>.

¹¹² In 2005, Facebook announced a new home page feature called "news feed." News feed highlights what's happening in a user's social and professional circles on Facebook, and updates a personalized list of news stories on the user's home page throughout the day. Whenever users log into Facebook, they can quickly review the latest headlines generated by the activity of their friends and social or professional groups. See Ruchi Sanghvi, *Facebook Gets a Facelift*, The Facebook Blog (Sept. 5, 2006 1:03am), <https://blog.facebook.com/blog.php?post=2207967130>.

¹¹³ Tweets are pushed to a user's "timeline," which is a feed of all the accounts the user has subscribed to or followed on Twitter. See *What is Twitter?*, Twitter, <https://business.twitter.com/en/basics/what-is-twitter/> (last visited Jan. 24, 2013).

¹¹⁴ See *Inside Facebook Pages*, Sysomos (Nov. 2009), <http://www.sysomos.com/insidefacebook/>.

Today, the Pope has a Facebook page and a Twitter account¹¹⁵ for the same reason that major corporations and small businesses alike are flocking to social media: it is a highly efficient means for broadly disseminating many different forms of information in a non-exclusionary manner. It is, in many respects, a mode of communication uniquely ill-suited to the selective disclosure of information, absent the use of privacy settings, which is a consideration not here at issue.

The Commission has also joined the Pope in the move to social media. As previously noted, the Commission has two Facebook pages, a LinkedIn account, a YouTube account, and four Twitter accounts.¹¹⁶ Ironically enough, the Commission established its first Twitter account the day before it released the 2008 Guidance on the Use of Company Websites.¹¹⁷ Thus, the Commission was apparently aware of social media as of the date of its website release, but determined not to address that rapidly growing means of communication. And, by 2012, the Commission acknowledged that the evolution of social media is “landscape shifting,” and that “[t]he use of social media by the financial services industry is rapidly accelerating.”¹¹⁸

VI. As a Restraint on Truthful Speech, Regulation FD Is Subject to Constitutional Challenge.

Courts commonly strive to resolve controversies without reaching constitutional questions.¹¹⁹ This rule of decision increases the probability that a complaint against Netflix and Mr. Hastings would be dismissed on at least one of the grounds already presented.¹²⁰

If, however, a court reaches the constitutional question, the litigation would not only reprise the arguments over Regulation FD’s constitutionality that were presented but not addressed in *Siebel*, but would also implicate the more recent Supreme Court decision in *Sorrell v. IMS Health, Inc.*¹²¹ and the Second Circuit’s decision in *United States v. Caronia*.¹²² These two precedents are not favorable to the argument that Regulation FD is constitutional as applied on the facts of this case. Further, Regulation FD is hardly the only Commission rule or regulation

¹¹⁵ See Pope Benedict XVI home page, Twitter, <https://twitter.com/Pontifex/status/278808536404852736> (last visited Jan. 24, 2013).

¹¹⁶ See *supra* notes 67-70.

¹¹⁷ Michelle Leder, *The SEC Discovers Twitter*, Footnoted (Aug. 7, 2008), <http://www.footnoted.com/sec-stuff/the-sec-discovers-twitter/>.

¹¹⁸ See Office of Compliance Inspection and Examinations, *Investment Adviser Use of Social Media*, at 1, Nat’l Examination Risk Alert, Vol. II, Issue 1 (2012), available at <http://www.sec.gov/about/offices/ocie/riskalert-socialmedia.pdf>. See also Fin. Ind. Regulatory Auth., Regulatory Notice 10-06 (Jan. 2010), available at <http://www.finra.org/Industry/Regulation/Notices/2010/P120760> (“Americans are increasingly using social media Web sites, such as blogs and social networking sites, for business and personal communications.”)

¹¹⁹ The Supreme Court has developed “a series of rules under which it has avoided passing upon a large part of all the constitutional questions pressed upon it for decision.” See *Ashwander v. Tennessee Valley Auth.*, 297 U.S. 288, 347 (1936). For example, the Court “will not pass upon a constitutional question, although properly presented by the record, if there is also present some other ground upon which the case may be disposed. Thus, if a case can be decided on either of two grounds, one involving a constitutional question, the other a question of statutory construction or general law, the Court will decide only the latter.” *Id.*

¹²⁰ See, e.g., *Siebel Sys.*, 384 F. Supp.2d at 697, 709 n.16 (“Since the complaint itself fails to allege a cognizable cause of action for violation of Regulation FD, this Court declines to opine on the constitutional challenges raised.”).

¹²¹ 131 S. Ct. 2653 (2011).

¹²² No. 09-5006-cr, 2012 WL 5992141 (2d Cir. Dec. 3, 2012).

that burdens the dissemination of truthful speech. For example, all of the Commission's quiet period regulations relating to the public offering process, and all restrictions on communications to and by analysts, are burdens on truthful speech. The constitutionality of all of these provisions could be called into question by a sufficiently broad-based Commission loss on constitutional grounds in the contemplated Netflix proceeding.

The constitutional argument against Regulation FD would, among other considerations, emphasize the fact that Regulation FD's prohibition is not on the act of trading. Nor is the restriction on committing an act of fraud or manipulation. The restriction is instead on the act of communicating truthful information without any connection to whether the speaker or recipient actually violates the federal securities laws as a result of the disclosure. People are thus punished for speaking the truth in a manner not prescribed by the federal government. They are not punished for committing or contributing to any wrongful act.

The facts of any enforcement proceeding against Netflix or Mr. Hastings would also be less favorable to the Commission than the facts litigated in the failed *Siebel* prosecution. In *Siebel*, defendants made no effort to publicize the information at issue through any channel whatsoever. Here, however, Netflix and Mr. Hastings turned to social media when precisely the same information disseminated through different channels would not give rise to any liability. The Commission seeks to draw this distinction even though there is no basis on which to conclude that traditional media or static webpages would have been more effective in disseminating the information at issue. Thus, the claim arises that the application of Regulation FD on the facts of this case unconstitutionally discriminates against social media.

Although the debate over the constitutionality of Regulation FD inevitably implicates several complex questions relating to the interpretation of the First Amendment, the general parameters of the challenge are easily described.

First, just as the government cannot act to favor one medium of communication over another, it cannot act to favor traditional media or static webpages over social media, particularly in the absence of any showing that social media are less effective in achieving the regulation's purported objective.

Second, Regulation FD governs the dissemination of truthful speech only to four specific categories of recipients. But no violation arises if the recipients of that information trade on that information provided that the information was not disseminated to anyone in the four disfavored classes. Regulation FD is thus neither rationally nor narrowly tailored to achieve its objective.

Third, Regulation FD applies only to specifically identified disfavored speakers - - the issuer and certain of its affiliates. Precisely the same information spread by any other person would not be actionable under Regulation FD, again raising questions as to whether Regulation FD is rationally tailored to achieve its objective.

Fourth, because Regulation FD applies only to the dissemination of material speech conditional on disclosure to persons in four identified categories, and because the definition of material speech can be highly controversial, Regulation FD is a content-based regulation that

relies on vague and ambiguous standards to define the scope of the prohibited truthful speech. Thus, to paraphrase the Second Circuit’s decision in *Caronia*,¹²³ because Regulation FD disfavors truthful speech with a particular content [material speech] when expressed by certain disfavored speakers [issuers and certain affiliates] and to certain disfavored recipients [members of four disfavored categories] and, here, made over disfavored media [social media rather than a press release or filing on Form 8-K], it is easy to see how the courts can conclude that Regulation FD, particularly as applied on the facts of this case, restricts speech in violation of First Amendment guarantees.

A. The Proposed Enforcement Action Unconstitutionally Discriminates Against Social Media.

Just as the government cannot favor *The New York Times* over *The Wall Street Journal* without carrying a heavy burden, the Commission cannot privilege disclosures made through traditional media, through the use of static web pages, by press release, or through other older forms of communication, over social media without carrying an equally heavy burden.¹²⁴ A similar constitutional challenge to Regulation FD as applied on the facts of this case is that the regulation is both over-inclusive and under-inclusive in its treatment of social media. It is over-inclusive as here applied because it punishes Internet-based social media communications that result in broad public dissemination. It is under-inclusive as here applied because it does not prohibit reliance on Form 8-K filings, press releases, and other modes of distribution that do not

¹²³ 2012 WL 5992141, at *12 (finding “[t]he government’s construction of the FDCA’s misbranding provisions to prohibit and criminalize the promotion of off-label drug use by pharmaceutical manufacturers is content- and speaker-based, and, therefore, subject to heightened scrutiny”).

¹²⁴ See, e.g., *The Florida Star v. B.J.F.*, 491 U.S. 524, 540 (1989) (“When a State attempts the extraordinary measure of punishing truthful publication in the name of privacy, it must demonstrate its commitment to advancing this interest by applying its prohibition evenhandedly, to the smalltime disseminator as well as the media giant.”); *Smith v. Daily Mail Pub. Co.*, 443 U.S. 97, 104-105 (1979) (statute is insufficiently tailored to interest in protecting anonymity where it restricted only newspapers, not the electronic media or other forms of publication, from identifying juvenile defendants); *United States v. Massino*, 356 F. Supp. 2d 227, 232 (E.D.N.Y. 2005) (“Further, as the Government concedes, First Amendment concerns would likely bar the Government or the court from allowing a news organization to publish a sound recording only in print or on radio or television while barring that same organization from publishing the recording on the internet.”); *Comcast Cablevision of Broward County, Inc. v. Broward County*, 124 F. Supp. 2d 685, 693 (S.D. Fla. 2000) (“Under the First Amendment, government should not interfere with the process by which preferences for information evolve. Not only the message, but also the messenger receives constitutional protection.”). In *Leathers v. Medlock*, 499 U.S. 439 (1991), the Supreme Court struck down a state tax that taxed cable operators more heavily than newspapers, magazines, television broadcasters, and radio stations. The Court held that “the power to discriminate between these media triggers the central concern underlying the nondiscrimination principle: the risk of covert censorship. . . The power to discriminate among like-situated media presents such a risk. By imposing tax burdens that disadvantage one information medium relative to another, the State can favor those media that it likes and punish those that it dislikes.” *Id.* at 458. “Inflicting a competitive disadvantage on a disfavored medium violates the First Amendment ‘command that the government . . . shall not impede the free flow of ideas.’” *Id.* (quoting *Associated Press v. United States*, 326 U.S. 1, 20 (1945)). The Court further noted that “[d]ifferential taxation across different media [] ‘limit[s] the circulation of information to which the public is entitled,’ where, as here, the relevant media compete in the same information market.” *Id.* at 458-59 (quoting *Grosjean v. American Press Co.*, 297 U.S. 233, 250 (1936)). “By taxing cable television more heavily relative to its social cost than newspapers, magazines, broadcast television and radio, [the government] distorts consumer preferences for particular information formats, and thereby impairs ‘the widest possible dissemination of information from diverse and antagonistic sources.’” *Id.* at 459 (quoting *Associated Press*, 326 U.S. at 20).

result in public dissemination as broad as that actually achieving through the Facebook-based dissemination of the Posting.

In *Reno v. American Civil Liberties Union*,¹²⁵ the Supreme Court held that Internet speech was subject to full First Amendment protection. There, the government argued that even though the Communication Decency Act (“CDA”) prohibited certain speech in chat rooms, newsgroups, and mail exploders, it was nevertheless constitutional because it allowed speakers to engage in the restricted speech in other areas of the web. The court rejected that justification because the CDA was a content-based restriction, and a time, place, and manner analysis (which considers whether alternative avenues of expression are available) was therefore irrelevant. According to the court,

[t]he Government's position is equivalent to arguing that a statute could ban leaflets on certain subjects as long as individuals are free to publish books. In invalidating a number of laws that banned leafletting on the streets *regardless of* their content, we explained that ‘one is not to have the exercise of his liberty of expression in appropriate places abridged on the plea that it may be exercised in some other place.’¹²⁶

So too, disfavoring social media as a mechanism for complying with Regulation FD cannot be justified by the observation that Netflix and Mr. Hastings could have disseminated the same information on the company’s own webpage or through many other forms of media.

The district court in *Reno*¹²⁷ amplified the protected status and particular value of communications over the Internet. There, the court observed that

[T]he Internet deserves the broadest possible protection from government-imposed, content-based regulation. If ‘the First Amendment erects a virtually insurmountable barrier between government and the print media,’ [citation], even though the print medium *fails* to achieve the hoped-for diversity in the marketplace of ideas, then that ‘insurmountable barrier’ must also exist for a medium that *succeeds* in achieving that diversity. If our Constitution ‘prefer[s] the power of reason as applied through public discussion’ [citation], ‘[r]egardless of how beneficent-sounding the purposes of controlling the press might be’, [citation], even though ‘occasionally debate on vital matters will not be comprehensive and ... all viewpoints may not be expressed’, [citation], a medium that *does* capture comprehensive debate and *does* allow for the expression of all viewpoints should receive at least the same protection from intrusion.¹²⁸

¹²⁵ 521 U.S. 844 (1997).

¹²⁶ *Id.* at 880 (quoting *Schneider v. New Jersey*, 308 U.S. 147, 163 (1939)).

¹²⁷ *Am. Civil Liberties Union v. Reno*, 929 F. Supp. 824 (E.D. Pa. 1996).

¹²⁸ *Id.* at 881 (quoting *Miami Herald Publ’g Co. v. Tornillo*, 418 U.S. 241, 259, 260 (1974) (White, J., concurring)).

These judicial observations are even more salient in the context of social media through which individuals can comment, react, debate, “like”, dislike, or refute information in close to real time and on a massively public basis.

Most fundamentally, the Commission would find it difficult, if not impossible, to demonstrate that the dissemination resulting from the Facebook Posting and subsequent prompt re-dissemination through myriad online and traditional channels did not generate results fully comparable with the level of dissemination that would have been achieved through more traditional forms of communication that would not have induced Commission action, including the filing or posting of a Form 8-K on the Commission’s own static webpage or activity consistent with the very specific but outdated recommendations of the 2008 Guidance. There is, accordingly, no rational basis upon which to discriminate against the Posting simply because it appeared on Facebook rather than on a static webpage or in a printed newspaper. Such a distinction would be unconstitutional.

B. The Constitutionality of Regulation FD as Argued in *Siebel*.

The traditional debate over the constitutionality of Commission regulations governing truthful speech, and Regulation FD, follows a well-rehearsed script that has evolved in the academic literature and in litigated cases.¹²⁹ Defendants in *Siebel* argued that Regulation FD is subject to strict scrutiny because it regulates speech, *qua* speech, on the basis of its content by both restricting and compelling speech depending on whether a speaker has uttered material, nonpublic information.¹³⁰ Content-based restrictions of this sort are subject to strict judicial scrutiny; they are upheld only if they can be justified by compelling government interests and if they are narrowly tailored to effectuate those interests.¹³¹ Defendants in *Siebel* explained that the Commission justified Regulation FD based on three policy objectives: (1) to prevent the use of inside information for trading of securities, (2) to preserve confidence in the markets by promoting full and fair disclosure by public companies, and (3) to preclude corporate management from using private information as a “commodity to be used to gain or maintain favor with particular analysts or investors,” who may then feel inclined to slant their analysis in favor of the company.¹³² But none of these justifications pass muster, according to the *Siebel* defendants.

¹²⁹ See, e.g., Memorandum of Points and Authorities in Support of Defendants’ Motion to Dismiss the Complaint at 17-20, *Siebel Sys.*, 384 F. Supp. 2d 694 (S.D.N.Y. 2005) (No. 04 CV 5130) (hereafter cited as “*Siebel* Mot. to Dismiss”); Brief of the Chamber of Commerce of the United States as Amicus Curiae in Support of Motion to Dismiss, at 11-20, *Siebel Sys.*, 384 F. Supp.2d 694 (S.D.N.Y. 2005) (No. 04 CV 5130) (hereafter cited as “Chamber of Commerce Brief”); see also Lloyd L. Drury, III, *Disclosure is Speech: Imposing Meaningful First Amendment Constraints on SEC Regulatory Authority*, 58 S.C. L. Rev. 757, 786-88 (2007) (“If a litigant can provide courts with the empirical evidence that Regulation FD stifles a substantial amount of truthful speech by issuers, the courts should give serious consideration to whether it should strike down the regulation as an unlawful prohibition of commercial speech under the First Amendment.”); Christopher McKie, *Corporate Communications and Regulation Fair Disclosure*, 34 Lincoln L. Rev. 21, 32 (2006-2007) (“substantive arguments exist that [Regulation FD] is unconstitutional on a variety of fronts”); Antony Page & Katy Yang, *Controlling Corporate Speech: Is Regulation Fair Disclosure Constitutional?*, 39 U.C. Davis L.R. 1 (2005) (concluding that Regulation FD is unconstitutional).

¹³⁰ *Siebel* Mot. to Dismiss at 18; Chamber of Commerce Brief at 11; Page & Yang, *supra* note 129, at 43-46.

¹³¹ *Siebel* Mot. to Dismiss at 18; Chamber of Commerce Brief at 12.

¹³² Adopting Release at *4-*7.

Regulation FD is over-broad because it targets *all* material nonpublic information, even information that is innocuous and not likely to produce insider trading or curry favor with analysts.¹³³ Regulation FD thus “burdens more speech than is necessary to achieve its ends” because it “requires disclosure of general business information, whether or not such information actually stimulates a securities transaction.”¹³⁴ Regulation FD also fails to advance the Commission’s interest in full and fair disclosure because it chills speech that is not disclosed on a filing with the Commission, and thereby decreases the amount of information available to investors, regarding corporate operations and economic trends.¹³⁵

Regulation FD is under-inclusive because it does not preclude all selective disclosures by all issuers, and instead applies to only a subset of speakers and recipients.¹³⁶ As a result, Regulation FD does not apply to some situations where trading may occur.¹³⁷ It is also under-inclusive with respect to the Commission’s goal of preventing corruption of analysts because material nonpublic information may still be valuable to analysts even if the analysts are required to keep the information confidential.¹³⁸ Finally, less restrictive alternatives to Regulation FD are available, such as a more vigorous enforcement of insider trading laws¹³⁹ or legislation that would preclude trading based on selective disclosures.¹⁴⁰

Further, even if Regulation FD is deemed “commercial” speech and therefore subject to an intermediate standard of review, critics contend that it would not withstand scrutiny. Under the four-part test for review of commercial speech outlined in *Central Hudson Gas & Electric Corp. v. Public Service Commission*, 447 U.S. 557, 561 (1980), a court must consider: (1) whether the speech concerns lawful activity and is not misleading; (2) whether the asserted state interest in regulating the speech is “substantial;” (3) whether the regulation “directly advance[s] the governmental interest involved;” and (4) whether “the governmental interest could be served as well by a more limited restriction on speech.”¹⁴¹ Thus, in *Siebel*, it was argued that Regulation FD does not “directly advance” the SEC’s stated goals of preventing insider trading and preserving the integrity of the market because it extends to speech that is entirely unrelated to trading.¹⁴² Regulation FD is also not narrowly tailored because it extends to business matters unrelated to securities – and hence unrelated to potential insider trading violations – and because less restrictive alternatives are available, including strict enforcement of insider trading laws.¹⁴³

¹³³ *Siebel* Mot. to Dismiss at 19.

¹³⁴ Chamber of Commerce Brief at 16.

¹³⁵ *Siebel* Mot. to Dismiss at 19-20.

¹³⁶ Page & Yang, *supra* note 129, at 80-82.

¹³⁷ Page & Yang, *supra* note 129, at 81-82 (noting that Regulation FD does not apply to most Securities Act offerings, to underwriters, to foreign private issuers or foreign governments, to issuers who negligently disclose material nonpublic information, or to trading in substitutes).

¹³⁸ Page & Yang, *supra* note 129, at 82.

¹³⁹ Chamber of Commerce Brief at 19.

¹⁴⁰ Page & Yang, *supra* note 129, at 79. Critics also point out that Regulation FD’s “savings clause” – which permits selective disclosure of material nonpublic information if the recipient agrees to keep the information confidential – does not save the regulation from constitutional challenge, because the need to secure such consent could itself chill protected speech. Chamber of Commerce Brief at 18.

¹⁴¹ Chamber of Commerce Brief at 19 (citing *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n of New York*, 447 U.S. 557 (1980)).

¹⁴² Chamber of Commerce Brief at 19.

¹⁴³ Chamber of Commerce Brief at 20.

The case in favor of Regulation FD's constitutionality as presented in *Siebel* responds that Regulation FD is not a content-based restriction on speech.¹⁴⁴ Regulation FD is concerned with the *manner* of disclosure –e.g., whether the disclosure is selective or not – as opposed to the *content* of the information disclosed.¹⁴⁵ Further, Regulation FD should be judged under the commercial speech standard, or, alternatively, under a rational review standard because it regulates “the exchange of information regarding securities,” which, like commercial speech, is “subject to only limited First Amendment scrutiny.”¹⁴⁶ Regulation FD satisfies these standards because the interests protected by the Regulation are substantial, and because it advances those interests in a reasonable manner.¹⁴⁷ Finally, even if Regulation FD is deemed a content-based restriction, supporters contend that it satisfies strict constitutional scrutiny because the SEC's interests in preventing insider trading and preserving confidence in the markets are compelling.¹⁴⁸ Supporters further argue that Regulation FD does not chill communications with investors and analysts because it permits selective disclosures in all circumstances where the recipient agrees to keep the information confidential.¹⁴⁹

C. *Sorrell and Caronia.*

The Supreme Court's 2011 decision in *Sorrell v. IMS Health, Inc.*¹⁵⁰ held unconstitutional a Vermont statute that prohibited pharmacies and other entities from selling prescriber identifying information for marketing purposes but that permitted the sale of the same information for non-marketing purposes. The court found that the statute “enacts content- and speaker-based restrictions on the sale, disclosure, and use of prescriber-identifying information.”¹⁵¹ It disfavors marketing, “that is, speech with a particular content,” and “[m]ore than that, the statute disfavors specific speakers, namely pharmaceutical manufacturers.”¹⁵² “The law on its face burdens disfavored speech by disfavored speakers.”¹⁵³ Precisely the same observation applies to Regulation FD: the regulation burdens disfavored speech (material information that is disclosed to persons in one of four categories) by disfavored persons (issuers and certain affiliates), while permitting the same speech by other persons or by issuers to persons not within the four enumerated categories.

¹⁴⁴ See, e.g., Plaintiff Securities and Exchange Commission's Opposition to Motion to Dismiss the Complaint at 20, *Siebel Sys.*, 384 F. Supp.2d 694 (S.D.N.Y. 2005) (No. 04 CV 5130) (hereafter cited as “*Siebel Opp.*”).

¹⁴⁵ *Id.* at 21-22.

¹⁴⁶ *Id.* at 23 (quoting *SEC v. Wall St. Publ'g Inst.*, 851 F.2d 365, 373 (D.C. Cir. 1988)); see also Law Professors Brief as Amicus Curiae in Opposition to Motion to Dismiss at 16-22, *Siebel Sys.*, 384 F. Supp.2d 694 (S.D.N.Y. 2005) (No. 04 CV 5130) (hereafter, “Law Professors Brief.”). In the *Siebel* litigation, the law professor amici argued that “Regulation FD is nothing more than an ordinary regulation of commercial activity, like hundreds of other nondisclosure, labeling, mandatory disclosure, and other commercial regulations. Defendants and the Chamber of Commerce seek to use the First Amendment as a means to escape ordinary commercial regulation. This claim, if taken seriously, threatens to render constitutionally suspect not only Regulation FD, but large portions of securities law, and many other areas of law in which commercial or criminal communication is regulated.”). See Law Professors Brief at 16.

¹⁴⁷ *Siebel Opp.* at 24.

¹⁴⁸ *Id.*

¹⁴⁹ *Id.* at 25-26.

¹⁵⁰ 131 S. Ct. 2653 (2011).

¹⁵¹ *Id.* at 2663.

¹⁵² *Id.*

¹⁵³ *Id.*

In considering whether the Vermont statute directly advanced the government's policy interest in improving public health and reducing medical costs, the Court emphasized that "the 'fear that people would make bad decisions if given truthful information' cannot justify content based burdens on speech."¹⁵⁴ According to the Court, "[t]he First Amendment directs us to be especially skeptical of regulations that seek to keep people in the dark for what the government perceives to be their own good."¹⁵⁵ So too, it can be argued that the Commission's concern over insider trading and market confidence is insufficient to warrant the burden on speech that results when issuers stop disclosing information for fear of violating Regulation FD, or change the manner in which they make such disclosures. In particular, the fear that people will engage in trading that is not insider trading, or that they will perceive the market as not being a level playing field "cannot justify content based burdens on speech." The failure of this justification is particularly apparent when the definition of the burdened speech is arbitrarily constructed in a manner that is so obviously over- and under-inclusive.

In reaching its conclusion, the Court shared several observations regarding the value and protected status of commercial speech. "The First Amendment requires heightened scrutiny whenever the government creates 'a regulation of speech because of disagreement with the message it conveys,'" and "[c]ommercial speech is no exception."¹⁵⁶ The majority suggested that commercial speech may deserve the same level of heightened protection long accorded to political speech, noting that "[a] 'consumer's concern for free flow of commercial speech may often be keener than his concern for urgent political dialogue.'"¹⁵⁷ The majority also likened the statute to one that suppressed political speech, criticizing Vermont for "tilt[ing] public debate in a preferred direction."¹⁵⁸ The Court did not articulate a specific level of heightened scrutiny to be applied to the Vermont statute, but instead concluded that because the restrictions at issue could not pass muster even under the less exacting *Central Hudson* test, as traditionally applied to commercial speech, there was no reason to decide whether a more rigorous First Amendment test should govern.¹⁵⁹

Commentary and Justice Breyer's dissent suggest that a majority of the Supreme Court may be leaning toward stricter scrutiny of burdens on truthful commercial speech.¹⁶⁰ To the

¹⁵⁴ *Id.* at 2670-71 (quoting *Thompson v. W. States Med. Ctr.*, 535 U.S. 357, 374 (2002)).

¹⁵⁵ *Id.* at 2671 (quoting *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 503 (1996)).

¹⁵⁶ *Id.* at 2664 (quoting *Ward v. Rock Against Racism*, 491 U.S. 781, 791 (1989)).

¹⁵⁷ *Sorrell*, 131 S. Ct. at 2664 (quoting *Bates v. State Bar of Ariz.*, 433 U.S. 350, 364 (1977)).

¹⁵⁸ *Id.* at 2671.

¹⁵⁹ *Id.* at 2663, 2667-68.

¹⁶⁰ See, e.g., Ashutosh Bhagwat, *Sorrell v. IMS Health: Details, Detailing, and the Death of Privacy*, 36 Vt. L. Rev. 855, 855 (2012) ("The majority's application of the commercial speech doctrine in *Sorrell* confirms the modern vigor of that doctrine, and some of the language used by the majority may portend a further strengthening of constitutional protections for commercial speech in the future."); Kyle Thomson, *The Changing Landscape of the Commercial Speech Doctrine and FDA Advertising Regulation: Off-Label Marketing in the Wake of Sorrell* 2-3 & n.8 (May 31, 2012) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2071226 ("The 2011 ruling in *Sorrell v. IMS* demonstrated the Court's readiness to expand heightened judicial scrutiny to restrictions on commercial speech"). In his dissenting opinion, Justice Breyer characterized the majority's new rule as subjecting content-based restrictions on commercial speech to a standard "stricter than *Central Hudson*." *Sorrell*, 131 S. Ct. at 2677 (Breyer, J., dissenting). See also *id.* at 2673 (Breyer, J., dissenting) (noting that the majority applies a "far stricter, specially 'heightened' First Amendment standard," rather than the usual *Central Hudson* test).

extent that Regulation FD imposes such burdens,¹⁶¹ *Sorrell* suggests that it will be reviewed under a heightened form of scrutiny that may be more demanding than the traditional intermediate test outlined in *Central Hudson*, and possibly as demanding as strict scrutiny.¹⁶² It is far from clear that Regulation FD could survive a straightforward *Central Hudson* inquiry, much less an inquiry based on a heightened standard, particularly on the facts that would be presented in an enforcement action against Netflix and Mr. Hastings.

More recently, in *United States v. Caronia*, the Second Circuit invalidated a construction of the Federal Drug and Cosmetic Act (“FDCA”) that prohibited and criminalized a pharmaceutical manufacturer’s truthful and non-misleading promotion of the off-label use of an FDA-approved drug.¹⁶³ The court found that the government’s construction of the FDCA “‘paternalistically’ interferes with the ability of physicians and patients to receive potentially relevant treatment information; such barriers to information about off-label use could inhibit, to the public’s detriment, informed and intelligent treatment decisions.”¹⁶⁴

The logic of *Caronia* draws directly on *Sorrell*. *Caronia* involved content-based restrictions on truthful commercial speech that restrict the flow of potentially beneficial information to recipients based on a paternalistic concern for *how* the recipients *might* use the information. Regulation FD does exactly the same. Instead of targeting insider trading, which is the real culprit, or deceptive speech, which is actually harmful to investors, Regulation FD precludes a company’s selective disclosure of *any* material nonpublic information, based largely on the government’s speculative belief that *some* recipients *might* trade on the information they receive. Commentators have argued, however, that selective disclosure may actually benefit investors, and that Regulation FD, by restricting the free flow of real-time information to analysts and investors, may result in investors receiving less timely and less accurate information.¹⁶⁵ Thus, in the wake of *Sorrell* and *Caronia*, a court could easily find that Regulation FD does not “directly advance” the government’s interests, and that it fails to satisfy even *Central Hudson*’s less rigorous standards.

¹⁶¹ Regulation FD does not apply exclusively to commercial speech. Most likely, it would be deemed a restriction on mixed speech, some of which is commercial and some of which is non-commercial. Where commercial and non-commercial speech are inextricably intertwined, the speech is typically subject to full First Amendment protection. *Village of Schaumburg v. Citizens for a Better Env’t*, 444 U.S. 620, 633 (1980).

¹⁶² At least one Circuit Court has held that “after *Sorrell*, it is clear that commercial speech is subject to a demanding form of intermediate scrutiny analysis.” *Minority Television Project, Inc. v. F.C.C.*, 676 F.3d 869, 881 n.8 (9th Cir. 2012). See also *Friendly House v. Whiting*, 846 F. Supp. 2d 1053, 1057-58 (D. Ariz. 2012) (“if a ban on commercial speech is content-based, *Sorrell* instructs that it must be ‘drawn to achieve’ ‘a substantial governmental interest,’ whereas the *Central Hudson* test requires that the regulation not be ‘more extensive than is necessary to serve that interest’”); *Hart v. Elec. Arts, Inc.*, 808 F.Supp.2d 757, 769-770 (D.N.J. 2011) (In *Sorrell*, “[t]he Supreme Court made clear that challenges to content-based restrictions on both commercial and noncommercial speech are generally subject to heightened scrutiny,” but noting that “even after *Sorrell*, commercial speech may still be entitled to less First Amendment protection than that afforded non-commercial speech, in certain contexts.”). But c.f. *Demarest v. City of Leavenworth*, No. CV-11-0072-JLQ, 2012 WL 2466512, at *7 (E.D. Wash. June 27, 2012) (“Though *Sorrell* is a significant opinion, it did not overturn the long line of Supreme Court precedent based upon *Central Hudson*.”).

¹⁶³ 2012 WL 5992141, at *15.

¹⁶⁴ *Id.* at *13.

¹⁶⁵ See Page & Yang, *supra* note 129, at 26-35 (discussing various studies of the effects of Regulation FD).

VII. The Staff's Action Has Already Chilled the Use of Social Media Without Concurrent Form 8-K Filings, and Has Done So Without Commission Action.

Commission investigations can impose significant costs on respondents even if they never lead to an enforcement action. While I have no information regarding the costs incurred by Netflix in responding to the Commission's inquiry in this matter, or in preparing its Wells Submission in response to the Staff's notice, personal experience suggests that Netflix has, at a minimum, already incurred hundreds of thousands of dollars in attorneys' fees. It would not be surprising to learn that, by the end of the day, the Staff's inquiry will impose costs in excess of \$1 million on Netflix, regardless of whether an enforcement action is instituted.

Disclosure of this investigation thus puts every other publicly traded company on notice that the Staff is willing to impose defense costs on registrants who post to social media without concurrently filing a Form 8-K. Because the costs of filing a Form 8-K are low relative to the costs of responding to a formal or informal inquiry, rational counsel will advise clients not to post information that is even remotely material without concurrently filing a Form 8-K.

In fact, this is exactly what they have done. Client memoranda prepared by leading law firms in the wake of Netflix's disclosure advise registrants to use extreme caution when disclosing information through social media, and thereby document the constitutional burden imposed by the contemplated enforcement action.¹⁶⁶ Consistent with this advisory, when Netflix disclosed the receipt of its Wells Notice in a Facebook posting it concurrently filed on Form 8-K.¹⁶⁷ The concurrent Form 8-K was filed notwithstanding the fact that receipt of a Wells Notice is not clearly a material event, particularly when the disclosures at issue are truthful and the

¹⁶⁶ See Cory Hester, *Social Media at the Crossroads of Securities Law: A Cautionary Note*, SNR Denton, Dec. 13, 2012, available at http://www.snrrenton.com/pdf.aspx?page=6436&template=article_pdf ("While social media has emerged as a powerful tool to connect with customers and shareholders, executives of publicly-traded companies should proceed with caution when communicating information about their company or its securities electronically, including through the use of social media. . .Recent actions by the Staff of the US Securities and Exchange Commission involving Netflix indicate that they may apply a very traditional lens to these modern forums."); Darrick M. Mix, *SEC Staff Issues Wells Notice to Netflix and Its CEO*, Duane Morris Blog (Dec. 7, 2012), http://blogs.duanemorris.com/DuaneMorrisCapitalMarkets/entry/sec_staff_issues_wells_notice ("In light of the SEC staff's apparent belief that a Facebook post does not satisfy Regulation FD's requirements, public companies would certainly be wise to avoid using Facebook, Twitter and other social media as a means of public dissemination of material information. . .Also, if they have not done so already, public companies should consider adopting social media policies designed to assure that executives and other employees do not post information via social media that may be material."). See also Cory Hester, *Disclosure watch: avoiding SEC social media scrutiny in the wake of Netflix*, Westlaw Business (Dec. 13, 2012), <http://currents.westlawbusiness.com/Article.aspx?id=7a1eef9d-91f6-4a98-97fb-d5f293783f32&cid=&src=&sp=> (noting that "the safest route to avoid SEC scrutiny" is for companies to "prohibit executives from communicating information about the company via personal social media platforms"); Kirsten Salyer, *The Facebook Post That Got Netflix CEO Reed Hastings in Trouble With the SEC*, Business Week (Dec. 7, 2012), <http://www.businessweek.com/articles/2012-12-07/the-facebook-post-that-got-netflix-ceo-reed-hastings-in-trouble-with-the-sec> ("the SEC's response [to the Posting] offers a warning to other companies as they develop their social media strategies").

¹⁶⁷ See Posting by Reed Hastings, Facebook (Dec. 6, 2012), <https://www.facebook.com/reed1960>; Netflix, Inc., Current Report (Form 8-K) (Dec. 5, 2012), available at <http://www.sec.gov/Archives/edgar/data/1065280/000106528012000025/a8-kfacebook.htm>.

company has very substantial defenses to liability.¹⁶⁸ Nonetheless, in accordance with the advice reflected in publicly available client memoranda, Netflix likely determined that the benefits of filing the concurrent Form 8-K far exceeded the costs of simply posting the information without a concurrent Form 8-K filing.

The Staff has thus successfully chilled the use of social media postings without concurrent Form 8-K filings. If a posting to a social media site with more than 200,000 followers, and that is freely accessible to all Internet users, and that clearly leads to broad dissemination in other media outlets is sufficient to instigate a Staff inquiry, it makes little sense for other publicly traded companies to test where, whether, when or how the Staff might draw the line in other situations. Will it be sufficient to have 500,000 followers? Will 1 million followers suffice? Will it be necessary to demonstrate that key market analysts follow the webpage? How many analysts have to follow a webpage before the Commission Staff will decide not to institute an inquiry? Do reporters for *The New York Times*, *The Wall Street Journal*, or the *Financial Times* have to follow the website? Why spend company resources trying to guess where the Commission Staff might or might not draw the line in instituting an inquiry that can cost the company hundreds of thousands of dollars?

The Commission's Staff typically initiates inquiries of the sort at issue in this proceeding without any prior review by the Commission itself. The chilling effect on the usage of social media absent concurrent Form 8-K filings has thus likely been accomplished exclusively through Staff action. The pattern here presented to the Commission is an instance not simply of regulation through prosecution: this is, instead, an example of regulation through the threat of an investigation, instituted at the Staff's discretion, that might or might not lead to prosecution.

This reality of the matter should not be lost on the Commission, particularly because it suggests that, if the Staff's objective is to chill the use of social media absent concurrent Form 8-K filings, then it has already achieved its objective without subjecting itself to Commission oversight. Put another way, given the economics of Form 8-K filings and the risks to the Commission's entire disclosure program that arises if the Commission seeks to litigate Netflix's dissemination of truthful information on the facts and circumstances here presented, the Commission's optimal point of leverage likely occurs if it simply walks away from the threatened litigation.

VIII. The Proposed Enforcement Action Seeks to Penalize Truthful Speech and Is a Questionable Allocation of Agency Resources.

Has the Commission run out of frauds to pursue? Are there no leads resulting from the 3,000 or so Dodd Frank whistleblower tips¹⁶⁹ that deserve to be prosecuted? Are there no accounting frauds to investigate?

¹⁶⁸ See *Richman v. Goldman Sachs Group, Inc.*, 868 F.Supp.2d 261, 272-75 (S.D.N.Y. 2012) (holding that Goldman Sachs did not have a duty under Section 10(b) or applicable SEC regulations to disclose its receipt of the Wells Notices, and dismissing plaintiffs' claims).

¹⁶⁹ See U.S. Sec. & Exch. Comm'n, *Annual Report on the Dodd-Frank Whistleblower Program*, at 4, 8 & Appendix A (2012) (documenting a total of 3,001 tips in Fiscal Year 2012, and describing one tipper who provided substantial information that helped the Commission stop an ongoing multi-million dollar fraud).

The federal government is subject to significant budgetary stress and the Commission has been hard pressed for resources.¹⁷⁰ The Commission can therefore expect close public scrutiny of its budget allocation decisions, including a decision to engage in potentially expensive litigation over a practice that does not constitute a fraud and that has harmed no investors. Members of Congress may reasonably question whether the budget provided to the Commission is effectively allocated if the agency is spending scarce enforcement dollars on proceedings of this sort. Congress could well conclude that a proceeding against Netflix is evidence either that the enforcement budget is over-funded or not efficiently managed. Such conclusions by Congress could give rise to collateral consequences that are not in the agency's self-perceived best interests.

IX. The Appropriate Response to Concern Over the Evolution of Social Media Is Through the Administrative Process and Not Through Regulation by Prosecution.

The rapid evolution of social media presents a challenge to the interpretation and enforcement of Regulation FD. To address these concerns the Commission could either institute formal rulemaking proceedings or seek comment on how the 2008 Guidance might be expanded to address the realities of an Internet in which social media play a significant role. Alternatively, the Commission might institute a broader rulemaking that would be sensitive to the constitutional issues raised by Regulation FD as currently constructed.

Indeed, even if the Commission remains committed to the basic philosophy that animated the adoption of Regulation FD, it could adopt a much simpler rule that is arguably less susceptible of constitutional challenge: it could require that all material disclosures by issuers be promptly posted on a Form 8-K without regard to the identities of the recipients of the disclosure or the means by which the disclosure is otherwise disseminated. The Commission would then not need to draw fine distinctions among different forms of dissemination, as all media would be treated equally under all circumstances. The argument that the regulation is content-based would also be weakened because the disclosures subject to regulation would not be limited to those made by certain issuers to members of four enumerated groups. Further, because filing a Form 8-K is relatively inexpensive and because investors would then know that they can expect to find all material information available at the Commission's EDGAR website, the Commission would have a stronger argument that its regulation is rational and imposes minimal, non-discriminatory costs on the market. This argument would, moreover, be strengthened if the Commission redesigned its EDGAR website so that it acted more like a set of Facebook pages or Twitter feeds and allowed the public easily to subscribe to EDGAR postings that could be pushed to

¹⁷⁰ See, e.g., James E. Stewart, *As a Watchdog Starves, Wall St. Is Tossed a Bone*, N.Y. Times, July 16, 2011, at A1, available at http://www.nytimes.com/2011/07/16/business/budget-cuts-to-sec-reduce-its-effectiveness.html?pagewanted=all&_r=0 ("the Republican-controlled appropriations committee cut the Securities and Exchange Commission's fiscal 2012 budget request by \$222.5 million, to \$1.19 billion (the same as this year's), even though the S.E.C.'s responsibilities were vastly expanded under the Dodd-Frank Wall Street Reform and Consumer Protection Act."); Jim Puzzanghera, *SEC Chief Warns Against Budget Cuts*, Los Angeles Times (Feb. 5, 2011), <http://articles.latimes.com/2011/feb/05/business/la-fi-sec-schapiro-20110205> ("Securities and Exchange Commission Chairwoman Mary L. Schapiro warned that her agency doesn't have enough money to police Wall Street adequately"); Jason Voss, *Fact File: Annual Budget of the U.S. Securities and Exchange Commission*, CFA Institute (Apr. 12, 2012), <http://blogs.cfainstitute.org/investor/2012/04/27/fact-file-annual-budget-of-the-u-s-securities-and-exchange-commission/> (describing the SEC's annual budget as "paltry").

individual securities' followers. The Commission would then become part of the social network rather than in tension with the social network.

A rational reconsideration of Regulation FD in the age of social media might thus lead to the conclusion that, if FD-style information disclosure requirements remain appropriate and constitutional, they are best implemented through technology that emulates modern social media rather than through approaches that are privileged by the rule's current construction. In any event, litigating the application of Regulation FD as currently constructed on the facts likely to evolve in litigation against Netflix and Mr. Hastings seems the least attractive alternative available to the Commission.

Conclusion.

For all the reasons stated above, the Commission should decline the Staff's invitation to institute enforcement proceedings alleging a violation of Regulation FD by Netflix and by Mr. Hastings.

With best regards,

Sincerely,

Joe Grundfest
The William A. Franke Professor of Law
and Business
Senior Faculty, Rock Center on Corporate
Governance
Stanford Law School
559 Nathan Abbott Way
Stanford, CA 94305

TABLE 1: Regulation FD Enforcement Actions

No.	Date of Action	Case Name	No. of Information Recipients	Type of Information Recipients	Method of Disclosure	Could the Discloser Control Identity of Recipients?	Were Members of the Press Among the Recipients?	Type of Information Disclosed
1	11/25/2002	<i>Raytheon</i> ¹⁷¹	11	Analysts	Telephone	Yes	No	Earnings guidance
2	11/25/2002	<i>Secure Computing</i> ¹⁷²	4	Portfolio managers and brokerage personnel	Telephone	Yes	No	Significant new contract
3	11/25/2002	<i>Siebel I</i> ¹⁷³	Nearly 200	Brokers and investors	In person at private conference hosted by Goldman Sachs	Yes	N/A	Business activity levels
4	9/9/2003	<i>Schering-Plough</i> ¹⁷⁴	N/A	Analysts and portfolio managers	In person at private meetings with institutional investors	Yes	No	Earnings guidance
5	6/29/2004	<i>Siebel II</i> ¹⁷⁵	2 portfolio managers, representatives of 6 investors, and “a number of” brokerage personnel	Institutional investors and brokerage personnel	In person at two private events	Yes	No	Business activity levels and transaction pipeline
6	9/16/2004	<i>Senetek PLC</i> ¹⁷⁶	N/A	Research firm and financial advisory firm	Email	Yes	No	Revenue and earnings projections
7	3/24/2005	<i>Flowserve</i> ¹⁷⁷	Analysts from 4 investment and brokerage firms	Analysts	In person at private meeting with analysts	Yes	No	Earnings guidance
8	9/25/2007	<i>Electronic Data Systems</i> ¹⁷⁸	Analysts from 3 different broker-dealers	Analysts	N/A	Yes	No	Amount paid to settle outstanding derivative transactions

¹⁷¹ See Order Instituting Public Cease-and-Desist Proceedings, *In re Raytheon Co.*, Admin. Proc. File No. 3-10950 (Nov. 25, 2002).

¹⁷² See Order Instituting Cease-and-Desist Proceedings, *In re Secure Computing Corp.*, Admin. Proc. File No. 3-10948 (Nov. 25, 2002).

¹⁷³ See Order Instituting Proceedings Pursuant to Section 21c of the Securities Exchange Act of 1934, *In re Siebel Sys., Inc.*, Admin. Proc. File No. 3-10949 (Nov. 25, 2002); Complaint, *SEC v. Siebel Sys., Inc.*, No. 1:02CV02330 (D.D.C. filed Nov. 25, 2002).

¹⁷⁴ See Order Instituting Cease-and-Desist Proceedings, *In re Schering-Plough Corp.*, Admin. Proc. File No. 3-11249 (Sept. 9, 2003).

¹⁷⁵ See Complaint, *SEC v. Siebel Sys.*, No. 04-CV-5130 (S.D.N.Y. filed June 29, 2004).

¹⁷⁶ See Order Instituting Cease-and-Desist Proceedings, *In re Senetek PLC, Inc.*, Admin. Proc. File No. 3-11668 (Sept. 16, 2004).

¹⁷⁷ See Order Instituting Cease-and-Desist Proceedings, *In re Flowserve Corp.*, Admin. Proc. File No. 3-11872 (Mar. 24, 2005); Complaint, *SEC v. Flowserve Corp.*, No. 1:05CV00612 (D.D.C. filed Mar. 24, 2005).

No.	Date of Action	Case Name	No. of Information Recipients	Type of Information Recipients	Method of Disclosure	Could the Discloser Control Identity of Recipients?	Were Members of the Press Among the Recipients?	Type of Information Disclosed
9	9/24/2009	<i>Christopher A. Black</i> ¹⁷⁹	8	Analysts	Email	Yes	No	Earnings guidance
10	3/9/2010 (civil action) 5/15/2012 (admin proceeding)	<i>Presstek</i> ¹⁸⁰	1	Investor	Telephone	Yes	No	Poor financial performance
11	10/21/2010	<i>Office Depot</i> ¹⁸¹	18	Analysts	Telephone	Yes	No	Earnings guidance
12	4/28/2011	<i>China Voice</i> ¹⁸²	2	Shareholders	Email	Yes	No	Payment delays related to the sale of domestic subsidiaries to a third party
13	11/22/2011	<i>Fifth Third Bancorp.</i> ¹⁸³	N/A	DTC members and non-member subscribers to DTC's Legal Notification System	DTC's Legal Notification System, available only to DTC members and non-member subscribers	No	None indicated	Fifth Third Bancorp.'s decision to redeem certain trust preferred securities
14		Netflix ¹⁸⁴	Approx. 204,990 followers, 1 billion Facebook users, and 2.4 billion Internet users	Members of the public, reporters, analysts, investors, etc.	Facebook	No	Yes	Marketing metric

¹⁷⁸ See Order Instituting Cease-and-Desist Proceedings, *In re Electronic Data Sys. Corp.*, Admin. Proc. File No. 3-12825 (Sept. 25, 2007).

¹⁷⁹ See Order Instituting Cease-and-Desist Proceedings, *In re Christopher A. Black*, Admin. Proc. File No. 3-13625 (Sept. 24, 2009); Complaint, *SEC v. Black*, No. 09-CV-0128 (S.D. Ind. filed September 24, 2009).

¹⁸⁰ See Order Instituting Cease-and-Desist Proceedings, *In re Edward J. Marino*, Admin. Proc. File No. 3-14879 (May 15, 2012); Complaint, *SEC v. Presstek, Inc.*, No. 1:10-cv-1 0406 (D. Mass. filed Mar. 9, 2010).

¹⁸¹ See Order Instituting Cease-and-Desist Proceedings, *In re Office Depot, Inc.*, Admin. Proc. File No. 3-14094 (Oct. 21, 2010); Order Instituting Cease-and-Desist Proceedings, *In re Patricia A. McKay*, Admin. Proc. File No. 3-14096 (Oct. 21, 2010); Order Instituting Cease-and-Desist Proceedings, *In re Stephen A. Odland*, Admin. Proc. File No. 3-14095 (Oct. 21, 2010); Complaint, *SEC v. Office Depot, Inc.*, No. 9:10-CV-81239 (S.D. Fla. filed Oct. 21, 2010).

¹⁸² See Complaint, *SEC v. Allen*, No. 3:11-CV-00882 (N.D. Tex. filed June 20, 2011).

¹⁸³ See Order Instituting Cease-and-Desist Proceedings, *In re Fifth Third Bancorp.*, Admin. Proc. File No. 3-14639 (Nov. 22, 2011).

¹⁸⁴ Proposed enforcement action against Netflix and its CEO, Mr. W. Reed Hastings.