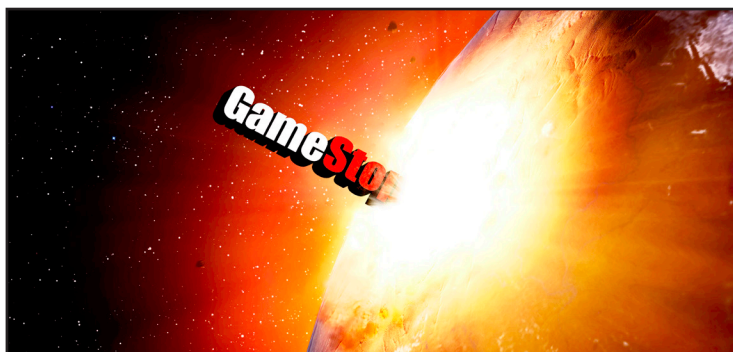


TUESDAY, MARCH 2, 2021

PERSPECTIVE

The SEC wants to know who's in your Clubhouse

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New York Times News Service

With social media's power to swing the markets on full display in the recent rise and fall of GameStop's share price, the question remains whether the Securities and Exchange Commission will begin using tools such as Regulation Fair Disclosure (known as "Reg FD") to crack down on public companies and their executives' social media presence. Communications on social media played an outsized role in influencing GameStop and other stocks' share prices by pushing investors to take advantage of an alleged "short squeeze." Although no one has suggested that GameStop executives themselves used social media inappropriately, there has been increased criticism of social media's part in fueling GameStop's rise. In a related development, several high-profile executives recently made appearances on newer social media platform Clubhouse, a "closed" private network enabling audio chats. Given the demonstrated power of older social media platforms to impact markets and the burgeoning development of newer social media platforms, the SEC may be looking for an opportunity to flex its Reg FD muscles.

Two Decades of Reg FD Developments

The SEC adopted Reg FD (17 C.F.R. Section 243.100 et seq.) in August 2000 to "level the playing field" between institutional and retail investors by prohibiting the selective disclosure of material, non-public information to market professionals. Securities and Exchange Commission Historical Society, "20th Anniversary of Regulation Fair Disclosure," Aug. 17, 2020. The regulation aimed to curtail public companies from providing market advantages to institutional investors, analysts, or other market professionals by disclosing material information to these groups before the rest of the market had access to the same information, such as through closed quarterly analyst calls. Since then, the SEC has updated guidance on complying with Reg FD both for websites in 2008 (Release No. 34-558288) and for social media in 2013 (Release No. 69279). The SEC's core guidance is relatively simple: For disclosure of materi-

al information to be considered "public," it must be made through a "recognized channel of distribution" that makes the information available to the marketplace. Determining whether a website or social media platform is a "recognized channel" depends on "whether the company has made investors, the market, and the media aware of the channels of distribution it expects to use, so these parties know where to look for disclosures of material information about the company or what they need to do to be in a position to receive this information."

Disclosure outside of these channels can draw scrutiny, even if the disclosure may seem innocuous at the time. In 2013, for instance, the SEC investigated Reed Hastings, the CEO of Netflix, for congratulating Netflix on its monthly streaming numbers on a personal social media account. The SEC took issue with Hasting's disclosure because the company normally disclosed streaming numbers on a "milestone" basis

through official channels and Hastings had previously underscored streaming numbers as a relevant benchmark for Netflix's performance. Hastings' "private" disclosure therefore meant that only a portion of the market received the news. Although the SEC opted to issue guidance on Reg FD and social media usage in lieu of pursuing an enforcement action, the investigation underscored that executives must be careful in disclosing information outside official "channels of distribution." Hastings was investigated even though his social media account could be viewed by the public, had 200,000 subscribers, and the disclosure reached the market "incrementally" through blogs and news outlets within hours of the post. Disclosures to a smaller group are likely to receive less favorable treatment.

Reg FD's Prior Guidance May Be Outdated Given the Potential Rise of "Closed" Social Networks

While "open" social media platforms have become increasingly popular sites to discuss the market in recent months, "closed" platforms are carving out their own niche. One platform in particular, Clubhouse, has been gaining traction. Unlike "open" social media sites that allow anyone to make an account and follow an individual or group, Clubhouse is

invitation only. Once invited, members can join “rooms,” group voice-chats opened to discuss certain topics at certain times, or “clubs,” private voice-chats controlled and moderated by certain members. These “rooms” are not necessarily publicly available even with the app, as moderators have the ability to block members from joining rooms.

Despite — or perhaps because of — the exclusive nature of the platform, recent appearances by Elon Musk, Mark Zuckerberg, and Vlad Tenev on Clubhouse have created a “stampede” for invitations. But the SEC’s increased scrutiny on social media’s impact on the market may mean increased regulatory risks for public company executives using platforms like Clubhouse.

Companies Risk SEC Inquiry Through Disclosures of Material Information in Closed Social Networks

Based on the SEC’s guidance, Reg FD disallows the use of “closed” platforms for disclo-

sure of material, nonpublic information. Under some circumstances, company or executive posts on “open” social media platforms may withstand Reg FD scrutiny because of these platforms’ near-universal accessibility and ability to disseminate broadly information to the market, provided the company has appropriately disclosed the social media platform as a source of information. Indeed, the early disclosure of one of Elon Musk’s personal social media sites as a source of information on a company he was an executive for may have been the reason the SEC did not pursue Reg FD claims against Musk following social media posts that led to an enforcement action and settlement with the SEC on Musk’s social media presence.

Closed forums like Clubhouse are different. Whether or not the public is aware that Clubhouse is a potential source of information about a company does not matter because the public does not necessar-

ily have access to Clubhouse chats. If an executive were to disclose material, nonpublic information on Clubhouse, for instance, the only individuals who would receive it in real-time would be (i) those who had been invited to Clubhouse and (ii) those able to access the “room” or “club” where the executive disclosed the information. As such, the SEC would likely conclude that a material disclosure on Clubhouse would not “disseminate[] the information in a manner making it available to the securities marketplace in general,” or allow for a “reasonable waiting period” for the market to react to the information as required by Reg FD. The SEC may therefore see Clubhouse’s “rooms” and “clubs” as a return to the closed analyst calls that initially led to the SEC’s adoption of Reg FD in the first place. If Reed Hastings’ disclosure to 200,000 subscribers on an “open” platform drew SEC attention, then disclosures to an even smaller “room” on a closed platform are sure to pique the SEC’s interest.

A Misplaced Opportunity for Enforcement

The SEC may see Reg FD as a useful tool to score a few wins in the face of mounting pressure to “protect” retail investors and crack down on attempts by market participants to “rig” the game against retail investors. Although congressional hearings into trading in GameStop have not focused on the company’s executives or statements — indeed no one from GameStop was asked to testify — the hearings will increase the pressure on the SEC to act. In this environment, the SEC may be searching for a high-profile return to Reg FD’s original justification as a tool to “level the playing field” between retail and institutional investors. Public company executives discussing material, nonpublic information on a closed forum like Clubhouse, outside of the view of retail investors, may therefore present an attractive opportunity for the SEC to relieve the pressure on it and be seen protecting retail investors. ■

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