

# COVID-19: SECURITIES LAW CONSIDERATIONS FOR U.S. PUBLIC COMPANIES

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## U.S. Capital Markets Alert

By: Sean M. Jones, Coleman Wombwell, Amy S. Wallace, Margaret N. Rosenfeld, Mark L. Johnson

As the novel coronavirus (COVID-19) continues to spread and its impact on the U.S. markets and economy rapidly intensifies, U.S. public companies are faced with a number of complex disclosure and other considerations they must address under increasingly dynamic circumstances. We discuss below actions by the Securities and Exchange Commission (SEC) to date, steps certain public companies have already taken, and issues that virtually all public companies should be considering.

## INITIAL SEC GUIDANCE

On January 30, 2020, SEC Chairman Jay Clayton noted in a public statement that he had asked the staff "to monitor and, to the extent necessary or appropriate, provide guidance and other assistance to issuers and other market participants regarding disclosures related to the current and potential effects of the coronavirus." Chairman Clayton acknowledged that while these effects may be difficult to assess or predict with meaningful precision, he also stated that "how issuers plan for that uncertainty and how they choose to respond to events as they unfold can nevertheless be material to an investment decision."

On February 19, 2020, Chairman Clayton, SEC Division of Corporate Finance Director Bill Hinman, SEC Chief Accountant Sagar Teotia, and Chairman of the Public Company Accounting Oversight Board William D. Duhnke III issued a joint statement in which they reported on their recent dialogue with senior leaders of the largest U.S. audit firms. They noted that they had discussed the potential exposure of public companies to the effects of COVID-19 and the impact that exposure could have on financial disclosures and audit quality, including audit firm access to information and company personnel. Specifically, they emphasized the need for companies to consider potential disclosure of subsequent events in the notes to the financial statements in accordance with guidance included in Accounting Standards Codification 855, *Subsequent Events*. They also encouraged public companies and their advisors to contact the SEC staff regarding the need for relief or guidance.

## EXTENSION OF FILING DEADLINES

On March 4, 2020, the SEC issued an order providing conditional relief to public companies affected by COVID-19. The order provides public companies with an additional 45 days to file certain disclosure reports that would otherwise have been due between March 1 and April 30, 2020, subject to certain conditions. For more information about this conditional relief, see our alert [SEC Announces Conditional Relief for Companies Affected by Coronavirus](#) issued on March 5, 2020.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis (MD&A) should be a, if not *the*, key SEC disclosure focus for any public company experiencing, or anticipating, repercussions from the COVID-19 outbreak. As a critical element of its MD&A disclosures, a public company must discuss any known material trend or uncertainty that is reasonably likely to cause its historical financial information to not be indicative of future operating results or financial condition. This disclosure should include, where feasible, forward-looking language regarding potential effects on future operating results, capital expenditures, and liquidity.

In addressing issues relating to COVID-19 in MD&A, a public company should focus on the impact the coronavirus outbreak may have on its business and industry. Many COVID-19 MD&A disclosures to date have focused on the effects of issues like supply chain disruptions, reduced consumer demand, and governmental restrictions on future earnings and cash flows. Companies addressing COVID-19 concerns should consider the appropriateness of disclosures in each section of MD&A, including:

- in the outlook or other introductory section, an overview paragraph can provide a quick, easily located summary for investors who are trying to identify just how concerned they should be;
- the "line-by-line" analysis in the results of operations section should offer more detailed information that can identify, and size, the operating statement impact, or potential impact, of COVID-19;
- the cash flow impact of COVID-19 should be depicted in the liquidity and capital resources section, including a discussion of any effects on the company's ability to generate cash and meet future cash requirements; and
- if the board or management is using key financial metrics that exclude charges or liabilities relating to COVID-19, consider including disclosure or discussion of those metrics, in a key financial metrics or a similar section, in order to provide for greater transparency with respect to metrics used by management in its financial and operational decision-making -- subject to compliance with any applicable non-GAAP presentation requirements.

## RISK FACTORS

Due to the increasingly far-reaching effects of COVID-19, hundreds of public companies have referenced the virus and related COVID-19 disease in the risk factors section of their periodic reports and registration statements. While the effects of COVID-19 are pervasive and have affected a wide variety of industries and geographies, Item 105 of Regulation S-K instructs public companies not to present risks that could apply generically to any company. In preparing risk factor disclosures, public companies must instead specifically consider how this novel threat with an unknowable ultimate effect on international commerce will affect their businesses. With that consideration in mind, we have collected examples of risk factors describing different types of impacts caused by COVID-19.

- **Supply chain disruption.** China is the world's largest exporter and where COVID-19 originated. As a result, many companies' supply chains were disrupted even before the disease became widespread internationally. Steven Madden, Ltd., a fashion accessory company, included a risk factor in its [Form 10-K filed on March 2, 2020](#), explaining that, although it does not own or operate any foreign manufacturing facilities, 88 percent of its total 2019 manufacturing purchases were from China. Interruption of its supply chain could result in an inability to fill its customers' orders.

- **Interruption of operations.** Social distancing – avoiding public spaces that pose a higher risk of encountering a person carrying COVID-19 – is a preventative measure being adopted around the world. Restaurants and bars will likely see less visitors, or temporarily close, as a result. Additionally, such businesses that need staff members to perform their jobs on site, may see more illness among their employees. Del Taco Restaurants, Inc. included in its [Form 10-K filed on March 13, 2020](#) a risk factor addressing these possibilities.
- **Effect on consumer demand.** Leisure travel has been another closely watched industry during the COVID-19 epidemic. Wynn Resorts Limited led the risk factors section of its [Form 10-K filed on February 28, 2020](#), with a description of the adverse effect of the decrease in visitors to its Macau and Las Vegas casinos caused in part by various travel restrictions in effect around the world. Gogo Inc., a provider of in-flight wireless internet, cited the reduction in airline traffic due to COVID-19 in a risk factor included in its [Form 10-K filed on March 13, 2020](#).
- **Precautionary measures.** Even if a public company is not directly affected by COVID-19, it may need to adjust the way it conducts business to avoid being so affected. Just like tech giants Amazon, Apple, and Google (and, as of March 10, 2020, the SEC itself), Fastly, Inc., a cloud computing services provider, has adopted a work-from-home policy, as described in a risk factor included in its [Form 10-K filed on March 3, 2020](#). Fastly noted that precautions such as the work-from-home policy as well as its suspension of non-essential travel and postponing sponsored events could harm its business.

## EARNINGS CALLS AND GUIDANCE

Public companies addressing COVID-19's impact on earnings guidance have elected to do so largely via press releases and on earnings calls with investors. The live call format allows management to provide more, and more nuanced, information about emerging COVID-19 issues than would be included in periodic SEC reports. Management can respond immediately and directly to specific investor questions, which enables management not only to clarify key issues but also to monitor investor concerns.

During earnings calls, public companies have focused on the current financial impact of the COVID-19 outbreak on their operations and results. They have used earnings calls as an opportunity to address deviations from previously issued guidance and, as appropriate, revised or withdrawn prior forecasts. Additional details on the current affects and future risks of the outbreak are being furnished by companies with significant operations or relationships in affected regions, particularly with respect to the impact that COVID-19 is expected to have on demand, supply, or a specific industry as a whole.

## VIRTUAL STOCKHOLDER MEETINGS

As proxy season rapidly approaches, many public companies are considering holding virtual stockholder meetings solely by remote communication or by so-called "hybrid" meetings in which stockholders are able to participate remotely or in person. On March 13, 2020, the SEC issued [guidance](#) describing certain accommodations for public companies that have already mailed proxy materials to stockholders but, in light of worsening COVID-19 conditions, now wish to modify the schedule or format for their annual meetings. Specifically, those public companies may change the date, time or location of their meeting – or change from an in-person meeting to a hybrid or virtual meeting – without mailing additional materials to

stockholders if they (1) issue a press release announcing the change, (2) file the announcement as definitive additional soliciting material (i.e., a DEFA14A) on EDGAR, and (3) take reasonable steps to inform other intermediaries in the proxy process and other relevant market participants (such as securities exchanges) of the change. These actions are to be taken "promptly" after a decision to change is made, but no specific deadlines are imposed. Public companies should also consider state law requirements; for example, Delaware corporate law requires companies to provide stockholders with notice of the means of remote communication for a meeting at least ten days before the meeting date. The SEC encourages public companies that have not yet mailed proxy materials to consider including disclosures regarding the possibility that the date, time or location of their annual meetings will change due to COVID-19.

The SEC guidance acknowledges challenges that may be faced by stockholder proponents that need to attend a meeting in order to present a proposal, as required by Rule 14-8(h) of the Exchange Act. Public companies are encouraged, to the extent feasible under state law, to provide stockholders with alternative means, such as telephone conferencing, by which to present their proposals. If COVID-19 complications preclude a stockholder proponent from attending an annual meeting, the SEC will consider this to be "good cause" should a public company assert Rule 14a-8(h)(3) as a basis to exclude a proposal made by the stockholder proponent for any meeting held in the next two calendar years.

Public companies should note that virtual and/or hybrid stockholder meetings are not permissible under certain states' laws. For more information about virtual and hybrid stockholder meetings for both Delaware corporations and those organized under the laws of other states, see our alert [Taking Another Look at Virtual Stockholder Meetings as the COVID-19 Outbreak Spreads](#) issued on March 11, 2020.

## **DISCLOSURE CONTROLS AND PROCEDURES**

A public company's disclosure controls and procedures are the procedures it follows in preparing its periodic reports to be filed with the SEC and in preparing earnings announcements and related disclosures. Public companies should review their current disclosure controls and procedures to consider whether additional persons within the company handling the COVID-19 response should be included in reviewing the company's disclosures. Public companies also should consider whether additional time for disclosure review will be needed to sufficiently evaluate the disclosure impacts of COVID-19 on their business and operations. For example, public companies should consider whether additional time will be needed to prepare new risk factors, to evaluate effectively any trends related to COVID-19 to be discussed in MD&A, and to allow the audit committee ample time to review any new disclosures. As discussed above, the SEC announced conditional regulatory relief and assistance for companies affected by COVID-19 with respect to the filing of disclosure reports that would have been otherwise due between March 1 and April 30, 2020.

## **SPECIAL BLACKOUT PERIODS/REGULATION FD ISSUES**

As public companies evaluate the actual and potential impacts of COVID-19 on their businesses and operations, they should consider whether any of those impacts may constitute material, nonpublic information requiring a close of the company's trading window for directors, officers, and other insiders until the impacts and risks are disclosed. In its press release on March 4, 2020, addressing certain matters related to COVID-19, the SEC specifically cautioned companies regarding this potential need for special trading blackouts:

For example, where a company has become aware of a risk related to the coronavirus that would be material to its investors, it should refrain from engaging in securities transactions with the public and to take steps to prevent directors and officers (and other corporate insiders who are aware of these matters) from initiating such transactions until investors have been appropriately informed about the risk.

To the extent that the COVID-19 impact on a public company's business is material and has not otherwise been publicly disclosed, the public company should also be sensitive to Regulation FD and selective disclosure issues

## BOARD AND COMMITTEE OVERSIGHT

Risk oversight is a primary responsibility of a public company's board of directors, and the potential impact of COVID-19 on a company's business and operations is a risk area that every public company board should be addressing. Without stepping into risk management, which is a role for management of the company, a board should create a list of topics to review with management to ensure that management is appropriately considering and evaluating COVID-19 effects. This list would include the topics addressed in this alert as well as areas such as the company's crisis management plan, workforce health and safety issues, remote working plans, technology capacity, government-forced shutdowns and quarantines, supply chain disruption, investor relations, social media, insurance coverage strategies, and any risks specific to a company's particular industry. Because the impact of COVID-19 is dynamic, the board's risk oversight review should not be a one-time event but should continue on a schedule and in a manner deemed appropriate for the board to remain fully informed and lend oversight assistance to management as they face increased demands on their time due to the impact of COVID-19.

## KEY CONTACTS



**SEAN M. JONES**  
PARTNER

CHARLOTTE  
+1.704.331.7406  
SEAN.JONES@KLGATES.COM



**COLEMAN WOMBWELL**  
PARTNER

CHARLOTTE  
+1.704.331.7551  
COLEMAN.WOMBWELL@KLGATES.COM

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