Proskauer

Public Company Reporting in the Shadow of the Pandemic

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As the COVID-19 virus disrupts businesses, public companies face both operational and compliance challenges as public disclosure has become a more complex and evolving task. Companies with calendar year-ends are beginning to prepare their quarterly reports on Form 10-Q, and companies with other fiscal year-ends may be preparing annual reports on Form 10-K, or on Form 20-F in the case of foreign private issuers. This alert summarizes a few areas that companies should think about as they consider what disclosures are required, and what other disclosures it may be sensible to make voluntarily.

The SEC staff just issued new guidance on considerations for public disclosures in light of COVID-19, and we will be discussing that guidance below in the context of the basic disclosure requirements. See Coronavirus (Covid-19), CF Disclosure Guidance: Topic No. 9 (the "SEC Guidance"). In the SEC Guidance, the staff states that it is monitoring how companies are reporting the effects and risks of COVID-19 on their businesses, financial condition and results of operations.

In addition to the SEC's new guidance, we address in this alert:

- disclosure controls and procedures;
- the Management's Discussion and Analysis ("MD&A") and Risk Factor sections of quarterly reports on Form 10-Q and annual reports on Form 10-K;
- the quarterly earnings release and earnings guidance;
- a few additional 8-K filing obligations that may be triggered;
- an update on SEC filing relief, which permits companies to delay their SEC-required filings up to 45 days if they face difficulties; and
- the shift of many companies to virtual annual meetings.

Form 10-Q/10-K/20-F Disclosure Considerations

Disclosure Controls and Procedures

Companies face rapidly-evolving business and other challenges, and in preparing public disclosures must consider novel categories of events that could materially impact a company's results of operations, such as restrictions on travel, the need for employees to work remotely and regulations forcing retail outlets to close. For many companies, for example, the MD&A sections of quarterly and annual reports will look nothing like they did last quarter. These developments could put significant pressure on companies' ability to implement required disclosure controls and procedures, and internal controls over financial reporting. Extra time and attention may be demanded of company personnel at a time when they could be distracted by other business challenges.

Public companies are required to implement disclosure controls and procedures and internal controls over financial reporting under SEC rules. Furthermore, management is required to evaluate the effectiveness of disclosure controls on a quarterly basis, and internal controls over financial reporting on an annual basis (and disclose any material changes to financial controls on a quarterly basis). The CEO and CFO must sign certifications quarterly that state, among other things, that he or she has evaluated the effectiveness of disclosure controls and procedures, and designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

As explained further below, under "Delayed Filings," companies that are unable to satisfactorily implement their control procedures as a result of impacts from COVID-19 may obtain an extension of their filing deadlines.

Management's Discussion and Analysis

Annual reports and quarterly reports must include an MD&A, or on Form 20-F, a substantially-equivalent section on Operating and Financial Review and Prospects. Under these requirements, in the words of the preamble of the rule that applies to domestic issuers, a company should provide information it "believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations." In the current environment, determining the necessary information to provide can be a difficult task and will generally require senior management, in consultation with internal and external legal and accounting advice, to review a significant portion of the MD&A disclosure.

Results of Operations

A company must "[d]escribe any unusual or infrequent events or transactions or any significant economic changes that materially affected the amount of reported income from continuing operations . . ." The company must also disclose any "known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations."

Different companies and different industries will experience different trends and uncertainties as a result of COVID-19. For example, the inability of members of the workforce to travel internationally or work from the company's offices, impacts on supply chain, suspension of clinical trials, reduced or increased demand for the company's goods or services, or government orders that close the company's retail outlets, factories or other operations may be a "known trend" and a "known uncertainty." Oil and commodity prices might be "known uncertainties" where the business is dependent on those commodities, including in particular the impact from current events such as those in Russia and Saudi Arabia.

Other factors that some companies should consider when evaluating their disclosure, depending on the industry and a company's unique circumstances, are changes in terms of supply or customer agreements requested by counterparties, changes in the valuation of collateral, and counterparty or customer risk.

In order to provide appropriately balanced disclosure, the MD&A should reflect both positive and negative developments to the business. If the COVID-19 crisis has increased demand for existing products or services or may create new opportunities, for example, appropriate disclosures should be considered.

Liquidity

A company must disclose "any known trends or any known demands, commitments, events, or uncertainties" that will result or that are reasonably likely to result in the company's liquidity increasing or decreasing in any material way.

Material changes to a company's liquidity or liquidity strategy, including intentions surrounding the use of borrowings, should be disclosed. For example, if a company expects negative impacts to liquidity as a result of the curtailment of operations or sales, appropriate disclosures should be considered. Moreover, disclosure might be warranted where a company has taken proactive measures to ensure ample liquidity (or to continue to fund operations), such as atypical drawdowns on revolving credit facilities. Similarly, if a company has adjusted its plans for capital expenditures, it should revise its disclosures accordingly to discuss those changes and the related impact on liquidity as well as future operating results.

Many companies in recent periods have employed cash to repurchase their own common stock. If the company has material, non-public information about COVID-19 impacts that it is not yet in a position to publicly disclose, it may have to suspend those programs. Some companies whose liquidity has been impacted may choose to suspend or reduce stock repurchase programs in order to preserve cash. We have also seen companies suspending or deferring dividend payments, or paying stock dividends instead of cash.

Similarly, if the company was planning on selling equity or debt to raise capital, it must consider whether it can do so now given that it may have material, non-public information about the COVID-19 impacts that it is not yet prepared to disclose. The potential inability of companies to engage in public offerings was mentioned in the SEC Guidance, and disclosure may be necessary depending on the availability of other sources of capital.

Capital Resources

A company is required to disclose "any known material trends, favorable or unfavorable, in . . . capital resources," including any expected material changes in the mix and relative cost of such resources.

Volatility in the capital markets may result in a change in the availability or mix of the company's capital resources, and that should potentially be addressed. Companies should consider impacts on the cost of or access to capital and funding sources. Many companies have elected to draw down their revolving credit facilities as a preventive measure in the face of potential sales and revenue declines; if so, that is a matter that should also be disclosed if material.

SEC Guidance

The SEC Guidance highlights some key questions about the impact of COVID-19 that management should consider in preparing its disclosures. The guidance is most directly relevant to MD&A, but should be considered when preparing other parts of the company's report. They include impacts on:

- assets on the balance sheet and the ability to timely account for those assets;
- anticipated material impairments, increases in allowances for credit losses, restructuring charges, other expenses or certain changes in accounting judgements;
- the ability to maintain operations, such as supply chain or product distribution channels, travel requirements or systems for financial reporting, internal controls and disclosure controls; or
- demand for the company's products or services.

Risk Factors

Given that the future impact of COVID-19is not yet predictable with certainty, it makes sense to ensure the company's risk factors cover that uncertainty. While many companies already have risk factors that cover natural disasters, including pandemics, it may be prudent to update that risk factor to mention the COVID-19 pandemic and perhaps add detail about potential consequences. If the company has a significant, unique risk, such as significant operations in Italy or that it has been shut down or may face a shut down in the U.S., or its business is dependent on international travel, one or more new risk factors may be warranted.

Based on recent case law and SEC enforcement actions, a company could be subject to liability if a risk has already partially or fully materialized, while the language of the applicable risk factor speaks only to potential future risk. In other words, it is not sufficient to say that something may happen if it has already happened. Accordingly, new or updated risk factor language that addresses COVID-19 should reflect the extent to which the risk has already materialized. Given the rapidly developing pandemic, it may be sufficient to state that the risk has materialized and that the company is assessing the impact, perhaps providing some detail on the areas where it has seen an impact. For individual companies, the appropriateness of any given disclosure will depend on its unique circumstances and information available at the time such disclosure is made.

It is also important to ensure that the language of the risk factor is consistent with the language in the MD&A. If a risk has already materialized, for instance, it may (or may not) be appropriate to reflect it as a "known uncertainty" in the MD&A.

In the ordinary course, a company's quarterly report must disclose any material changes from the risk factors included in the annual report. However, some companies have recently updated their "natural disaster" risk factors or added risk factors specific to the outbreak by filing a voluntary Form 8-K well in advance of their quarterly reports. The decision to file a new risk factor before the next quarterly or annual filing involves complex judgements, and counsel should be consulted on that question. Once disclosed, whether in a Form 8-K or a quarterly report, the updated risk factor can help to mitigate exposure to liability, and if properly drafted may provide the company with marginally more flexibility to engage in discussions with investors, analysts and others about the potential business impacts without violating Regulation FD, which prohibits selective disclosure of material non-public information.

Companies should be particularly sensitive to the requirements of Regulation FD with respect to any discussion of the impact of COVID-19 on operations. Such information should be presumed to be material and, as such, disclosed only in a broadly disseminated manner. Given the interest of various market stakeholders, investor relations teams should be prepared with talking points that are aligned with public disclosures so as not to inadvertently run afoul of Regulation FD.

Earnings Release and Guidance

As a company begins to prepare its earnings release and remarks for its quarterly earnings conference call, some of the same considerations that guide the disclosure in the MD&A should also guide the disclosure in the earnings release and script. Companies that file their annual or quarterly reports within the same approximate timeframe as their earnings conference may want to draft the MD&A section of their filing before drafting the earnings release, as that may save time and help to focus the company's message.

The SEC Guidance recognizes that there may be instances when companies present non-GAAP financial measures in their earnings releases before the comparable GAAP measure is available because COVID-19 related adjustments require the need for additional information or analysis. The SEC staff stated that "[w]e would not object to companies reconciling a non-GAAP financial measure to preliminary GAAP results that either include preliminary provisional amount(s) based on a reasonable estimate, or a range or reasonably estimable GAAP results." For example, if a company intends to disclose EBITDA, it can reconcile that measure to GAAP earnings, to a reasonable estimate of its GAAP earnings that includes a provisional amount or to an estimated range of GAAP earnings. This relief is only available, however, for non-GAAP measures a company "is using to report financial results to the Board of Directors." The implications of this condition may differ for each company, but at a minimum, a company should be mindful of not taking advantage of the guidance and disclosing provisional or estimated results when more definitive information is available. The company's disclosure, furthermore, should explain why the line items or accounting is incomplete, and what additional information or analysis will be necessary to finalize them.

As a practical matter, this relief is not available for filings, such as the Forms 10-Q or 10-K, where GAAP financial statements are required. Moreover, companies that use non-GAAP financial measures and performance metrics to discuss their operating results should be mindful of the SEC rules and guidance when making any additional adjustments for COVID-19 related charges. If a company makes such adjustments, or uses new non-GAAP measures or metrics to explain the impact of COVID-19, it should disclose why management finds the measure or metric useful. For more information, please see our alert here.

Some companies that issued earnings guidance at the beginning of their fiscal years have either withdrawn or modified their guidance. Other companies either had not issued guidance, or have not modified guidance, possibly pending their next earnings conference and press release. When does it make sense to withdraw guidance out of cycle, between earnings conferences? The situation for each company is unique, but factors that would weigh in favor of doing so include the size of the gap between guidance and current management estimates, the ability of management reliably to estimate that gap in a rapidly-changing environment, a significant gulf between street earnings estimates and the company's internal estimates, a desire by management to "get the bad news behind it" in order to start navigating forward, and/or a desire to project that the company intends to have full transparency about the impacts of the virus beyond what is legally required. These factors must be balanced against the risk of the company making too frequent updates to its disclosure, or disclosing information that may be incomplete or inadvertently leave out information that has not yet been fully processed.

Companies with December, January and February fiscal year ends are the first to hold earnings conferences covering fiscal periods in which they may have been materially impacted by COVID-19, and we expect some of those companies to withdraw or adjust guidance. Such companies should be prepared to provide information consistent with what they expect to be in the MD&A sections of their annual reports. If the company does not believe it will be in a position to provide a full picture of the COVID-19 impact on its business, it should discuss what information it can provide early on, and whether it can communicate the variables and the timing for when it could provide a more complete picture.

Current Reports on Form 8-K

Ensuring that a company timely files all required current reports on Form 8-K can be challenging, even in normal times. Given that many companies are currently scrambling to keep up with new developments involving COVID-19, monitoring for required 8-K filings may be significantly more challenging. As business conditions rapidly evolve, we expect that material agreements will be amended or in some cases terminated at an increased pace and that new material agreements, including with respect to borrowings or the acquisition or disposition of material assets, may be entered into on an urgent basis. In addition, impairments to certain existing assets may be recorded, particularly where there is a lengthy delay in returning to full operations. Now would be a good time to ensure that a company's disclosure controls and procedures are current, that appropriate resources are mobilized and that personnel in the finance, compliance and legal teams are apprised of all material developments to the business so that they may evaluate disclosure requirements and consult with outside counsel where appropriate

Below are a few 8-K triggers that the company should keep in mind, although other Items may be triggered as well:

- Item 1.01: This Item may be triggered if the company materially amends a material contract, such as to adjust a supply or customer agreement to new COVID 19-related conditions, or to amend a debt instrument.
- Item 2.03: If the company, among other things, enters into a new agreement to borrow money, this Item may be triggered.
- Item 2.04: With respect to an existing financial obligation, if there has been an acceleration due, for example, to the failure to maintain a covenant, or an increase in the obligation, this Item may be triggered.
- Item 2.05: This Item may be triggered if the company commits to "an exit or disposal plan, or otherwise disposes of a long-lived asset or terminates employees under a plan of termination described in FASB ASC paragraph 420-10-25-4 (Exit or Disposal Cost Obligations Topic), under which material charges will be incurred under generally accepted accounting principles ..." This Item may be triggered by a plan for the termination of employees.
- Item 2.06: This Item may be triggered in the event of a material impairment, including with respect to securities or goodwill. In the SEC Guidance, the staff specifically urges companies to consider impairments due to goodwill, intangible assets, long-lived assets, right of use assets and investment securities.
- Item 5.02: This Item may be triggered if the company materially amends an employment agreement with a senior executive to reduce cash compensation in

order to preserve cash.

As noted above, although not warranted in most circumstances, some companies should consider "voluntary" 8-K filings under Item 7.01 or 8.01. Some companies, for instance, have updated a risk factor on natural disasters or pandemics (or included one for the first time), or included specific risk factors addressing the outbreak, by filing it on a Form 8-K. Foreign private issuers are not subject to the requirements of Form 8-K, but likewise may consider voluntary filings on Form 6-K.

SEC Permits Filing Delays & Sudden Popularity of Virtual Annual Meetings

Delayed Filings

The SEC has granted companies an additional 45 days to file any periodic or current report due between March 1 and July 1, 2020. Companies wishing to rely on the relief must file a current report on Form 8-K or Form 6-K (for foreign private issuers) stating the reasons for seeking relief on or before the filing deadline. So far, we have principally seen smaller companies with significant operations in China or Italy rely on the relief, although we expect more companies will rely on it as the pandemic spreads to other regions of the world, particularly smaller public companies with leaner compliance and accounting staff. Please see our prior client alerts on this topic, here and here.

Companies considering relying on the SEC's relief should consider a number of factors, including:

- the possibility that some disclosure about material developments in the quarter will need to be included in the 8-K filed to satisfy the conditions for the relief, consistent with the practice of companies that file late based on Exchange at Rule 12b-25;
- whether other comparable companies in size, and perhaps industry, have relied on it, or are expected to do so;
- the likelihood that the trading window for insiders to transact in the company's stock will have to remain closed; and
- the potential for difficult decisions on handling MD&A when the next quarter is already in progress. For example, will the disclosure of trends and uncertainties have to speak as of the delayed filing date, rather than the end of the fiscal quarter?

Virtual Annual Meetings

Because of safety and travel concerns, government restrictions on business activities, and the need to maintain "social distancing," many companies are switching or are considering switching their annual shareholder meetings to a "virtual only" process (or disclosing the option in their proxy statements). At a virtual shareholder meeting, shareholders attend the meeting through an online portal rather than at the company's offices or another physical location, but may still ask questions, vote their shares, inspect the company's list of stockholders and generally take the other actions they would have been able to take at a physical meeting held in person.

The ability to conduct virtual-only meetings is subject to the laws of a company's state of incorporation. The corporate law of Delaware, where the majority of publicly traded companies are incorporated, permits virtual-only shareholder meetings. Many companies incorporated in Delaware had already shifted to virtual-only meetings in prior years, but the COVID-19 outbreak has led to many more companies that would otherwise have not adopted the process shifting to virtual only meetings for their 2020 shareholder meetings.

For companies incorporated in New York, New York State Governor Andrew Cuomo issued an executive order clarifying that, in light of the COVID-19 pandemic, effective starting March 20 and until April 19, 2020, among other things, companies incorporated in New York are permitted to hold virtual-only meetings. New York companies with later scheduled meetings should continue to monitor state requirements and the Governor's office, as the order may be extended past April 19.

The general corporation law of Maryland, where many REITs and BDCs are incorporated, imposes other procedural restrictions on virtual meetings, including to provide, if requested by a stockholder, a place where the requesting stockholder may access the meeting on the internet.

Several other states also permit virtual-only meetings. Regardless of where a company is incorporated, its bylaws should be reviewed and outside counsel should be consulted to ensure the requirements of its respective jurisdiction are satisfied.

Many companies, while not affirmatively deciding to hold a virtual-only meeting, have disclosed in their proxy statements that they may switch to a virtual meeting due to the impact of the COVID-19 outbreak. The SEC issued guidance on March 13, 2020 regarding how companies should appropriately disclose the switch to a virtual-only meeting if they ultimately decide to switch to the virtual only process. See Staff Guidance for Conducting Annual Meetings in Light of COVID-19 Concerns. In addition to reviewing the SEC's guidance, companies should ensure they are complying with state law notice requirements with respect to accessing a virtual-only meeting if they ultimately make the switch.

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Proskauer's cross-disciplinary, cross-jurisdictional Coronavirus Response Team is focused on supporting and addressing client concerns. Visit our **Coronavirus Resource Center** for guidance on risk management measures, practical steps businesses can take and resources to help manage ongoing operations.

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