Cakes Gone Bad: The Cheesecake Factory Faces Securities Scrutiny

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COVID-related securities claims continue to rattle the marketplace. On December 7, a leading plaintiffs firm announced an investigation on behalf of shareholders of The Cheesecake Factory Inc., just days after the SEC announced it was settling charges against the company for making misleading disclosures about the impact of the COVID-19 pandemic on its business operations and financial condition. The SEC's action was its first charging a public company for actions tied to the worldwide pandemic.

In SEC filings in March and April, The Cheesecake Factory disclosed that its restaurants were "operating sustainably" during the pandemic. The SEC order, however, states that on March 18, 2020, the company sent a letter to its landlords saying it would not be paying rent in April 2020 due to a "severe decrease in restaurant traffic [due to COVID-19 that] has severely decreased our cash flow and inflicted a tremendous financial blow to our business." Shortly thereafter, the company drew down the last $90 million on a revolving line of credit and began seeking additional liquidity and internal documents noted that the company was experiencing a negative cash flow rate of $6 million per week. When the company filed a Form 8-K on March 23, however, it only detailed the credit drawdown. Following media reports of the landlord letter, the company filed another Form 8-K on March 27, 2020. And on April 3, the company filed yet another 8-K, which provided a preliminary Q1 2020 sales update in which The Cheesecake Factory again disclosed that its restaurants "are operating sustainably at present."

The company agreed to pay a civil money penalty in the amount of $125,000 to settle the case with the SEC, but it appears that will not be the end of this issue for The Cheesecake Factory. On the news of the SEC settlement, the company's stock price fell $.81 per share, or 2%, to close at $38.62 per share on December 4. And on December 7, the Rosen Law Firm announced that it is preparing a securities lawsuit on behalf of The Cheesecake Factory's shareholders in light of these alleged misstatements.

There are two main takeaways from The Cheesecake Factory's recent experiences. First, as COVID-19 continues to batter businesses worldwide, public corporations may face similar lawsuits based on disclosures relating to their ability to weather the pandemic, especially if their predictions of continued operations do not pan out. As noted in the press release by the SEC accompanying the settlement, "[w]hen public companies describe for investors the impact of COVID-19 on their business, they must speak accurately."

Second, while the civil money penalty was only $125,000, the SEC's order shows its emphasis on companies providing accurate and complete descriptions of their financial state at the time of each disclosure, even on Form 8-Ks. In particular, the SEC's order notes the company's enhancement of its liquidity position through a $200 million subscription agreement for the sale of convertible preferred stock to a private equity investor. But, in the SEC's view, the subsequent liquidity enhancement did not cure the company's prior failure to disclose the liquidity problems in the first place.

Check back here for updates on The Cheesecake Factory's saga, as well as to learn about other lawsuits alleging securities law violations related to COVID-19.

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