

INSIGHTS

SEC Sends Warning Shot on COVID-Impact Disclosures

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By: [Matthew G. Nielsen](#), [David A. Shargel](#), [Thomas F. Kokalas](#), and [Shelby Harden](#)

The Securities and Exchange Commission fired a warning shot last week to all public companies about the quality and accuracy of disclosures made regarding the impact of the COVID-19 pandemic on business operations. On December 4, the SEC announced settled charges against The Cheesecake Factory Incorporated for making misleading disclosures about the impact of the COVID-19 pandemic on its business operations and financial condition in March and April of 2020.¹ The timing of the case and relatively minor penalties against the company, a \$125,000 fine and cease-and-desist order, indicates that the SEC chose the case as a message to the market for the upcoming 10-K reporting season on the need for public companies to disclose the full effect of the pandemic on their operations, both current and future.

The SEC's order found that in its March and April 2020 Form 8-K disclosures The Cheesecake Factory falsely stated its restaurants were "operating sustainably" during the pandemic. The SEC order found that despite its public statements, the company was actually losing approximately \$6 million in cash per week and only had a projected 16 weeks of cash on hand at the time— information that had been shared only with potential private equity investors and lenders in an effort to secure additional liquidity. The SEC also found that, while The Cheesecake Factory did describe in its March 23, 2020 filing some actions it had undertaken to preserve financial flexibility during the pandemic, the company failed to disclose that it had already informed all of its landlords that it did not intend to pay rent in April. The SEC found that partial disclosure was not sufficient when there was a clear upcoming threat to business operations.

The SEC's action against The Cheesecake Factory was its first following warnings of increased scrutiny of COVID-19 related public disclosures. On April 8, SEC Chairman Jay Clayton and William Hinman, the Corp-Fin Director, issued a statement about the importance of disclosure during the COVID-19 pandemic. They "urge[d] companies to provide as much information as is practicable regarding their current financial and operating status, as well as their future operational and financial planning."² The statement urged that historical information in company disclosures will be less significant, and upcoming disclosures should focus on "(1) where the company stands today, operationally and financially, (2) how the company's COVID-19 response, including its efforts to protect the health and well-being of its workforce and its customers, is progressing, and (3) how its operations and financial condition may change as all our efforts to fight COVID-19 progress."³

The SEC has historically taken similar action when confronted with disasters. For instance, in 2012 the SEC filed a settled suit against BP p.l.c. for misstating the severity of the Deepwater Horizon oil spill. The SEC alleged that BP fraudulently understated in public filings the daily flow rate from the oil spill, which mislead investors about the severity of the disaster. The settlement resulted in BP paying a \$525 million penalty, one of the largest SEC penalties at that time.⁴ Similarly, the incoming presidential administration is expected to place an increased emphasis on the disclosure of companies' risks related to climate change.

Turning back to disclosures related to the impact of COVID-19 and related government actions, the SEC's settled action with The Cheesecake Factory highlights the need for issuers to carefully consider the need to disclose current and expected impacts of the pandemic. With the new administration, enforcement is expected to increase and there is not likely to be a decreased focus on matters related to the novel coronavirus.

Fortunately, the SEC has provided issuers with guidance on how assess potential disclosure obligations related to the impact of COVID-19, including the June 23, 2020 guidance from CorpFin, which can be found [here](#). At bottom, the SEC expects that issuers' disclosures should be created to "allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management" and that the agency will look to hold companies accountable who fail to do so.

¹ Available at: <https://www.sec.gov/news/press-release/2020-306>. Unless otherwise identified, matters in quotations in this update are text from the Press Release.

² Available at: <https://www.sec.gov/news/public-statement/statement-clayton-hinman>.

³ *Id.*

⁴ Available at: <https://www.sec.gov/news/press-release/2012-2012-231htm>.