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SEC disclosures in the COVID-19 enforcement age

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In three recent pronouncements, the Securities and Exchange Commission (SEC) described important considerations for publicly-traded companies in making disclosures about the impact of the COVID-19 pandemic on their businesses, the best practices for non-public companies, and the SEC's enforcement considerations. To assist the investing public, these pronouncements instruct listed companies to provide meaningful disclosures about material changes to their earlier forecasts resulting from the pandemic, along with changes to their current and future operations. The SEC warns that those who fail to do so may be punished.

Many corporate boards already do not feel adequately prepared for "communicating during a crisis like the Covid-19 virus outbreak," *see* Andrea Vittorio "*Corporate Boards Slammed by Coronavirus Rethink Risk Planning*," Bloomberg Law (April 29, 2020). The SEC recognizes that such uncertainties exist. As its advice in this evolving crisis continues to be fluid, companies making disclosures in these uncertain times face difficult hurdles. The SEC is regularly updating its SEC Coronavirus (COVID-19) Response page, which provides a good overview of the agency's focus, priorities, and actions. In light of the SEC's recent pronouncements, and as the SEC continues to change its recommendations, publicly-traded companies should regularly review this webpage before making their disclosures or other public statements.

This article reviews the recent SEC initiatives related to the pandemic and their content, examines specific risk areas requiring careful attention to avoid liability, and outlines ways to reduce these risks. This process will not be easy for listed companies. In making or revising their disclosures, they must balance the importance of risking actionable matters and potential harm from disclosing any missteps against their economic challenges and the likely impact from their actions on their business' viability. They should understand that the temporary flexibility allowed by the SEC for required filings will not permit them to make inaccurate or misleading disclosures.

As explained below, COVID-19 has prompted renewed enforcement focus on areas such as insider trading, fraud, illicit schemes, and other manipulative activities that may be external and internal to business, as bad actors take advantage of the turbulent market and people's fears. Other key risks to be assessing for disclosure purposes (and also preventing or expeditiously addressing) include hacking and other cybersecurity risks.

The Trilogy of Recent SEC Pronouncements Impacting Disclosures

1. **Pronouncement from the SEC's Division of Enforcement.** On March 23, 2020, the SEC's Division of Enforcement cautioned market participants to continue "maintaining market integrity and following corporate controls and procedures" despite the pandemic. *See* "Statement from

Stephanie Avakian and Steven Peikin, Co-Directors of the SEC's Division of Enforcement, Regarding Market Integrity." The statement focuses on insider trading and compromised disclosure controls. It alerts companies to guard against these internally-generated missteps in this challenging environment, noting that more people may have access to material nonpublic information than in less challenging times.

2. **Guidance from the SEC Division of Corporate Finance.** The SEC's Division of Corporate Finance (CF) also recently issued a disclosure guidance that shows its way of thinking and promises continued monitoring and the possibility of "targeted regulatory relief." *See* CF Disclosure Guidance: Topic No. 9 Coronavirus (COVID-19) (March 25, 2020). This guidance explains that publicly-traded companies must *disclose COVID-19's effects on the company*, which includes its predicted future impact, how management is responding, and the plans for virus-related uncertainties. In determining what must be disclosed, the standard remains "material information that is widely disseminated" and "material to investment and voting decisions." The SEC expects robust, *principles-based* disclosures that "articulate an objective and look to management to exercise judgment in satisfying that objective by providing appropriate disclosure when necessary." William Hinman, "Applying a Principles-Based Approach to Disclosing Complex, Uncertain and Evolving Risks: Remarks at the 18th Annual Institute on Securities Regulation in Europe," London, England (March 15, 2019).

3. **Statement by SEC Chairman Jay Clayton and CF Director Hinman.** On April 8, 2020, Chairman Clayton and Director Hinman issued a public statement entitled "The Importance of disclosure-For Investors, Markets and Our Fight Against COVID-19" that advises companies making disclosures to use available safe harbors for forward-looking statements: "We encourage companies that respond to our call for forward-looking disclosure to avail themselves of the safe-harbors for such statements and . . . we would not expect good faith attempts to provide appropriately framed forward-looking information to be second guessed by the SEC." As companies are releasing their first quarter earnings and having investor/analyst calls, Chairman Clayton and Director Hinman emphasize that these calls should *not* be routine, nor focus on historical measures, but should be tailored to address the problems caused by the pandemic. "Investors and analysts are thirsting to know where companies stand today and importantly, how they have adjusted and expect to adjust today, and in the future, their operational and financial affairs to most effectively work through the COVID-19 health crisis," they said.

These challenges will differ among industry sectors. For instance, the healthcare sector's challenges are not the same as those in transportation, food supply, or other sectors. The SEC recognizes the effort to mitigate the COVID-19 pandemic has caused a deep economic contraction that requires a strategy that balances the population's health risks while fostering a meaningful responsible increase in economic activity. While the SEC seems to understand that accurately predicting their risks will be difficult, it advises companies to note these difficulties in their discussions and forward-looking statements.

One example of a briefly tailored, forward-looking disclosure is described in General Motor's recent post entitled "*General Motors Takes Additional Steps to Fortify Balance Sheet*" (April 27, 2020). "We continue to enhance our liquidity to help navigate the uncertainties in the global market created by this pandemic," said GM Chief Financial Officer, Dhivya Suryadevara. "Fortifying our cash position and strengthening our balance sheet will position the company to create value for all our stakeholders through this cycle." Another example is from Deutsche Bank's ad hoc April 26, 2020 release entitled "*Deutsche Bank announces results for the first quarter 2020 above market expectations. Outlook for full year 2020 updated*" "[t]he short-term implications of the COVID-19 pandemic make it difficult for the bank to accurately reflect the timing and the magnitude of changes to its original capital plan."

Increased-enforcement Impacts Disclosure Considerations

Companies should actively monitor how the SEC and other federal and state agencies are responding to the pandemic and stay abreast of related efforts and initiatives by federal and state executive and legislative branches and local governments. Other risks that may impact their disclosure obligations include the threat of civil actions by unhappy shareholders, workers, customers, and competitors under various legal theories, and the increased risks of multiple litigation fronts developing.

1. **Parallel Proceeding Risks are Heightened in this Environment.** Parallel proceedings always pose a variety of difficult problems. Multiple actions arising from the same event(s) may develop from a combination of agency administrative enforcement actions, suits in federal or state district courts (including class actions and shareholder derivative suits), and the threat of U.S. Department of Justice (DOJ) or state criminal actions. Parallel proceedings require carefully coordinated efforts as making any misstep in one proceeding can result in disastrous effects, such as waived privileges, admissions, and collateral estoppel problems in others. Plaintiffs' counsel will try, for example, to leverage a company's settlement with the SEC to their advantage if a company is must admit to wrongdoing despite the SEC's informal settlement policy—under which a settling party neither admits or denies the agency's allegations.

2. **Companies Should Protect Against Securities Fraud, Insider Trading, and Foreign Corrupt Practices Act (FCPA) Violations.** Securities fraud liability does not result solely from a breach of duties, as some fraud or deception must be involved. Most securities fraud actions charge violations in the secondary market under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), codified at 15 U.S.C. §78a et seq., and its implementing rule, 10b-5, which has a broader reach than the Securities Act of 1933 (Securities Act), codified at 15 U.S.C. § 77a et seq. (which is limited to fraud related to a public offering). Securities fraud actions are evaluated under different approaches, depending on whether the alleged fraud involves an omission (which requires establishing the breach of a duty to disclose material information and reliance) or an affirmative misrepresentation of material information (which does not depend on an underlying duty). *See* Michael E. Clark, "*Securities Law Issues and Disclosure Considerations for Life Sciences Companies*," Ch. 12, p. 762, Pharmaceutical and Medical Device Law: Regulation Of Research, Development, And Marketing (Bloomberg BNA/ABA Health Law Section, 2d Ed. 2015) (Michael E. Clark, Ed.).

Section 10(b) of the Exchange Act makes it unlawful for any person "to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe." SEC Rule 10b-5, codified at 17 C.F.R. §240.10b-5, in turn makes it unlawful to: (a) employ any device, scheme, or artifice to defraud; (b) make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Insider Trading Risks. In a recent key case, *United States v. Blaszczak*, 947 F.3d 19 (2d Cir. 2019), the Second Circuit ruled that the government's failure to prove the "personal benefits test" under 15 U.S.C. § 10(b) and Rule 10b-5 (*i.e.*, providing benefits to the tipper known by the tippee) did *not* preclude an insider trading conviction under the Securities Fraud Statute (18 U.S.C. § 1348) or the Wire Fraud Statute (18 U.S.C. § 1343), as neither require a personal benefit as an element of proof. While SEC civil enforcement is limited to Title 15 offenses, DOJ criminal enforcement under Title 18 means that acts of embezzlement or misappropriation of the inside information can be used to establish insider trading liability. Even public officials can be liable for using confidential government information to trade stocks. At least two U.S. Senators are reportedly being investigated for stock trades perhaps tied to confidential and material government information obtained about COVID-19 ahead of stock trades, which may implicate the 2012 Stop Trading on Congressional Knowledge (STOCK) Act (Pub. L. 112–105) that bans insider trading by members of Congress. Thus, full disclosure of the non-public information is incumbent by the insider and company to avoid either criminal or civil liability.

Under the "classical theory" of insider trading an insider must "disclose-or-abstain" from trading on a company's inside information. This duty is based on a *relationship* meant to provide access to inside information for a *corporate purpose*, *not to let an insider exploit the informational advantage* for personal gain. Under the "misappropriation doctrine," a similar fiduciary-like duty covers permanent insiders and extends to attorneys, accountants, and other temporary fiduciaries. *United States v. O'Hagan*, 521 U.S. 642, 651-52 (1997).

To address this problem, and to create a safe harbor, in 2000 the SEC adopted Rule 10b5-1, codified at 17 C.F.R. §240.10b5-1. It establishes an *awareness* test, subject to affirmative defenses which preclude such awareness (*i.e.*, that before the individual obtained such knowledge, s/he had in good faith entered into a binding contract to buy or sell the security, instructed another to do so for his or her account, or adopted a written plan for trading securities).

FCPA Risks. Both SEC and DOJ have Federal Corrupt Practice Act (FCPA) enforcement authority. The SEC civilly sanctions the falsity or inadequacy of books and records and the lack of internal controls, while the DOJ criminally prosecutes bribery and related offenses. The SEC is especially active in its FCPA efforts, although recently its investigations seem to depend more on voluntary disclosures. FCPA investigations often take years to complete. In the current environment, companies that buy foreign supplies, like drugs and PPE for example, and particularly those with majority-owned foreign subsidiaries, are likely at heightened risks now from pressures to get needed supplies, so must take great care to accurately report and disclose their financial transactions. The pressures from the pandemic also heighten the importance of ensuring books and records are as accurate as possible. Adding to the risks, the Sarbanes Oxley Act increased these responsibilities by requiring CEO's and CFO's to certify to the accuracy of internal controls and financial statements.

SEC Can Suspend Trading. As set out in the SEC Coronavirus (COVID-19) Response website, the SEC is prioritizing the protection of investors and other market participants and actively coordinating with other enforcement agencies. It recently imposed trading suspensions against some listed companies in connection with COVID-19. On April 22, 2020, it suspended trading in the shares of Predictive Technology Group, Inc. (PRED), terminating on May 5, 2020, due to questions about the accuracy and adequacy of information in the marketplace related to statements by PRED in press releases about being able to immediately distribute large quantities of serology tests to detect the presence of COVID19 antibodies. *See* "Trading Suspensions in Connection with COVID-19: Predictive Technology Group, Inc., SpectrumDNA, Inc., and SCWorx Corp. (4/21/2020)." Similarly, in SEC v. Praxsyn Corp., No. 20-cv-80706 (S.D. Fla., complaint filed April 28, 2020), the first SEC enforcement action related to the pandemic, the SEC sued Praxsyn Corp. and its CEO for violating Exchange Act § 10(b) and Rule 10b-5 by making false claims about having access to huge quantities of PPE (N95 masks) in great demand, which claims were blatantly false. The SEC focused on two press releases issued in late February and March 2020 and alleged that the company's trading volume dramatically increased after these releases. It suspended trading of Praxsyn's stock from March 26 through April 8, 2020, and seeks a permanent injunction, fines, and an order barring the CEO from serving as an officer or director of a public company.

3. **Effect of Coordinated Federal Actions by Other Agencies on SEC Disclosures.** Actions or threatened actions by other federal or state agencies may require more fulsome disclosures. While a "Wells Notice" from the SEC (which requires a response to a staff investigation and a potential enforcement action) may not need to be disclosed, *see, e.g., In re Lions Gate Entertainment Corp. Sec. Litig.,* 165 F.Supp.3d 1 (S.D.N.Y. 2016), a threatened indictment by the DOJ most certainly should be disclosed. Moreover, in this environment a company may be better off (after a careful review with experienced counsel) disclosing a non-routine government subpoena. *See* Michael E. Clark, Robert Hauberg, and Mark Schnapp, "Silence Is Not Always Golden," *Securities Regulation Daily* (Dec. 12, 2019).

4. **U.S. Department of Health and Human Services.** The U.S. Department of Health and Human Services (HHS) is the lead federal agency for the government's COVID-19 Response. It issues daily updates about its activities, including such things as protocols for testing and treating the COVID-19 disease. *See* HHS Coronavirus (COVID-19) updates. HHS also monitors the distribution of enormous amounts of funds under its many programs, including, most recently, a sizeable part of the over *Two Trillion Dollars* authorized by the landmark Coronavirus, Aid, Relief, and Economic Security Act (CARES Act) (Pub. L. 116-136), enacted on March 27, 2020, and more funds in other stimulus packages. *Different segments of the healthcare industry should tailor*

their disclosures to address their unique issues. For example, hospitals may consider disclosing that they may face liability for how they have treated COVID-19 patients. While it is not fully established how to effectively treat patients suffering from COVID-19 infection, many hospitals have used respirators to treat patients with breathing problems, an approach being seriously questioned due to the resultant high mortality rates. See "*Why some doctors are moving away from ventilators for virus patients*", AP/NBC News (April 9, 2020).

Among the various considerations that a publicly-traded hospital chain or other healthcare provider may include in its disclosures are how reimbursement delays are affecting the business; the effect from the instruction from the Centers for Medicare and Medicaid Services (CMS) to suspend discretionary surgeries; the effect of marshaling resources to treat COVID-19 on recruiting and retaining medical professionals; and the effect from other allocations of resources. For this reason, the HHS website should be reviewed to determine if additional information should be disclosed. Useful information is also found on Coronavirus.gov website.

5. **Food and Drug Administration.** Within HHS, the Food and Drug Administration (FDA) plays a key role in protecting the public health—which impacts when or how a company may reopen. As no known cure or vaccine for COVID-19 exists, the FDA has been authorizing emergency use tests intended to detect the virus. The agency also has enforcement powers it uses in administrative proceedings. Along with the Federal Trade Commission (FTC), it has been exercising its powers to stop the sales of phony or deceptive COVID-19 treatments. *See, e.g.,* FDA Coronavirus (COVID-19) Update: Daily Roundup April 22, 2019. A recent example of an FDA action that of interest is its caution against the use of hydroxy chlorine or chloroquine outside the clinical trial or hospital setting since the drug has not been shown to be safe for treating COVID-19 and has a known risk of causing dangerous heart problems. *See* "*FDA cautions against use of hydroxychloroquine or chloroquine for COVID-19 patients outside of the hospital setting or a clinical trial due to risk of heart rhythm problems*" (April 24, 2020). Other issues drug companies should consider in making disclosures are the FDA's anticipated delays in approving any investigational drugs to treat the virus; the major potential *known* side effects for drugs approved by the FDA to treat other diseases when being used as experimental drugs in clinical trials to treat COVID-19; progress issues in clinical trials of investigational new drugs being used to treat COVID-19; the potential for *unknown* side-effects of new drugs; the fast-tracking of FDA approvals; and vaccine developers' disclaimers.

   The FDA may even ask DOJ to prosecute companies and individuals. Under the federal Food, Drug, and Cosmetics Act, codified at 21 U.S.C. § 301, *et seq*., all curative claims for a disease require FDA approval and preclearance. Such representations cannot be made until after the approved investigational review process for new drugs or medical devices is completed. Introducing an unapproved new drug or device into commerce is a felony. Moreover, both the FDA and FTC have exacting requirements for approving such advertisements or claims.

6. **Data Security/Cybersecurity Risks.** In this environment, the SEC expects listed companies to be particularly vigilant about information security by staying informed and addressing cybersecurity risks. Not only does it impose requirements for disclosing risks and incidents, but the SEC now has a targeted enforcement unit to handle appropriate cases. *See* Commission Statement and

Guidance for Public Company Cybersecurity Disclosures, Release No. 33-10459 (Feb. 26, 2018). It has actively warned publicly-traded companies to assess their cybersecurity risks as part of their disclosure obligations. These risks have increased during this crisis, as seen in a recent alert about *ransomware* affecting hospitals and other "front line" medical suppliers. *See* Interpol, "Cybercriminals targeting critical healthcare institutions with ransomware" (April 4, 2020).

7. **Antitrust Risks Still Must be Assessed Despite Limited, Temporary Relaxation.** The DOJ's and FTC's Joint Antitrust Statement regarding COVID-19 (updated on March 24, 2020) warns that actions will be filed against companies that collude to increase prices, lower wages, decrease output, or reduce the quality of their products. Such "hard core" anticompetitive activities may lead to similar antitrust enforcement by state attorney generals and claims by private plaintiffs.

   Collusion in Hiring and Wages. On April 13, 2020, the DOJ and FTC warned about collusion in the labor markets and said that, to protect front-line workers dealing with the pandemic's effects (doctors, nurses, first responders, and those working in grocery stores, pharmacies, and warehouses, among other essential service providers), they will target any such anticompetitive conduct. *See* Federal Trade Commission and Justice Department Issue Joint Statement Announcing They are on Alert for Collusion in U.S. Labor Markets. The DOJ has established a Procurement Collusion Strike Force, which is focused in part on enforcing earlier pronouncements barring "no poach" agreements.

   Product Collaborations/Temporarily Expedited Business Reviews. While the DOJ and FTC allow pro-competitive joint ventures and collaborations, they will carefully scrutinize product collaborations given the potential for antitrust problems. To help businesses get needed product to market quicker, the agencies issued a Joint Statement on March 24, 2020 that they would resolve COVID-19-related business review requests within seven days of receiving all necessary information. On April 4, 2020, the first DOJ Business Review Letter under this expedited, temporary review procedure was issued to McKesson Corporation; Owens & Minor Inc.; Cardinal Health Inc.; Medline Industries Inc.; and Henry Schein Inc. to help expedite and increase the manufacturing, sourcing, and distribution of personal-protective equipment (PPE) and coronavirus-treatment-related medication. These collaborative efforts are part of an emergency response led by the Federal Emergency Management Agency (FEMA) and the HHS to address supply needs caused by the pandemic. *See* Department of Justice Issues Business Review Letter to Medical Supplies Distributors Supporting Project Airbridge Under Expedited Procedure for COVID-19 Pandemic Response."

Other Enforcement Risk Areas

Other specific areas of risk to consider for disclosure purposes include the following:

1. **DOJ Hoarding and Price Gouging Task Force.** Fraudulent schemes will face enforcement action. *See* U.S. Attorney General William Barr, Memorandum to Department Heads, Law Enforcement Agencies and United States Attorneys (March 24, 2020), which directed "the creation of a task force charged with addressing hoarding and price gouging associated with the Coronavirus (COVID-19) pandemic." The same day, Deputy Attorney General Jeff Rosen issued

a memorandum entitled "Department of Justice Enforcement Actions Related to COVID-19" about close interagency and state coordination to address fraud related to the pandemic.

2. **Misrepresentations About Drugs, Personal Protective Equipment.** On March 9, 2020, the FTC and FDA jointly sent warning letters to seven companies expressing concerns about advertisements and claims for COVID-19 related products lacking FDA approval. These companies must cease such claims and take corrective measures or risk a federal injunction and financial recompense for consumers.

3. **Workforce Liability Risks.** How a company deals with the disruptions to its workforce may result in a variety of problems, including inquiries from the Occupational Safety and Health Administration (OSHA), an agency of the U.S. Department of Labor (DOL) not just for workers' safety issues, but also for retaliation against workers who report unsafe or unhealthful working conditions during the pandemic. The DOL also has enforcement jurisdiction over violations of the Worker Adjustment and Retraining Notification Act of 1988 (WARN Act), Pub. L. 100–379, which protects employees, their families, and communities by requiring most employers with 100 or more employees to provide 60 calendar-day advance notification of plant closings and mass layoffs of employees. Depending on how a company decides to address layoffs in dealing with its ability to operate, this may be another potential litigation risk for disclosure purposes.

Increased Risks from Private Plaintiffs and Event-Driven Lawsuits

Another clear disclosure risk in this environment are "event driven" private securities fraud class actions filed by opportunistic plaintiffs. They may make liability claims following an adverse event like workers becoming infected with COVID-19. The claims may state that the company did not adequately prepare, ignored risks, and failed to adequately disclose these risks. *See, e.g.*, John C. Coffee, Jr., "Securities Litigation in 2017: 'It Was the Best of Times, It Was the Worst of Times,'" CLS Blue Sky Blog (March 19, 2018); Julie G. Reiser and Steven J. Toll, "Event-Driven Litigation Defense," Harvard Law School Forum on Corporate Governance (May 23, 2019) ("So-called "event-driven litigation" describes cases in which a company recklessly concealed or misrepresented the risk of a major negative event, making statements touting its strong safety policies and procedures, for example, or its compliance with the law. When dangerous operations or illegal conduct are exposed—often because of a catastrophic event—the market reacts negatively and artificial inflation dissipates from the stock price, damaging investors who relied on the false or misleading statements.").

This theory of liability is an attempted end-around the normal required proof of scienter, akin to the tricky tests for willful blindness or reckless disregard, or even gross negligence. As an example, Zoom is now named in a putative securities fraud class action in *Drieu v. Zoom Video Communications, Inc.,* et al., No. 5:20-cv-02353 (N.D.Ca. filed April 7, 2020) (alleging, *inter alia*, that defendants made false and/or misleading statements and/or failed to disclose that Zoom had inadequate data privacy and security measures; contrary to Zoom's assertions, its video communications service was not end-to-end encrypted; and as a result users of Zoom's communications services were at an increased risk of having their personal information accessed by unauthorized parties).

Proactive Measures to Limit These Risks

1. **Key Areas Required for Disclosures.** In formulating disclosures, while specific line-items naming a particular risk may not be necessary, the following reporting categories should include a tailored COVID-19 risk assessment:
   - Management, Discussion and Analysis (MD&A);
   - Business Section;
   - Risk Factors;
   - Legal Proceedings;
   - Disclosure Controls and Procedures;
   - Internal Controls over Financial Reporting; and
   - Financial Statements

   In CF Disclosure Guidance: Topic No. 9; Order Modifying Exemptions from the Reporting and Proxy Delivery Requirements for Public Companies (March 25, 2020), the SEC's Division of Corporate Finance explains that assessing the evolving effects of COVID-19 and associated risks will require a *facts-and-circumstances analysis* tailored to provide material to investors and market participants about the (likely) impact of COVID-19. It offers a non-exhaustive list of questions for management to consider that are very helpful and should be carefully reviewed before making disclosures. Other things to assess are whether there are legal inconsistencies among various jurisdictions that may affect a business, its subsidiary, or the company's vendors and suppliers. For instance, the definition an *essential worker* may differ. Similarly, stay-at home or safer-in-home orders may vary (which may erode customer bases or demand). Different guidance or orders also affect related issues, such as when employees can return to work; the scope of unemployment insurance; and the future restart of operations. These inconsistencies will make it harder to accurately predict how a company's operations can be affected.

2. **Take Advantage of Safe Harbor Protections.** The statutory provisions protecting forward-looking statements, including their effect in private securities actions, appear in 15 U.S.C. §77z-2 and 15 U.S.C. §78u-5. The SEC's corollary regulations are set out in Rule 175 for the Securities Act, codified at 17 CFR § 230.175, and its twin, Rule 3b-6 for the Exchange Act, codified at 17 CFR § 240.3b-6. The term *forward-looking statement* is statutorily defined. These provisions effectively codify the bespeaks caution doctrine and may protect forward-looking statements that include cautionary language. While such safe harbor protection has express limitations, there is a procedural advantage in private securities class actions to use them. In considering a motion to dismiss, a judge must not consider any statement absent from a complaint. Thus, any cautionary statement accompanying the forward-looking statement that is not subject to material dispute may present a clear defense.

3. **The Duty to Update Doctrine has Likely been Triggered.** While the securities laws still do not require continuous disclosure of information, obligations change when significant developments occur, like the COVID-19 pandemic. Under the duty-to-update doctrine, publicly-traded companies must timely provide corrective information if new developments have made prior disclosures inaccurate or misleading. Some key SEC Staff Accounting Bulletins to consider reviewing are SAB No. 99-Materiality; SAB No. 100-Restructuring and Impairment Charges; and SAB No. 101-Revenue Recognition.

Companies must not take a "head-in-the-sand" approach to this important duty. Consider what recently happened to Mylan N.V. In August 2019, two wholly-owned subsidiaries paid $465 million to resolve allegations they knowingly misclassified EpiPen (a branded drug) as a generic to avoid paying rebates owed to Medicaid. *See* Press Release, U.S. Attorney's Office, D. Mass., Mylan Agrees to Pay $465 Million to Resolve False Claims Act Liability" (Aug. 17, 2019). The next month, the SEC acted against the company in part for not disclosing material information about the effects on the company from the enforcement, as outlined in a release entitled "Mylan to Pay $30 Million for Disclosure and Accounting Failures Relating to EpiPen," LITIG. REL. No. 24621 (Sept. 27, 2019). The release explains the terms and basis for its settlement with Mylan N.V. to resolve allegations in its simultaneously filed complaint. (*Securities and Exchange Comm'n v. Mylan NV.*, No. 19-civ-2904 (D.D.C.) ("As alleged in the complaint, public companies facing possible material losses from a lawsuit or government investigation must (1) disclose the loss contingency if a loss is reasonably possible; and (2) record an accrual for the estimated loss if the loss is probable and reasonably estimable. Mylan, however, failed to disclose or accrue for the loss relating to the DOJ investigation before October 2016, when it announced a $465 million settlement with DOJ. As a result, Mylan's public filings were false and misleading.").

4. **Forbid Selective Disclosure of Information and Carefully Monitor Compliance.** Companies should emphasize there will be zero tolerance for Regulation Fair Disclosure (Regulation FD) violations by reiterating that no board member, officer, or employee may *selectively disclose* any material, non-public information to any market participants (analysts, investment advisors, investors, lenders, or the media). Compliance must be carefully monitored. If such information has been improperly disclosed, it must be immediately provided to the public.

5. **Heighten Board Oversight to Address Caremark Doctrine Risks.** A company's board of directors also should be requiring answers about specific COVID-related risks to meet its oversight obligations under the "Caremark Doctrine" (named after *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996) and its progeny). If a board fails to meet its duty of care, each director may face *personal* liability that cannot be indemnified. In *Stone ex rel. AmSouth Bancorporation v. Ritter,* 911 A.2d 362, 370 (2006), Delaware's Supreme Court explained that "*Caremark* articulates the necessary conditions predicate for director oversight liability: (a) the directors *utterly failed* to implement *any* reporting or information system or controls; or (b) having implemented such a system or controls, *consciously failed to monitor or oversee its operations* thus disabling themselves from being informed of risks or problems requiring their attention." (Emphasis added). The *Caremark* test's *second prong* has been the focus of recent Delaware cases and poses great risk for boards dealing with a myriad of difficulties caused by the pandemic.

   Boards must not take a "business as usual" approach in performing their oversight duties. They should be demanding *more information*. This is the clear message from *Marchand v. Barnhill*, 212 A.3d 805 (2019), where the Delaware Supreme Court examined shareholder derivative claims that an ice cream manufacturer's board breached its fiduciary duties by *consciously failing to monitor or oversee the company's operations*. The complaint alleged "that the board never received any information about listeria or more generally about food safety issues" and that as "problems accelerated … [it] remained uninformed about Blue Bell's problems." *Marchand*, 212 A.3d at 812. As such, the *Marchand* court found that the complaint adequately pled "that the Blue Bell board had made no effort at all to implement a board-level system of mandatory reporting of any kind." *Id.* The allegations supported two key inferences: (1) that the board had not made an effort to ensure it was informed of a critical compliance issue for the company's operation, and (2) that the board "did not make the good faith [oversight] effort that Caremark requires." *Id.* at 822. The Delaware Court of Chancery also examined this issue in *In re Clovis Oncology, Inc. Derivative Litigation*, No. 2017-0222-JRS, 2019 WL 4850188 (Del. Ch. October 1, 2019), where the shareholders complained that the board breached its fiduciary duties by not overseeing the company's clinical trials for its single product and allowing the company to mislead the market about the drug's efficacy. These allegations were held sufficient to proceed.

Management Must Certify Critical Filings. In addition to *Caremark's* oversight responsibilities placed on boards, Congress requires management to timely make and provide various certifications. The 2002 Sarbanes-Oxley Act requires the management of publicly-traded companies to certify to the accuracy of filed financial reports. Section 409 of Sarbanes-Oxley mandates real time disclosures of "additional information concerning material changes in the financial condition or operations of" securities issuers. Thus, the required CEO and CFO certifications of disclosure documents subject them to personal liability for inaccuracies or misrepresentations.

6. **Temporary Leeway is Allowed for Estimates and Forecasts, But Accuracy is Critical.** To avoid disclosure liability, accuracy is critical. All adjustments to prior statements must be carefully explained. The Commission has provided some leeway in arriving at estimates and forecasts. In addition to presenting Generally Accepted Accounting Principles (GAAP)-compliant financing information in Form 10-K (Item 10), as required by SEC Regulation G (17 CFR Part 244), recent Commission guidance temporarily allows *some* non-GAAP financial measures or metrics to be used. If a listed company does so, it should explain why the measure or metric is useful; how it assists investors in evaluating the ways that COVID-19 has impacted the company's finances and operations; and explain any incomplete line item or accounting (and what may be needed). In no instance should the sole purpose of using non-GAAP measures or metrics be to "present a more favorable review of the company." Forward-looking information should be used and clearly identified as such in to qualify for safe harbors in the 1933 and 1934 Acts. *See* 15 U.S.C. § 78u-5 and 15 U.S.C. §77z-2, which codify the common-law's "bespeaks caution" doctrine. Meeting the SEC's safe harbor provisions should also help meet the statutory safe harbors in the Private Securities Litigation Reform Act (PSLRA). But such protections are not unlimited. Plaintiff's counsel often contend that the language was not meaningfully cautionary, timely, or properly identified, or that some other deficiency precludes safe harbor protection.

7. **Have Short- and Long-term Plans to Gather Needed Information for Disclosure.** As events unfold in these uncertain times, publicly-traded companies must have both a short-term and a long-term plan to get the information needed to accurately make their periodic disclosures (in Forms 10-K and 10-Q), their interim disclosures (in Form 8-K) and, while not required, proper disclosures in investor/analyst calls. The disclosures must be truthful and accurate (*i.e.*, fairly presented, not misleading or deceptive, and without material information omitted). The information to be disclosed is noted in the forms, which cross-reference applicable regulations. To

review a comprehensive list of what must be disclosed in a Form 8-K, *see* "Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities, A Statement of the Technical Committee of the International Organization of Securities Commissions" (Oct. 2002), at 9-10.

8. **Centralize Communications/Know Counterparties Situation.** Listed companies should consider centralizing their communications to provide consistent and well-constructed messages. They should also make necessary changes to employee supervision (as many are likely working remotely, which raises cybersecurity risks), and do the same with service providers and the supply chain. A listed company also should consider whether it or a counterparty cannot perform their contractual obligations and review clauses that cover default, termination, indemnification, or legal justifications (such as *force majeure*).

9. **Consider Narrowing Trading Windows.** As articulated in both the SEC Enforcement Division and SEC Corporate Finance releases, no trading should occur in the shares of a publicly-traded company before the dissemination of material non-public information (unless done under a Rule 10b5-1 compliant trading plan that removes the individual's discretion). Companies should consider tightening their internal trading policies. When information arises outside the usual blackout periods, they should consider imposing immediate trading restrictions on specific types of directors, officers, and employees. In addition, they should consider circumstances when blackout periods could be shortened. Passive investment plans designed to meet the safe harbor protections of Rule 10b5-1 should be reviewed to determine if changing or terminating the plans raises the risk of insider trading accusations.

Conclusion

Companies face every day, in the current business landscape, an ever-nuanced series of SEC guidances, and the rapidity of other agency initiatives and warnings that affect the reliability of current financials and even forward-looking statements. To try to avoid enforcement consequences and private litigation risks, only a few general prescriptions may be true signposts to lead a company through its disclosure obligations and meet compliance expectations:

- Adjust corporate governance mechanisms and enhance compliance plans;
- Bolster the information chain up to the Board, even with daily updates;
- Keep the disclosure obligations in the forefront, of equal importance with business decisions about production and sales, closings and re-openings, vendor and supply chains, workforce issues (including PPE, reductions and rehiring), customer/patient relations, and related steps to survive and recover;
- Contact the SEC with questions and obtain expedited business reviews/approval from other gatekeepers for innovative/collaborative responses;
- Shore up protections/investment plans to prevent insider trading; and
- If in any doubt, err on the side of disclosure – early and often.

While there are no silver bullets or one hundred percent "safe harbors," straightforward action negating inferences of scienter or, even worse, intent to deceive the markets, will lessen the enforcement risk.