Securities
Regulation Daily

Wolters Kluwer

March 30, 2020

COVID-19: Coronavirus spreads and the SEC jumps into triage mode; filers do their best to explain challenges

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It is a new day for the American economy, for investors, and for the SEC. While everyone is confused and even frightened, it is important to remember that everyone is in this together and that federal securities regulations, particularly those regarding disclosure, are designed to protect the public and promote informed decision-making. As such, the Commission is working to ease reporting and filing deadlines and other requirements in the wake of the COVID-19 pandemic, and several public companies are taking advantage of the relaxed requirements.

Beyond reporting deadlines, however, companies should consider the impact of the COVID-19 pandemic on their potentially delayed risk disclosures and MD&A disclosures. In particular, registrants should begin to think about disclosing changes in trends and outlooks, discussing supply chain and distribution matters, adding or modifying risk factors, or even reporting the effect of COVID-19 on executive management. These issues could be amplified concerns for firms involved in the health care system, and investors should be made aware of potential changes to "business as usual" in SEC filings.

"This is an uncertain issue where actual effects will depend on many factors beyond the control and knowledge of issuers. However, 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," SEC Chairman Jay Clayton noted.

The path going forward remains uncertain, but the SEC urges market participants facing operational or reporting hardships relating to the effects of COVID-19 to speak with Commission staff and find solutions that meet the SEC's mission: to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

SEC Relief

Commission response

In early March, the SEC provided an update on its response to COVID-19 and the related effects on the markets. While noting that its efforts are centered on the safety of its employees and all Americans, the Commission also stressed that its efforts are also focused on maintaining operations; monitoring the functioning, integrity, and resiliency of the markets; providing targeted regulatory relief and guidance as necessary; and maintaining investor protection, particularly with regard to market systems and vulnerable investors. The Commission also stated that it is focused on monitoring and providing guidance with respect to corporate filings and disclosures of U.S. issuers and foreign companies listed in the U.S., as well as providing conditional relief as appropriate.

Finding that the coronavirus could present challenges for certain companies that are required to provide information to trading markets, shareholders, and the SEC, the Commission issued an order providing publicly traded companies with an additional 45 days to file certain disclosure reports that would otherwise have been due between March 1 and April 30, 2020. Companies were told to file a current report (Forms 8-K and 6-K) containing a summary of why the relief is necessary. In addition, the Division of Investment Management issued a staff statement regarding certain in-person board voting requirements. The Commission encouraged all companies to consider their activities in light of their disclosure obligations and evaluate how risks related to the coronavirus could be material to its investors and reminded firms that they may need to revisit and/or update previous disclosures to the extent that the information becomes materially inaccurate.

On March 25, the SEC announced that it was extending the filing periods covered by its previously enacted conditional reporting relief for certain public company filing obligations under the federal securities laws, as well as the relief previously provided to funds and investment advisers whose operations may be affected by COVID-19. The Commission's order, which supersedes the original order, provides public companies with an extension to file certain disclosure reports that would otherwise have been due between March 1 and July 1, 2020. Among other conditions, companies must continue to convey through a current report a summary of why the relief is needed in their particular circumstances for each periodic report that is delayed.

Staff guidance

The Division of Corporation Finance issued Disclosure Guidance Topic No. 9: Coronavirus (COVID-19), providing the division's views on disclosure and other securities law obligations that companies should consider with respect to the coronavirus outbreak and related business and market disruptions. The guidance encourages timely reporting while recognizing that it may be difficult to assess or predict with precision the broad effects of COVID-19 on industries or individual companies. Health and safety, the division stresses, should not be compromised to meet reporting requirements.

According to the guidance, assessing the risks and effects of COVID-19 will be a facts-and-circumstances analysis, and disclosures should be specific to each company's situation. The guidance includes a number of issues that companies should consider, including: (1) how COVID-19 has impacted financial conditions and results of operations; (2) the effect of COVID-19 on capital and financial resources and assets on balance sheets; and (3) travel restrictions and constraints on human capital resources. The division encourages disclosure that is tailored to provide material information and to allow investors to evaluate the expected impact through the eyes of management.

Recommendations

In a memo, law firm Cooley LLP also urged public companies to consider the impact of COVID-19 on their risk factor disclosures, as well as disclosures relating to forward-looking statements. These risks could include potential supply chain problems, transportation interruption, rising costs, and even the possibility of reputational harm if business is disrupted, according to the firm. In particular,

companies should consider conveying the evolving nature of these risks and the attendant uncertainties, which, to some degree, will depend on the severity of the pandemic, the success of efforts to contain it, and the availability of effective treatment and prevention through a potential vaccine. The firm also suggests that companies should evaluate the potential for resource depletion, opportunity costs related to limiting interpersonal interactions, telecommuting standards, and management diversion in connection with the ongoing crisis.

To effectively do this, the Cooley law firm suggests that companies will need to avoid boilerplate language in their risk factor disclosures and be as specific as possible about the impact of COVID-19 with respect to their own unique circumstances.

"For example," according to Cooley, "many companies have experienced supply chain disruptions and related inventory problems. Have those issues been exacerbated by a 'just-in-time' strategy of maintaining lower inventories to reduce costs? Are some supplies sole-sourced or has the company qualified alternative sources of supply? Are qualified alternatives located in regions that are also severely affected by the pandemic?"

Industry Response and Recent Filings

Many companies have taken advantage of the flexibility provided by the SEC and used the opportunity to delay their filings as necessary to accommodate the changes in interpersonal interactions. In fact, as Steve Quinlivan of Stinson Leonard Street notes, a number of Forms 8-K have been filed to inform the SEC and the public that additional time has been necessary to file reports in compliance with the SEC's order.

Examples of these filings include:

- PrimeEnergy Resources Corporation
- ChinaNet Online Holdings, Inc.
- Lilis Energy, Inc.
- Cool Holdings, Inc.
- Global Seed Corp.

Industry effects

In addition, with respect to risk factors, the SEC's long-standing advice has been and remains that disclosure must be specific and tailored to a company's particular facts and circumstances. Many companies have heeded the call to consider whether COVID-19 presents a risk to their respective businesses—across all industries. Several firms have addressed the specific risk factors particular to their operations. In fact, John Jenkins of *TheCorporateCounsel.net* noted that Altria Group recently filed a Form 8-K announcing that its chairman and CEO had contracted the virus and was taking a leave of absence and that Baxter International disclosed that its CFO and a board member had tested positive for COVID-19. Referencing a Sullivan & Cromwell memo, he noted that voluntarily disclosure could be the solution given the high risk of media leaks.

Drug companies

Biotech companies may need to take an extra step and consider unanticipated limitations on drug manufacture and difficulties related to the conduct of clinical trials, including enrolling patients and engaging staff, as well as the diversion of resources to prioritizing COVID-19 patients. In addition, various regulatory authorities around the world may be limiting approval to initiate trials in light of pandemic response activities. For example:

- Akers Biosciences, Inc. noted in a Form 10-K that it may fail to realize its anticipated growth as a result of its acquisition of Cystron Biotech, and, in the event of growth, benefits could take longer to realize than originally projected. As part of a license agreement, Premas Biotech PVT granted Cystron an exclusive license with respect to its vaccine platform for development of a COVID-19 vaccine or treatment. "Our ability to realize the anticipated benefits of the acquisition will depend, to a large extent, on our ability to produce a vaccine that successfully treats coronavirus," the company stated.

  Akers also explained that the acquisition could result in additional costs and difficulties, including issuance of equity securities that could dilute shareholder ownership, additional royalty payments, and operational difficulties, among other things. "Cystron is dependent on technologies that is has licensed, and Cystron may need to license in the future, and if Cystron fails to obtain licenses it needs, or fails to comply with its payment obligations in the agreements under which Cystron in-license intellectual property and other rights from third parties, Cystron could lose its ability to develop a COVID-19," the Form 10-K states.

  "Our pursuit of the COVID-19 Vaccine is at an early stage. We have not previously tested our rapid response capability and may be unable to produce a vaccine that successfully treats the virus in a timely manner, if at all … If we are successful in producing the COVID-19 Vaccine, we may need to devote significant resources to its scale-up and development including for use by the U.S. government," according to the filing.

- In its Form 10-K, Tonix Pharmaceuticals Holding Corp. made similar statements but added that it may not complete trials for development of its TNX-1800 vaccine if the COVID-19 outbreak subsides and may use its resources to pursue other research projects in this event. The company also discussed potential risks to its financial condition, noting that outbreaks could materially and adversely affect its business operations, limiting its ability to travel or ship materials within or outside of an affected country and forcing temporary closure of facilities.

- ACM Research, Inc. explained in its Form 10-K that most of its operations are located in China and other areas impacted by the COVID19 pandemic and that those operations have been, and may continue to be, adversely affected by the virus. In February 2020, its Shanghai headquarters was closed for an additional six days beyond government restrictions. A portion of expected sales of the company's tools have been delayed as a result of effects of COVID19, given customer operations principally in China and surrounding areas, the disclosure states. The company also notes that the global supply chain may be interrupted.

- With a broader issue, BridgeBio Pharma noted in a Form 8-K that in light of COVID-19, it is experiencing delays in, or suspension of, enrollment of patients in clinical trials and preclinical studies, which could adversely affect its business. The current pandemic could also cause disruptions to non-clinical experiments and studies of new practice standards, the disclosure explains. The company also noted that increased withdrawals of patients from ongoing studies could have a negative impact on its business and that certain clinical trial activities may be deemed "non-essential." "In addition, the trading prices for our common stock and other biopharmaceutical companies have been highly volatile as a result of the COVID-19 epidemic," the company states.

- Bristol-Myers Squibb used a Form 8-K to note that it posted a fact sheet on its website and noted that it is "taking steps to support the health and safety of our workforce, ensure patients have the medicines they need and support our global communities in relief efforts."

Business disruption

- In its 10-K, Surna Inc., a company focused on cultivation technologies for controlled environment agriculture including cannabis, discussed that the heightened uncertainty relating to coronavirus on business operations has led to a workforce reduction that could affect day-to-day operations and sales and that it may not be able to continue operations. Results could especially be affected in the wake of other natural disasters, major health events, or other catastrophic events, the company notes.

- Cambium Networks Corp. filed a Form 10-K which explained that its wireless broadband networking solutions could be affected by the pandemic, which ultimately could disrupt its manufacturing, sales, and other operations. Limitations on travel could significantly limit the company's ability to market products, the company explains.

- In a Form 8-K filing, MEDNAX, Inc., a provider of physician services for pediatric care, noted as an "Other Event" that its financial condition and operational results for FY 2020 could be materially adversely affected by COVID-19. "Across its medical groups, the [c]ompany believes that these patient volume declines primarily reflect a deferral of healthcare services utilization to a later period, rather than a permanent reduction in demand for its services," the company states.

- McDonald's has filed a Form 8-K to note that COVID-19 has disrupted its global restaurant operations, with substantially all restaurants in the U.S. operating drive-thru, delivery and take-away only. Further problems could result from limited hours and menus, and many European markets have closed all restaurants, according to the company. "[O]ur ability to maintain our supply chain and labor force may become challenging as a result of the COVID-19 pandemic," McDonald's notes.

- Nike also filed a Form 8-K to note that the outbreak has affected its business on a global level, through store closures and decreased retail sales. In particular, the company notes, the virus and responsive preventive measures have had a material negative effect on sales and operations in China. Nike also explained that COVID-19 has had an impact on its distribution centers and third-party manufacturing partners and vendors and that these supply chain issues could have an

adverse effect on ability to meet demand. "[E]ven after reopening there can be no assurance as to the time required to regain operations and sales at prior levels. However, as of March 24, 2020, approximately 80 percent of NIKE-owned and partner stores in Greater China have reopened and are operating at normal business hours," the company states.

- In a Form 8-K, 3M noted that COVID-19 has significantly increased demand uncertainty and that travel restrictions and the adoption of telecommuting has affected its operations. "COVID-19 may impact 3M's supply chains relative to global demand for products like respirators, surgical masks and commercial cleaning solutions," the company states. In addition, the virus could also affect vendor ability to provide products and services to 3M, according to the filing. The company also discussed the effect that the markets could have on its business and explained that, given the uncertainty surrounding the virus and timing of recovery, "3M is not able at this time to predict the extent to which the COVID-19 pandemic may have a material effect on its financial or operational results."

Cruise lines

- Royal Caribbean filed a Form 8-K reporting the following the notice on its press center website: "Given global public health circumstances, Royal Caribbean Cruises Ltd. has decided to extend the suspension of sailings of our global fleet."

- Carnival and Disney cruise lines have made similar statements. These distinct disclosures were likely made in connection with an 8-K filing by Norwegian Cruise Lines that resulted in a class action complaint charging the cruise line and certain executives with misleading investors about its business prospects while making false statements about COVID-19 to entice customers to purchase cruises.

Next Steps

As SEC Chairman Clayton said: "First, we are facing an unprecedented national challenge—a health and safety crisis that requires all Americans, for the sake of all Americans, to significantly change their daily behavior and, for many, to make difficult personal sacrifices. Second, the recognition that the continuing, orderly operation of our markets is an essential component of our national response to, and recovery from, COVID-19."

Public companies need to protect themselves from potential liability in both the short-term and the long-term. Accurate disclosure may be more crucial than ever, and companies should strongly consider the need for additional risk disclosures to protect both themselves and their investors. Perhaps SEC filings are not at the top of Americans' minds at present, but investors must remain informed about potential obstacles and threats. More than ever, the interrelationship of investors, public companies, the stock market, and the world in general cannot be overstated.

"In short, preserving the flows of credit and capital in our economy—to businesses and individuals alike—will help us better fight COVID-19, as well as speed and strengthen our recovery." Clayton explained.

