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4 Tips For Crafting Good Disclosures After A Chaotic Quarter

By **Tom Zanki**

Law360 (April 24, 2020, 9:15 PM EDT) -- After an unprecedented first quarter in which business operations were upended by the coronavirus pandemic, companies disclosing quarterly results should follow certain practices to satisfy investors seeking clarity amid the chaos, while also guarding against litigation.

Investor scrutiny of company results is expected to intensify as corporate America's quarterly ritual of earnings calls followed by fuller regulatory disclosures heats up in the coming days and weeks. Under normal conditions, companies devote most of their time to recapping recent performance and may provide some insight about where business is heading.

But current market tumult could turn that practice on its head. The U.S. Securities and Exchange Commission is urging companies to bolster their forward-looking statements, given that past performance before the outbreak will be less relevant to shareholders. Instead, investors are likely to press companies on how they are coping with economic fallout caused by COVID-19.

That puts companies in the position of assessing the impact of a pandemic that is still unfolding. The SEC acknowledges as much, saying it won't second-guess attempts by companies to provide "appropriately framed forward-looking information" if done in good faith.

But hazards remain for companies, which are susceptible to securities lawsuits in the event of a stock plunge. Lawyers say current volatility makes it even more vital for companies to follow precautions when drafting their disclosures if they don't want to land in hot water with plaintiffs, who may spot an opening for litigation if corporate disclosures are perceived as faulty.

"Even though the SEC has encouraged and instructed [companies] to provide as much forward-looking information as they can, that doesn't mean the plaintiffs firms are going to sit on the sideline for this," said Alston & Bird LLP partner Dave Brown, who advises public companies.

Here are four disclosure practices companies should follow to avoid trouble, experts say.

Avoid Generic Statements

Regulators often urge issuers not to provide overly broad descriptions about risks they face that can apply to any company. With information-hungry investors clamoring for direction from companies, the principle takes on more significance now. While it may be tempting to use generic wording to describe the economic downturn, lawyers say companies need to be as specific as they can to stay in the good graces of investors and regulators.

"It's not enough to say something hypothetical," Mayer Brown LLP counsel Laura Richman said. "It's not enough to simply say COVID-19 may have an impact on our operation."

One factor is that the crisis impacts varying industries differently. The hospitality industry, which is facing a steep plunge in bookings in the second quarter and thereafter as people cancel vacations, is under different stress than energy providers, a sector hit by plunging oil prices that are complicated by geopolitical factors, including the recent oil-price war between Russia and Saudi Arabia.

The technology industry, considered better suited to weather the pandemic, is also not immune. Social media giant Snap Inc. said Thursday in its first-quarter report that advertising may drop because of COVID-19. The Snapchat owner noted that some of its advertising revenue stems from in-person events that are now jeopardized, like sports competitions and music festivals.

Even within the same companies, Richman noted that varying segments can be impacted differently. A retailer may find that in-store business is reduced while online business increases.

In terms of specific actions companies are taking to weather the crisis, Gibson Dunn & Crutcher LLP partner Gerry Spedale said companies should disclose cost-cutting measures they are enacting, such as reducing cash outflow and capital expenses, cutting salaries or deferring payments to lenders. They should also describe how their supply chain is impacted by the pandemic.

On the flip side, companies also should give detail in explaining risks they reasonably expect to happen. Gibson Dunn partner Hillary Holmes pointed out that an energy company may have yet to shut a refinery, but that could be a plausible risk as the pandemic causes oil prices to fall.

"You need to be specific about that possibility as well," Holmes said. "Specificity about not just what's happened, but specificity about what could happen."

Make Use of Safe Harbors

Public companies are granted "safe harbors" from legal liabilities when they provide forward-looking statements, as long as those statements are couched with cautionary language. Such language can include words like "believe," "expect" or "anticipate." The idea is to allow companies to provide insight to investors about where their business is heading without being subject to litigation if certain developments don't come to pass.

In a recent joint statement, SEC Chairman Jay Clayton and Division of Corporation Finance Director Bill Hinman urged companies to avail themselves of safe harbors, which are available both for companies filing prospectuses in order to go public and for existing public companies filing periodic reports. Issuers typically tap these safe harbors in the form of disclaimers that warn investors not to take forward-looking statements as predictions of future events.

Lawyers also said that companies need to be clear in their disclosures in describing what risks their businesses face that may cause their expectations not to materialize. This is especially so when providing forward-looking information about fundamentals like cash flow, liquidity or sales.

"Through securities litigation, we have learned that you need the disclaimer to be specific about factors that can cause actual results to differ from what you are saying in the forward-looking statements," Spedale said. "Or it's not an effective disclaimer."

Tell Investors If You're Getting Aid

The SEC has urged companies to disclose whether they are receiving or seeking government aid, which could come from the Coronavirus Aid, Relief and Economic Security Act or other federal and state programs.

CARES Act loans, which are available to companies that don't exceed a certain size, are largely aimed at helping businesses avoid laying off employees amid the cash crunch. The bill also includes a $500 billion fund to aid municipalities and distressed industries, including airlines.

Holmes noted that many companies receiving aid from the act's Paycheck Protection Program have said they would have had to lay off employees if not for federally backed loans.

"That's a material piece of information for the investor to understand," Holmes said.

Keep Everyone on the Same Page

As the pandemic and its economic impact play out, companies may find themselves under pressure from investors and analysts to provide updates beyond their most recent disclosures.

The SEC's Regulation Fair Disclosure, or Reg FD, bars companies from releasing material nonpublic information to selected recipients. Many companies have policies in place to comply with Reg FD, including "quiet periods" during which executives don't talk to analysts or investors while preparing their quarterly reports in order to prevent inadvertent disclosures beforehand.

Considering that the pandemic's impact will reverberate after first-quarter earnings calls and regulatory reports are released, Brown of Alston & Bird said companies pressed by investors and analysts must be sure that any new information is released in a manner that complies with Reg FD. An interim SEC filing known as an 8-K is a common way to satisfy that requirement.

Brown said having strong Reg FD policies is vital now and "will probably be even more important starting in mid-May, given that it is such a quickly evolving situation."

"You can see investors calling up and wanting to understand what is going on with the business, particularly in the second quarter," Brown said.

--Editing by Breda Lund.