

# COVID-19 Considerations for SEC Reporting Companies

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# Agenda

- SEC COVID-19 guidance
- SEC disclosure topics
- Earnings releases, earnings calls
- Non-GAAP COVID-19 measures
- Considerations for correcting or updating disclosures
- Regulation FD issues
- Insider trading, share repurchase and enforcement issues
- Shareholder meeting logistics

# Guidance from the SEC Staff

- The SEC staff has issued guidance related to COVID-19 disclosures in various forms:
  - CF Disclosure Topic No. 9 – March 2020
  - Joint Statement regarding earnings releases – April 2020
  - CF Disclosure Topic No. 9A – June 2020
  - Statements from SEC’s Chief Accountant – April and June 2020
  - Comment letters issued to registrants

# Assessing and Disclosing COVID-19 Impacts

- **CF #9 series of considered questions:**

- How has COVID-19 impacted your financial condition and results of operations?
- How has COVID-19 impacted your capital and financial resources, including your overall liquidity position and outlook?
- How do you expect COVID-19 to affect assets on your balance sheet and your ability to timely account for those assets?
- Do you anticipate any material impairments, increases in allowances for credit losses, or changes in accounting judgments?
- Have COVID-19-related circumstances adversely affected your ability to maintain operations, including controls and procedures?
- Have you experienced challenges in implementing your business continuity plans?
- Do you expect COVID-19 to materially affect the demand for your products or services?
- Do you anticipate a material adverse impact of COVID-19 on your supply chain or distribution methods?
- Will your operations be materially impacted by any constraints or other impacts on your human capital resources and productivity?
- Are travel restrictions and border closures expected to have a material impact on your ability to operate and achieve your business goals?

# Disclosure in Form 10-K

- Disclosure of the actual and potential impacts of COVID-19 may be appropriate or necessary based on the SEC's principles-based disclosure requirements in connection with a registrant's preparation of its Form 10-K. Areas to consider include:
  - Risk factors
  - Business
  - Legal proceedings
  - Management's discussion and analysis
  - Disclosure controls and procedures
  - Internal control over financial reporting
  - Financial statements

# Amendments to Regulation S-K Item 101

## Description of Business

- Expands principles-based approach
- Registrants, in filings made after their initial filing, may provide an update of the general development of the business rather than a full discussion
- New human capital resources disclosure topic
  - The company's human capital resources (*e.g.*, number of employees), and
  - Human capital measures or objectives that the company focuses on in managing its business.
- Government regulations – not just environmental anymore
- Other disclosure items – any topic regarding the company's business that is material to an understanding of the business; no quantitative thresholds.

# Description of business

- While issuers may now have more flexibility with respect to the presentation in the Business section, given the pandemic's effect on the issuer's business, its workforce, actual or potential changes in its business model or policies regarding work from home, changes in demand for its products or services, and similar matters, this year, it may make sense to present a more detailed (*rather than a summary*) discussion

# Human Capital Resources

- Consider whether human capital management disclosure related to COVID-19 is required by the new disclosure topic in Regulation S-K
- “Beyond the income statement and the balance sheet effects, we recognize that COVID-19 may significantly impact operations, including as a result of company efforts to protect worker health and well-being and customer safety. The impact of company actions and policies in this area may be of material interest to investors, and we encourage disclosures that address that interest.”

# Business Description

- In SEC filings requiring a business description, consider whether:
  - Company exited any business line
  - Company closed any facilities
  - Any difficulty sourcing inventory and considering alternative sources
  - Any segments affected more than others
  - Any lay offs or other human capital issues
  - Any acquisitions or organic growth initiatives put on hold

# Legal Proceedings

- In SEC filings requiring a description of legal proceedings determine whether COVID-19 gave rise to, consider whether there are:
  - Any class actions or other lawsuits alleging failure to protect customers or workers from the virus
  - Any lawsuits regarding triggering of force majeure contractual provisions
  - Any lawsuits involving employees
  - Any lawsuits regarding insurance coverage

# Controls and Financials

- Disclosure controls and procedures considerations
  - Making the potential impacts of COVID-19 an express part of their disclosure controls and procedures
  - Expanding list of business units contacted as part of the process
- Internal control over financial reporting considerations
  - Impact of remote workforce on internal controls
- Financial statements
  - Discuss with accountants whether COVID-19 disclosure is needed as part of their financial statement footnotes
  - Possible subsequent event footnote

# Amendments to Regulation S-K Item 105

- Summary required if the Risk Factors section exceeds 15 pages
  - 2 pages or less
  - In the “forepart” of the annual report or prospectus
- Standard changed from “most significant” to “material” risks
- Organize logically under relevant headings
  - Subcaption describing the risk still required
- Generic risk factors are discouraged and, if presented, must be placed at the end under the caption “General Risk Factors”

# Risk Factors

- At the beginning of the pandemic, many companies addressed their risk factor disclosures by including a generic pandemic-related risk. As time has passed, the expectation is that an issuer will update to provide specific, tailored risks.

## Sample SEC comment

We note your disclosure that the extent to which your operations may be impacted by the COVID-19 pandemic will depend largely on future developments, which are highly uncertain and cannot be accurately predicted, including new information that may emerge concerning the severity of the outbreak and actions by government authorities to contain the outbreak or treat its impact. Please amend your risk-factor disclosure to provide more detailed risks related to the COVID-19 pandemic, tailored to your specific facts and circumstances. For guidance, see CF Disclosure Guidance: Topic No. 9 (25 March 2020)

- Review existing risk factors, and consider whether these should be revised to address events that already have come to pass, and to address new risks that have been identified as the pandemic has become more prolonged and its effects more wide-reaching
- Consider the impact of COVID-19 as it relates to all risks

# Potential Risk Factors

- Failure of third parties such as suppliers, manufacturers, distributors, contractors, banks or business partners, to meet their obligations
- Demand/pricing may be affected by:
  - Customers' inability to purchase products due to illness, quarantine, travel restrictions or financial hardship
  - Global recession resulting from actions taken to limit the spread of COVID-19
- Disruption/volatility in global capital markets from COVID-19 may have increased the cost, and adversely impacted access to, capital
- Cost increases may not be fully recoverable or adequately covered by insurance
- Need to modify business practices (*e.g.*, employee travel, work locations, and cancellation of physical participation in events)

# Potential Risk Factors *(cont'd)*

- Consumer spending affected in many different ways (*e.g.*, deferral of purchases, price points, and upgrading/replacement frequency)
- IT systems could be adversely affected by significant increase in remote working
- Impact of cancellation or postponement of sporting and entertainment events or reduced in-store visits
- Industry-specific risk factors
  - Banking and financial services companies may be dependent on the willingness and ability of customers to conduct financial transactions
  - Insurance companies may face increase of claims and potential coverage disputes
  - Results, financial position and liquidity of goods and service companies or travel companies may be adversely affected by temporary closures of facilities or suspensions or cancellations of services
  - Pharmaceutical companies may face disruptions in clinical trials

# Forward-looking disclosure

- Chairman Clayton and Director Hinman's joint statement urged companies to provide as much information as is practicable regarding their current financial and operational status, as well as their future operational and financial planning
- "We...recognize that companies often are cautioned to limit their forward-looking disclosures, and particularly specific estimates, to those required by our rules to limit legal risk in the event the forward-looking estimates prove to be incorrect. In this regard, we encourage companies to avail themselves of the safe-harbors for forward-looking statements." See Section 27A of the Securities Act and Section 21E of the Exchange Act
- Historical information may be relatively less significant
- Would not expect good faith attempts to provide appropriately framed forward-looking statements to be second-guessed by the SEC

# MD&A

- SEC Staff guidance has been particularly detailed regarding expectations for disclosure in the MD&A section that is specific to the issuer, the effects of the pandemic on the issuer's actual results of operations, the effects on liquidity (*including modifications to its debt obligations, recent financing transactions, access to credit lines, going concern issues*), and the need to provide investors with insight regarding trends and expectations for future performance

# MD&A

- Information “necessary to an understanding of its financial condition, changes in financial condition and results of operations”
- COVID-19 as a known trend or uncertainty with management’s perspective on the type and extent of its material impacts
- Possible specific areas of disclosure:
  - Supply chain or distribution issues
  - Liquidity and borrowings on bank facilities
  - Impact of location closures
  - Force majeure provisions that are or may be triggered
  - Disputes with insurance carrier over business continuity coverage

# SEC Comment Letters – COVID-19 Disclosures

## 2020 to Present

- Comments focus on how companies are disclosing the effects and risks of COVID-19 on their business, financial condition and operations. To the extent material:
  - Provide detailed, quantifiable discussion of COVID-19 impact on results, operations and liquidity
  - Enhance risk factor disclosures
  - Identify and discuss trends and uncertainties in MD&A
  - Follow CorpFin Guidance Topic Nos. 9 and 9A

# SEC Comment Letters – COVID-19 Disclosures

- Sample Comments:

- We note your general disclosures of the social and economic impacts from COVID-19. Please tell us what consideration you gave to providing **expanded information re specific impacts you have experienced to your operations and relevant metrics** resulting from the COVID-19 pandemic. Refer to CF Disclosure Guidance: Topic No. 9 and 9A.
- **Quantify the effects** of COVID-19 in the first and second quarters of 2020 on your results of operations.
- Please **address more specifically how COVID-19 has impacted your services**, explaining the extent to which you have reopened your business and demand has returned for your business following the lockdown earlier this year.
- Please include the **specific known material impacts** of the pandemic on your **revenue, expenses, and net income**.
- Please revise to clarify further the impact of COVID-19 on your **operations and liquidity**. For example, it is unclear how sensitive your sources of liquidity are to coronavirus-related tenant defaults, whether disruptions from shutdowns have materially impacted your ability to operate and achieve your business goals, and whether COVID-19 has materially impacted your **funding sources, access to capital or ability to maintain financial covenants**.

- Please provide **separate and detailed risk factor disclosure** related to the impact of COVID-19 on your financial condition and operations.
- Please amend your **risk factor disclosure** to provide more detailed risks related to the COVID-19 pandemic, and your Management's Discussion and Analysis to provide information about your financial condition as a result of COVID-19, tailored to your specific facts and circumstances. See CF Disclosure Guidance Topic No. 9

# SEC Comment Letters – COVID-19 Disclosures

- Sample Comments:

- Given the amount of time that passed since the initial outbreak, please update your disclosure to discuss any **known trends and uncertainties** that have had or likely will have a material impact on your business and results of operations.
- Revise to disclose known trends and uncertainties related to COVID-19. Disclose how you expect COVID-19 to impact future operating results and **near-and-long- term financial condition and how that compares to current period**.
- Include disclosure in the MD&A to **describe and quantify any known trends and uncertainties** that have had, or you reasonably expect will have, a material impact on your business, revenue or results of operations due to COVID.
- Your disclose that due to COVID-19, there is a significant uncertainty surrounding the potential impact on your results of operations and cash flows. Ensure that your MD&A disclosure **addresses known trends in recognized revenue and whether you expect the trends to continue in periods subsequent to the recent reporting period**. That is, describe the underlying factors that are impacting trends in your revenue recognized including customer behavior and your ability to maintain the sales cycle. To the extent such trends remain uncertain, consider including key performance indicators to provide data on the impact on your near-term and long-term revenues, earnings, liquidity and cash flows.
- Please describe how COVID-19 is reasonably expected to **affect your financial condition, key performance metrics and results of operations**.

# Impact on the Proxy Statement

- Letters to shareholders
  - An opportunity (*but not a requirement*) for company management to address, among other things:
    - The effects of COVID-19 on the company, its business, its workforce
    - The company's responses to COVID-19 in areas such as workforce management, safety, business adjustments, business continuity
  - Check for consistency of tone and message with the proxy statement and other disclosures
  - Present an accurate, balanced view

# Impact on the Proxy Statement *(cont'd)*

- Compensation disclosures
  - Changes to named executive officer (NEO) compensation
    - Has the NEO agreed to forgo salary, bonus or perquisites?
    - Have any of these amounts been adjusted? Or has compensation been paid in stock?
    - Has the company repriced options?
    - Has the company changed the metrics used to evaluate performance, eligibility for bonuses, or other aspects of compensation?
  - Revising the CD&A section this year may require close consideration of historical and expected financial performance

# Impact on the Proxy Statement *(cont'd)*

- Compensation disclosures *(cont'd)*
  - The SEC published new C&DI 219.05
    - Must continue to apply SEC's long-standing perquisite test
    - Enhanced technology needed to make the NEO's home his or her primary workplace due to local stay-at-home orders is **not** a perquisite because it is integrally and directly related to the performance of the executive's duties under perquisite test
    - But, new COVID-19-related health and transportation benefits **may be** perquisites unless they are generally available to all employees
    - There may not be the same outcome from a tax perspective

# Impact on the Proxy Statement *(cont'd)*

- Corporate governance disclosures
  - Board oversight of risk during the pandemic:
    - How has the board discharged its oversight role?
    - Additional meetings
    - Consideration of reductions in force, closures or similar measures
    - Consideration of workplace safety and human capital measures
    - Has the board or has the audit committee undertaken additional measures with respect to cybersecurity oversight?
  - Succession planning

# Impact on the Proxy Statement *(cont'd)*

- Corporate governance disclosures *(cont'd)*
  - Audit committee/Audit committee reports
    - Consider the statements made by the former SEC Chief Accountant, as well as the PCAOB's conversations with audit committee chairs
    - How has the audit committee responded to:
      - Complexities of company staff and audit teams working from home?
      - Changes to audit procedures or to the company's accounting policies?
      - Challenges relating to the company's control environment?
    - Has the committee vetted non-GAAP COVID-19 adjustments? Impairments? Changes to estimates or to policies requiring judgment?

# Impact on the Proxy Statement *(cont'd)*

- CEO Pay Ratio
  - Generally required to identify the median employee only once every three years
    - 2020 disclosure (based on 2019 compensation) was the third year of pay ratio disclosure
    - If the median employee has been re-used since the 2018 disclosure, must be re-identified for the 2021 disclosure
  - Where median employee is no longer employed, may substitute another employee
    - Must have substantially similar compensation as the previous median employee, using the same consistently applied compensation measure as was previously used

# Impact on the Proxy Statement *(cont'd)*

- CEO Pay Ratio *(cont'd)*
  - The company must re-identify the median employee for a fiscal year where the company reasonably believes there would be a significant change to its pay ratio disclosure because of a change in the company's:
    - Employee population or
    - Employee compensation arrangements
  - Do any COVID-19-related changes require re-identifying the median employee?

# Enforcement

- Statement of Former Co-Directors of Enforcement (Mar. 23, 2020)
  - “We wish to emphasize the importance of maintaining market integrity and following corporate controls and procedures.”
  - “[T]he Enforcement Division is committing substantial resources to ensuring that our Main Street investors are not victims of fraud or illegal practices in these unprecedented market and economic conditions.”
  - “The Enforcement Division is committed to protecting investors and maintaining confidence in the fairness and integrity of our markets.”

# Lessons from SEC Enforcement Actions

- Cheesecake Factory (Dec. 4, 2020) – First enforcement action for misleading investors about the financial effects of the pandemic
  - Statements the company was “operating sustainably” when it was losing \$6M per week and had only 16 weeks of cash remaining and had informed its landlords that it would not pay any rent in April, due to impacts of the pandemic
  - Shared its financial distress with potential private equity investors but gave the opposite message to the market
  - SEC: When public companies describe the impact of COVID-19, they must be accurate. Disclosure should be tailored to the firm and industry-specific effects of the pandemic on the business and operations. Issuers who make materially false or misleading statements will be held accountable
    - Echoes the March 23, 2020 Statement from the former Co-Directors of the Division of Enforcement

# Lessons from SEC Enforcement Actions *(cont'd)*

- Decision Diagnostics Corp. (Dec. 18, 2020) – Enforcement action against the company and the CEO following a temporary trading suspension in April 2020
  - Making false and misleading claims in press releases regarding the development of a working, break-through COVID-19 rapid blood test when, at the time, they had no physical testing device and their technology was unproven
  - SEC: This is an unprecedented time when the need for truthful disclosures concerning COVID-19 tests is very important. The Commission is identifying potential areas of fraud during the pandemic to hold accountable those who exploit the pandemic to harm investors

# Earnings Releases and Earnings Calls

- To the extent that it is, or is expected to be material, companies should address the impact of COVID-19 in upcoming earnings releases and be prepared to answer related questions on their earnings calls
- It may be difficult for companies to assess or predict with precision the broad effects of COVID-19 and its actual impact will depend on many factors beyond a company's control and knowledge, which will make it more challenging to be comfortable with the disclosures being made
- Three takeaways from CF#9
  1. Companies presenting a non-GAAP financial measure adjusted for or explaining the impact of COVID-19 should highlight why management finds it useful and how it helps investors assess the impact of COVID-19 on the company's financial position and results of operations
  2. Companies will be permitted to reconcile provisional amounts based on a reasonable estimate, or a range of reasonably estimable GAAP results provided an appropriate explanation is provided
  3. Companies should use non-GAAP financial measures for the purpose of sharing how management and the Board of Directors are analyzing the current and potential impact of COVID-19 and not for the purpose of presenting a more favorable view of the company.

# What is a Non-GAAP Financial Measure?

- A numerical measure of historical or future performance, financial position, or cash flows that either:
  - Excludes (or adjusts) amounts included in the most comparable GAAP measure; or
  - Includes (or adjusts) amounts excluded from the most comparable GAAP measure
- Operating and other financial measures and ratios or statistical measures are **not** non-GAAP financial measures if exclusively calculated from:
  - Financial measures calculated in accordance with GAAP; and/or
  - Operating or other measures that are not non-GAAP financial measures

# Item 10(e) of Regulation S-K

- Applies only to non-GAAP financial measures in SEC-filed documents
- Affirmative requirements:
  - Most directly comparable GAAP measure must receive equal or greater prominence
  - Must provide a quantitative reconciliation to GAAP – If prospective, required unless unreasonable effort
    - If non-GAAP financial measure is derived from or based on a measure calculated in accordance with U.S. GAAP, the reconciliation must be to U.S. GAAP
    - If reconciliation to prospective amounts would require unreasonable effort, disclose that fact and identify the information that is unavailable and its probable significance

# Item 10(e) of Regulation S-K *(cont'd)*

- Disclose how management uses the measure and why management believes the measure provides useful information to investors
- Negative requirements
  - Cannot exclude a cash charge from a liquidity measure – except EBIT and EBITDA
  - Cannot exclude items identified as nonrecurring, infrequent, or unusual if likely to recur – two-year window (forward and backward)
  - Cannot include on the face of or in footnotes to financial statements
  - Cannot include on the face of *pro formas* required by Article 11 of Regulation S-X
  - Cannot have a title that is the same as or similar to GAAP measures

# Regulation G

- Regulation G generally applies to all public disclosures that contain non-GAAP financial measures, including press releases, investor presentations, and conference calls, whether such disclosure is made in print, orally, telephonically, by webcast, or by broadcast
- In connection with the disclosure of a non-GAAP financial measure, Regulation G requires the presentation of:
  - The most directly comparable financial measure calculated and presented in accordance with GAAP; and
  - A reconciliation of the non-GAAP financial measure to the most directly comparable GAAP measure
- For public disclosure made orally, telephonically, or by webcast, broadcast, or similar means, an issuer may post the reconciliation simultaneously to its website and announce the location to investors of the presentation that includes the non-GAAP financial measure

# COVID-19 Non-GAAP Financial Measures

- Issuers may want to present financial results while giving effect to the consequences of the COVID-19 pandemic
- SEC has addressed in Disclosure Guidance: Topic No. 9
  - Provides reminders and guidance related to the presentation of non-GAAP financial measures and reconciliation
  - Companies should use non-GAAP financial measures for the purpose of sharing how management and the Board of Directors are analyzing the current and potential impact of COVID-19 and not for the purpose of presenting a more favorable view of the company

# COVID-19 Non-GAAP Financial Measures *(cont'd)*

- In an earnings release, companies may reconcile provisional amounts based on a reasonable estimate, or a range of reasonably estimable GAAP results provided an appropriate explanation is provided
- “[I]n filings where GAAP financial statements are required, such as filings on Form 10-K or 10-Q, companies should reconcile to GAAP results and not include provisional amounts or a range of estimated results”
- Disclosure Guidance: Topic No. 9A addressed operations, liquidity, and capital resources disclosures companies should consider with respect to business and market disruptions related to COVID-19

# Non-GAAP COVID adjustments

- Originally, may have been presented as a one-time adjustment:
  - PPE, cleaning supplies, dividers, retrofitting
  - Lease termination costs
  - Supply chain disruptions
  - Workforce issues such as severance or bonuses for working onsite
- As the pandemic lasts, consider if treating COVID-19 adjustments as temporary may imply that ongoing costs are lower

# Examples of COVID-19 Non-GAAP Measures

- Adjustments should be directly related to the effects of the pandemic
  - Employee compensation and benefits arising from the COVID-19 pandemic
  - Cost containment related to workforce optimization due to reduced demand
  - Sanitizing and disinfecting costs
  - Personal protective equipment costs
  - COVID-19-related restructuring costs

# SEC Comment Letters – COVID-19 Non-GAAP Measures and Adjustments

## 2020 to Present

- Not a lot of CorpFin comments on COVID-19 Non-GAAP measures and adjustments
- Some registrants were asked to explain nature of COVID-19 related adjustments
- *Sample SEC Comments:*

- Please explain in further detail the nature of the expenses associated with COVID-19 that have been excluded from Normalized Funds from Operations.
- Please clarify the nature of the adjustment titled “COVID-19 shelter in place restrictions on manufacturing activities.” In your response, tell us how you reasonably quantified this adjustment, the length of time within the quarter that applied to its calculation, and the related amount applicable to the quarter ended June 30, 2020. We may have further comment upon reviewing your response.

# SEC Comment Letters – COVID-19 Non-GAAP Adjustments

**Case 1:** REIT operating correctional and detention facilities, prisons.

- Q3 2020 10-Q: presented Normalized Funds from Operations, and reconciliation of net income to Normalized FFO for 9 months ended September 30, 2020 and 2019

	For the Nine Months Ended	
	September 30,	
	2020	2019
<b>FUNDS FROM OPERATIONS:</b>		
Net income	\$ 82,141	\$ 146,912
Depreciation and amortization of real estate assets	84,599	80,366
Impairment of real estate assets	10,155	4,428
Gain on sale of real estate assets, net of taxes	(4,388)	(287)
Funds From Operations	172,507	231,419
Expenses associated with mergers and acquisitions	338	957
Contingent consideration for acquisition of businesses	620	-
Expenses associated with COVID-19	10,985	-
Expenses associated with changes in corporate tax structure	5,045	-
Deferred tax expense on Kansas lease structure	3,085	-
Start-up expenses	-	9,480
Goodwill and other impairments	2,903	278
Normalized Funds From Operations	\$ 195,483	\$ 242,134

# SEC Comment Letters – COVID-19 Non-GAAP Adjustments *(cont'd)*

- **CorpFin Comment:** *Please explain in further detail the nature of the expenses associated with COVID-19 that have been excluded from Normalized Funds from Operations.*
- **Response:**
  - Based on interpretations of previous guidance from SEC, we concluded it was appropriate to exclude only items that were directly attributable to COVID-19 and were both: (A) Incremental to charges incurred prior to COVID-19 and not expected to recur once the pandemic has subsided and operations return to normal; and (B) Clearly separable from normal operations.
  - Taking available guidance into account, we determined that an adjustment to Normalized FFO to exclude certain direct and incremental costs associated with the Company's response in dealing with COVID-19 was appropriate during 2020. During 9 months ended Sep. 30, 2020 we excluded \$11.0 million from Normalized FFO. The following table illustrates nature of the costs included in this adjustment:

Frontline Workers - Hazard Pay	\$ 6,303,344
PPE Supplies (Masks, Face Shields, Gowns, Gloves, Thermometers)	2,867,011
Food Service Charges - Disposable Paper Products	652,647
COVID-19 treatment (Off-site Medical Care)	607,144
COVID-19 Testing	378,315
All Other	176,098
	<hr/>
	<b>\$ 10,984,559</b>

# SEC Comment Letters – COVID-19 Non-GAAP Adjustments *(cont'd)*

- In April 2020, we announced we would provide **incentive payments to our line and field staff, known as “hero bonuses”**, through Q2 2020, in appreciation of their service and dedication to Company’s mission during COVID-19. This **additional hazard pay** was provided to all staff in our facilities in the form of an additional \$500 incentive payment resulting in \$6.3 million of incremental bonuses paid in Q2 2020. While we provided additional benefits, such as an additional day of paid time off, and an expanded paid leave policy for ill team members or those caring for a sick family member, these additional costs were *not* included in the adjustment to Normalized FFO, consistent with interpretive guidance available.
- We also incurred incremental expenses to **procure personal protective equipment** and other supplies such as masks, face shields, gloves, gowns, thermometers, and test kits, all of which we used to protect staff. The increased costs related to food service delivery resulted from **incremental charges from our third-party food service provider to provide disposable food service products such as trays, styrofoam cups, and utensils**, which were used to facilitate delivery of food in a socially distanced manner, allowing our facilities to avoid congregated cafeteria-style food service delivery.
- Costs related to COVID-19 treatment represent incremental costs incurred by us when an offender or resident in required medical services from third-party medical providers outside the facility we manage. **Medical costs** included represent only those charges where individual’s treatment plan was **specifically COVID-19 related** and the medical provider billed us with a unique COVID-19 diagnosis code and without a comorbidity.

# SEC Comment Letters – COVID-19 Non-GAAP Adjustments *(cont'd)*

## Case 2: Computer chip/semiconductor manufacturer

- 8-K earnings press release: Company included adjustment for “COVID-19 shelter in place restrictions on manufacturing activities” to arrive at non-GAAP operating income

### RECONCILIATION OF GAAP OPERATING INCOME TO NON-GAAP OPERATING INCOME

	Three Months Ended	
	March 31,	
	2020	2019
Operating income, as reported	\$ 160.7	\$ 284.6
Share-based compensation expense	40.7	39.1
COVID-19 shelter-in-place restrictions on manufacturing activities	3.3	—
Acquisition-related costs	10.9	5.0
Professional services associated with certain legal matters	3.3	—
IT security remediation	1.1	—
Excess capacity charges to normalize acquired inventory levels	—	—
Acquired inventory valuation costs	—	1.8
Amortization of acquired intangible assets	248.5	176.9
Special charges (income) and other, net	17.2	(23.3)
Non-GAAP operating income	\$ 485.7	\$ 484.1

# SEC Comment Letters – COVID-19 Non-GAAP Adjustments *(cont'd)*

- **CorpFin Comment:** *Please clarify nature of adjustment titled “COVID-19 shelter in place restrictions on manufacturing activities.” In your response, tell us how you reasonably quantified this adjustment, length of time within quarter that applied to its calculation, and related amount applicable to the quarter ended June 30, 2020.*
- **Response:** Substantially all **our manufacturing activities were impacted by shelter in place restrictions** that prevented our sites from operating at normal levels. We calculated the equivalent number of days of lost production at each site and **quantified the costs associated with such impact (primarily compensation for idled employees, depreciation, utilities, and other fixed overheads)**. In total, adjustment for COVID-19 shelter in place restrictions during the quarter ended March 31, 2020 of \$3.3 million, represented lost production at 7 sites with an average of 5 days of lost production. **Amount of non-GAAP adjustment was quantified by accumulated fixed overhead costs for the period factored by the percentage of lost production days.** For quarter ended June 30, same calculation was performed and resulted in adjustment of \$2.8 million, representing lost production at 10 sites with an average of 4 days of lost production.

We had not closed our manufacturing operations or had production adversely impacted previously as a result of local government restrictions on employee movements and **do not expect to incur such costs again** during next two years after COVID-19 pandemic has passed. Adjustment included amounts that could be **objectively quantified** and **excludes other operational** costs (*e.g.*, increased transportation and warehousing costs, increased cleaning costs, lower production levels and inventory markdowns) **that could not be clearly separated** from business conditions, changes in demand or Company actions.

# Updating Disclosure and Guidance

- The SEC's reporting system is generally a periodic system of reporting, as opposed to a continuous system of reporting
  - Form 10-K
  - Form 10-Q
  - Form 8-K
- Other than specifically required disclosures, companies must ensure that the disclosures they make are not materially misleading or omit any material information

# Updating Disclosure and Guidance

## When might a COVID-19 impact trigger a Form 8-K filing?

- **Item 1.02** – Termination of a material definitive agreement
- **Item 1.03** – Bankruptcy or receivership
- **Item 2.02** – Results of operations and financial condition
- **Item 2.03** – Creation of a direct financial obligation
- **Item 2.04** – Triggering events that accelerate or increase a direct financial obligation or an obligation under an off-balance sheet arrangement
- **Item 2.05** – Costs associated with exit or disposal activities
- **Item 2.06** – Material impairments
- **Item 3.01** – Notice of delisting or failure to satisfy a continued listing rule or standard
- **Item 3.02** – Unregistered sales of equity securities
- **Item 5.03** – Amendments to articles of incorporation or bylaws
- **Item 7.01** – Regulation FD disclosure
- **Item 8.01** – Other events

# Updating Disclosure and Guidance *(cont'd)*

- Except for required disclosures, the federal securities laws do not mandate a specific duty to update prior statements, including guidance.
- There could be a duty to correct or update previously disclosed information under the anti-fraud provisions, in certain circumstances, such as when a company or its insiders are trading in the company's securities or when a company realizes that there is a material error in information that it has previously disclosed.
- Some courts have recognized a duty to update in particular circumstances.
- Consider updating previously issued guidance, or advising investors to no longer rely on that guidance, to the extent the assumptions underlying that guidance has materially changed.
- This should be considered even if a company would not normally update guidance quarterly.
- Another takeaway from CF#9 is that the Division of Corporation Finance reminded issuers to consider whether they "need to revisit, refresh or update previous disclosure to the extent that the information becomes materially inaccurate."

# Updating Disclosure and Guidance *(cont'd)*

- Don't forget about the applicable rules of any securities exchange, on which a company lists its securities as they generally require prompt disclosure of information that is material to investors
- Remember that both shareholders and the SEC will be closely monitoring the disclosures that companies are making this reporting period
- **Three last takeaways:**
  1. Begin drafting sooner rather than later
  2. Consider circulating proposed disclosures to a wider group than normal
  3. Keep reviewing disclosures right up to the time it is filed

# Regulation FD – Overview

- SEC considers “selective disclosure” by public companies to be a form of insider trading
  - Private investor conference where the company announces good news
    - The “little guy” is not invited and misses the opportunity to buy the stock before the price goes up
  - Guiding analysts privately prior to the company announcing bad news (for example, earnings miss)
    - Analysts tell their clients to sell the stock ahead of the “crash”
- Regulation FD (fair disclosure) was designed to “level the playing field” and protect market integrity/investor confidence
- General rule regarding selective disclosure
  - If a public company, or person acting on its behalf, discloses material, nonpublic information to certain types of recipients, then the company must publicly disclose the information:
    - Simultaneously, if disclosure was *intentional*, or
    - Promptly, if disclosure was *not intentional*

# Regulation FD – Overview *(cont'd)*

- Method of disclosure must be reasonably designed to provide broad, non-exclusionary distribution of information to the public
  - Press releases issued through a widely circulated news or wire service
  - Filings made with the SEC
  - Press conferences or telephonic conferences that members of the public may access (with adequate notice to the public)
  - Other methods that are reasonably designed to provide broad, non-exclusionary distribution of the information to the public
  - Website or social media posts?
  - Consider stock exchange requirements

# Regulation FD – SEC Guidance

- **CF Disclosure Guidance: Topic No. 9 (March 25, 2020)**

“When companies disclose material information related to the impacts of COVID-19, they are reminded to take the necessary steps to avoid selective disclosures by disseminating such information broadly to the public.”

- **Division of Enforcement Market Integrity Statement (March 23, 2020)**

Urging public companies to be aware of Regulation FD and selective disclosure prohibitions “to ensure to the greatest extent possible that they protect against the improper dissemination and use of material nonpublic information.”

# Regulation FD – Practical Considerations

- Coordinate responses to COVID-19 inquiries
  - Keep your FD “traffic cop,” investor relations team and counsel informed
  - Be especially careful when speaking privately with analysts or investors
  - Disclosure controls and procedures/disclosure committee
- Disclose material, non-public information in a Regulation FD-compliant method
  - Follow your Regulation FD policy
  - Website or social media posts?
  - Remind employees of communications and social media policies
- Real life examples
  - Impact on operations and financial conditions
  - COVID-19 illness of an executive officer or director
  - Outbreak at principal manufacturing or operating sites

# Insider Trading – Overview

- Based on Section 10(b) of the Exchange Act and Rule 10b-5

It is unlawful for any person, directly or indirectly, to engage in any course of business which operates as a fraud or deceit upon any person, in connection with the purchase or sale of a security. *SEC v. Texas Gulf Sulphur Co.*

- Trading a security on the basis of MNPI in breach of a duty

# Insider Trading – Overview

- Theories of insider trading
  - Classic – Breach of duty to shareholders based on MNPI
  - Misappropriation (outsider trading) – Breach of duty to source of MNPI
  - Tipping – Tippee knows/should know tipper breached duty for benefit
- Liability
  - Private Litigation
  - SEC Enforcement – Industry bar, financial penalties, disgorgement
  - Criminal Enforcement – Criminal fines, imprisonment

# Insider Trading – SEC Guidance

- **CF Disclosure Guidance: Topic No. 9 (March 25, 2020)**

“[W]here COVID-19 has affected a company in a way that would be material to investors or where a company has become aware of a risk related to COVID-19 that would be material to investors, the company, its directors and officers, and other corporate insiders who are aware of these matters should refrain from trading in the company’s securities until such information is disclosed to the public.”

- **Division of Enforcement Market Integrity Statement (March 23, 2020)**

“[I]n these dynamic circumstances, corporate insiders are regularly learning new material nonpublic information that may hold an even greater value than under normal circumstances.

This may particularly be the case if earnings reports or required SEC disclosure filings are delayed due to COVID-19.

Given these unique circumstances, ***a greater number of people may have access to material nonpublic information*** than in less challenging times.

Those with such access – including, for example, directors, officers, employees, and consultants and other outside professionals – should be mindful of their obligations to keep this information confidential and to comply with the prohibitions on illegal securities trading.” *[emphasis added]*

# Insider Trading – Practical Considerations

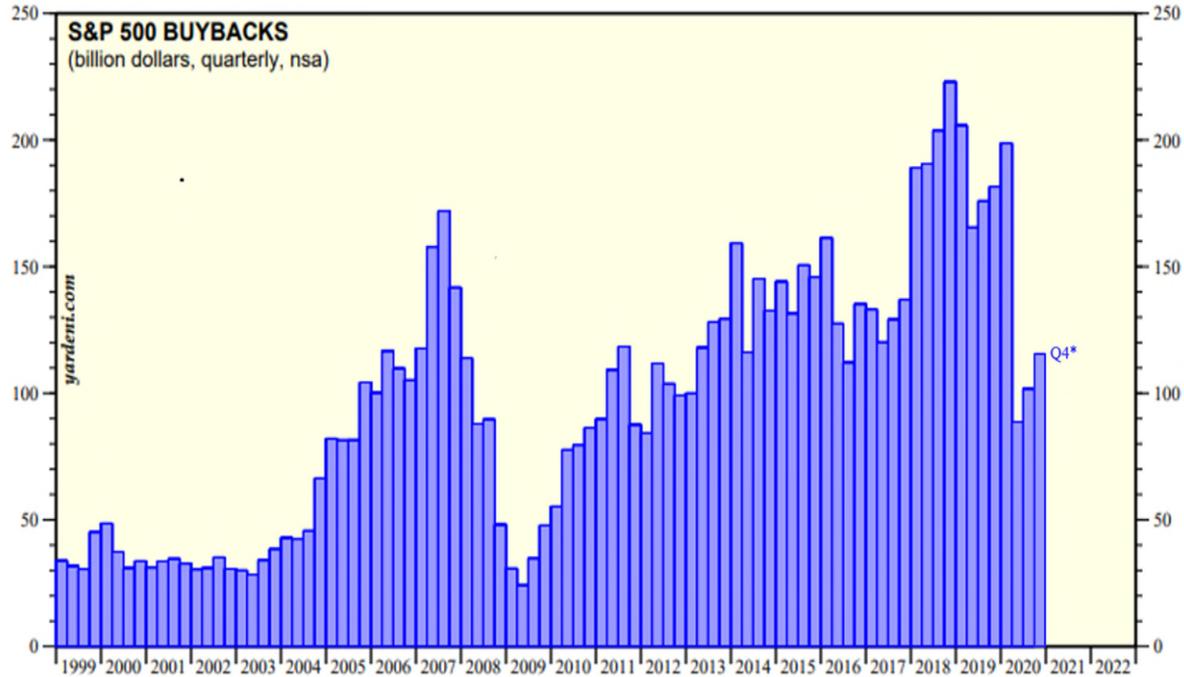
- Do not lose sight of typical safeguards during turbulent times
- Consider reminders and/or additional training for employees
  - Emails, internal website posts with clear guidance
  - Virtual training/affirmations
- Additional safeguards
  - Longer or supplementary black-out periods
  - Heightened pre-clearance requirements
  - Expanding black-outs to a broader range of individuals

# Stock Repurchases – Overview

- Company stock repurchase structures
  - Open market
  - Prepaid/accelerated share repurchase
  - Tender offers
- Rule 10b-18 safe harbor
  - Manner, timing, price and volume conditions
  - *Restricted by company having material non-public information* or reliance on 10b5-1 plan
- Following internal controls important for share repurchases

# Stock Repurchases – Practical Considerations

- Heightened risks – MNPI, investor relations, contractual restrictions
- Many companies suspended repurchase plans
- COVID-19 impacted buybacks
  - Buybacks by S&P 500 companies plunged 44% to \$102 billion in the first 9 months of 2020, according to data from S&P Global
  - Sharpest drop in second quarter of 2020
  - Full-year 2020 S&P 500 buybacks down from the prior year
- Buybacks may be making a comeback, but not yet at pre-pandemic levels



Source: Standard & Poor's.

\*Original Chart Source: Yardeni Research: Q4 2020 data from Reuters and S&P

# Stock Repurchases – Practical Considerations

- General trend of criticism regarding stock repurchases
- Coronavirus Aid, Relief, and Economic Securities Act (CARES Act) restrictions on stock repurchases
- Airlines getting aid must refrain from purchasing a listed equity security of the air carrier or the parent company through September 30, 2022
- ISS indicated that it could consider a board's actions related to repurchases during the pandemic to assess whether the directors managed risks in a responsible fashion

# SEC Guidance<sup>1</sup> - Conducting Annual Meetings in Light of COVID-19 Concerns

- Addresses compliance with federal proxy rules only
- Does not address procedural, notice or other requirements under:
  - State law
  - Governing documents
  - Exchange listing standards
- If a company has already mailed and filed definitive proxy materials, it can notify shareholders of a change in date, time, or location without additional mailing or proxy amendment if it:
  1. Issues a press release
  2. Files the announcement as definitive additional soliciting material
  3. Takes all reasonable steps to inform others (proxy service providers, national securities exchange)
- Take these actions “promptly” after a decision is made and sufficiently in advance of the meeting to alert the market in a timely manner

<sup>1</sup> Available at: <https://www.sec.gov/ocr/staff-guidance-conducting-annual-meetings-light-covid-19-concerns>.

# SEC Guidance - Conducting Annual Meetings in Light of COVID-19 Concerns

- If a company has not already mailed and filed definitive proxy materials, consider disclosure of the *possibility of* a change in date, time or location due to COVID-19
- Make this determination based on facts and circumstances, and reasonable likelihood of such a change
- Virtual meetings
  - Must be permitted by state law and company’s governing documents
  - Need “robust disclosures” to facilitate informed shareholder voting
  - Notify shareholders and others in a timely manner with clear directions on how to remotely access, participate in, and vote at the virtual meeting
- Presentation of shareholder proposals
  - Normally, proponent must *appear* to present its proposal (Rule 14a-8(h))
  - Staff encourages allowing proponents to present via alternative means
  - Staff will consider failure to appear due to COVID-19 a failure with “good cause”

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# Glass Lewis Update – Virtual Meetings

For 2021, Glass Lewis expects companies holding virtual meetings to transparently address the following points:

- Opportunity to ask questions, including a timeline for submitting questions, types of appropriate questions, and rules for how questions and comments will be recognized and disclosed to shareholders
- If there are restrictions on the ability of shareholders to ask questions during the meeting, the manner in which appropriate questions received prior to or during the meeting will be addressed by the board
- The procedure and requirements to participate in the meeting and/or access the meeting platform
- Technical support that is available to shareholders prior to and during the meeting

# Shareholder Meeting Logistics – Meeting Structure

- Three possibilities:
  1. In-person only with webcast/telecast
  2. Virtual only
  3. Hybrid
- Ability to vote and participate
- State law considerations
- COVID-19 local order considerations

# Shareholder Meeting Logistics – The Switch to Virtual or Hybrid

- Proxy statement disclosure
  - How to access remotely, participate/ask questions, vote
- Will the company's shareholder list be available for examination electronically?
- Engage your service provider – Can you retain your date and time?
- Alert meeting participants (board, management, auditor, inspector)
- Meeting script – Prepare in advance

# SEC Order – Conditional Exemptions from Reporting and Proxy Delivery Requirements

**In March 2020, the SEC provided relief from furnishing proxy or information statements - 2 Conditions:**

1. The company's security holder has a mailing address in an area where, as a result of COVID-19, the common carrier has suspended delivery service of the type or class customarily used by the company or person soliciting
2. Company or person soliciting made a good faith effort to furnish soliciting materials or information materials to the security holder, as required by the rules applicable to the particular method of delivering soliciting materials

The relief remains available to companies needing to send proxy materials to *international* addresses if the common carrier has suspended delivery service as a result of COVID-19

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