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SEC Action on Misleading COVID-19 Disclosures: Implications for the Municipal Market - Ballard Spahr

Summary

The U.S. Securities and Exchange Commission (SEC) announced earlier this month it settled charges against a corporate issuer of registered securities for misleading disclosures about the impact of the COVID-19 pandemic on its business operations and financial condition in connection with its required Form 8-K filings.

The Upshot

- The SEC alleged the company's Forms 8-K were materially false and misleading because in the context of a press release attached to a Form 8-K filing that said its restaurants were "operating sustainably," the company failed to disclose financial hardships.
- While municipal issuers are not subject to required Form 8-K filings, the SEC has strongly urged the municipal market to provide voluntary disclosures to Electronic Municipal Market Access (EMMA) in the light of COVID-19.
- The settlement is the SEC's first enforcement action against a public company for misleading COVID-19 disclosures.

The Bottom Line

The Order—as well as other prior SEC actions—signifies the SEC may not hesitate to scrutinize issuers' pandemic-related disclosures, which could have implications for municipal issuers.

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FULL ALERT

The U.S. Securities and Exchange Commission (SEC) announced earlier this month it settled charges against a corporate issuer of registered securities for misleading disclosures about the impact of the COVID-19 pandemic on its business operations and financial condition in connection with its required Form 8-K filings (the Order).

The Order, as well as other prior SEC actions, signifies the SEC may not hesitate to scrutinize issuers' pandemic-related disclosures, which could have implications for municipal issuers.

In the Order, the SEC alleged that the company violated Section 13(a) of the Exchange Act and Rules 13a-11 and 12b-20 thereunder, which collectively require an issuer of a registered security to file accurate reports to the Commission on Form 8-K that contain material information necessary to make the required statements made in the reports not misleading.

The SEC alleged that in March 2020 the company's Forms 8-K were materially false and misleading because in the context of a press release attached to a Form 8-K filing that said its restaurants were

"operating sustainably," the company failed to disclose the following:

- A letter the company sent to each of its restaurant landlords stating that the company was not going to pay rent for April 2020.
- The company was losing approximately $6 million in cash per week.
- It had only approximately 16 weeks of cash remaining.

In a press release accompanying the Order, the SEC included a reminder about the Corporate Issuer Statement of April 8, 2020, on the importance of disclosure. See our 2020 Mid-Year Newsletter for a recap of SEC statements and disclosure guidance related to COVID-19 for municipal issuers and market participants.

While municipal issuers are not subject to required Form 8-K filings, the SEC has strongly urged the municipal market to provide voluntary disclosures to Electronic Municipal Market Access (EMMA) in light of COVID-19.

SEC Chairman Clayton and Rebecca Olsen, Director of the Office of Municipal Securities, issued a public statement (Public Statement) on May 4, 2020, encouraging municipal issuers and conduit borrowers to voluntarily disclose future prospects regarding financial and operating status in light of the effects of, and economic and operational uncertainties created by, COVID-19. The Public Statement set forth examples of types of COVID-19 related disclosures Clayton and Olsen believe would be most beneficial for investors and the marketplace.

As an acknowledgement of the potential exposure municipal issuers and conduit borrowers face in making statements to the financial markets, Clayton and Olsen said in the Public Statement that they would not expect good faith efforts to provide "appropriately framed" current and forward looking information would be second guessed by the SEC. See our white paper on how to appropriately frame forward looking statements.

However, the omission of negative material facts such as those described in the Order presents a clear path to SEC scrutiny, especially in the context of another statement in a press release that the company was operating sustainably. The same set of facts outside a COVID-19 situation could be problematic—in both a primary offering document or a voluntary disclosure, regardless of the subject matter of the disclosure.

Ballard Spahr LLP

by the Municipal Securities Regulation and Enforcement Group

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