Cooley

COVID-19 Pandemic: Governance and Disclosure Considerations for Public Companies

March 16, 2020

The coronavirus outbreak – now officially categorized by the World Health Organization as a global pandemic – has quickly developed into a historic public health crisis. As the response to the coronavirus pandemic evolves and companies take action to address the impacts of the pandemic on their businesses, workforces and the communities they serve, public reporting companies should be mindful of related corporate governance and disclosure considerations. In a March 2020 statement, SEC Chair Jay Clayton reminded companies of the need "to provide investors with insight regarding their assessment of, and plans for addressing, material risks to their business and operations resulting from the coronavirus to the fullest extent practicable to keep investors and markets informed of material developments." To help management and board of directors of public companies with this challenge, we have developed the following Q&As.

What should our board of directors be doing?

Boards of directors of Delaware corporations have a duty to exercise oversight and monitor their corporation's operational viability, legal compliance and financial performance. Boards of corporations domiciled outside Delaware largely have similar oversight duties. Accordingly, given the high level of risk and operational disruption associated with the coronavirus pandemic, as well as the potential impact on companies' short- and long-term goals, directors should take steps to:

- regularly monitor the impact of the coronavirus pandemic;
- understand how management is assessing the impact; and
- consider the nature and adequacy of management's responses, including possible contingency planning.

In addition to operational and financial considerations, directors should consider whether disruptions affect their companies' ability to comply with applicable contracts, regulations and laws. Directors should also ensure they have an adequate compliance and monitoring system in place that requires the reporting of significant coronavirus risk-related information to the board for its consideration on a timely basis. Companies that are particularly impacted by the coronavirus pandemic may consider establishing special committees of the board that are charged with meeting regularly with management to review risks and evaluate responses. Proper documentation of oversight efforts in board minutes will be vital in the defense of shareholder claims against directors arising from actions taken (or inaction) during the crisis.

What should we disclose in our periodic reports?

Public companies should consider the risks arising from the coronavirus pandemic, as well as from the operational and financial impacts of their response to the pandemic, in upcoming periodic reports, earnings releases and earnings calls.

Management's discussion and analysis (MD&A). Keeping in mind that the overarching purpose of MD&A is to provide both a historical and prospective analysis of the company's financial condition and results of operations, with particular emphasis on the company's prospects for the future, public companies will need to assess in their periodic reports the extent to which the coronavirus pandemic has had a material impact on their reported operations and/or is reasonably likely have a material impact on future operations. In this regard, each public company is *required* by rule to identify and disclose in MD&A known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material impact on its financial condition or operating performance, even if such trends, events and uncertainties relate to broad economic or industry-wide factors. Public companies should bear in mind that the stated purpose of MD&A is to provide a discussion that would enable investors to see the company "through the eyes of management."

Trends and uncertainties surrounding the coronavirus pandemic may include changes in revenue due to volatility in demand, supply shortages, labor shortages, changes to product mix or impact of quarantines, changes in expenses that may result from supply chain and personnel issues, and extraordinary items arising from preventative actions or implementation of contingency plans. These developments could affect the company's critical accounting estimates and assumptions, which could require disclosure to the extent the change is material.

In addition, companies should consider the impact on cash flows and liquidity, including whether decreases in cash flows will require expense cutbacks for planned or necessary capital expenditures or other investments. Further, companies may need to take into account the availability of insurance to cover losses and contract defaults, or lack thereof, given that insurers often exclude epidemics in standard business-interruption coverage. Moreover, companies that rely on raising capital to fund their operations should consider the extent to which access to the capital markets has or may in the future become impaired.

To the extent that non-GAAP financial measures, key performance indicators or similar metrics are relied on by investors and analysts to assess company performance, companies should discuss trends and uncertainties in those metrics arising as a result of the actual or potential effects of the pandemic.

Risk factors and forward-looking statement disclosures. Public companies should consider the impact of the coronavirus pandemic on their risk factor disclosures and forward-looking statement disclosures. Potential risks include shortages and supply chain issues, transportation issues, rising costs, disruption of customer and vendor relationships, the potential for reputational harm, litigation over contract defaults and disputes regarding the application of *force majeure* clauses, the impact of government actions, as well as the consequences of potential litigation exposure.

Significantly, companies should consider conveying the evolving nature of these risks and attendant uncertainties, which, to some degree, will depend on the severity of the pandemic, the success of efforts to contain it and the ultimate availability of effective treatment and prevention through vaccine.

In addition to various risks identified above, companies should also consider the impact of diversion of management attention, depletion of resources (both inside and outside the company), closures of manufacturing locations, clinical trial sites and other facilities as preventive measures or as a consequence of outbreaks, possible impositions of containment zones or other limitations on travel, operations and transportation, potential opportunity costs as a result of cancellation of corporate events and in-person meetings, illness and quarantining of employees and work-from-home policies.

In their risk factor disclosures, companies will need to avoid boilerplate and be as specific as possible about the impact of the pandemic based on their own particular circumstances. For example, 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?

As a specific example, biotech companies may need to consider limitations on the availability of key materials for drug manufacture and difficulties related to the conduct of clinical trials, including problems initiating test sites, enrolling patients and recruiting clinical site investigators and staff, diversion of hospital and other healthcare resources from clinical trials as a result of prioritization of ill patients and coronavirus-related concerns, delays in receipt of materials necessary for trials due to transport and logistics issues, unavailability of clinical site monitors and interruptions due to quarantines, containment zones and limitations on travel. With regard to clinical trials conducted outside of the United States, companies may find typical issues related to foreign regulatory authorities to be more acute, including delays in receipt of foreign approval to initiate trials, changes in foreign regulations in response to the coronavirus outbreak and unavailability of regulators occupied with pandemic response activities.

Financial statements. In a public statement issued in mid-February, SEC Chair Jay Clayton and other officials of the SEC and PCAOB provided guidance regarding the impact of the coronavirus on financial reporting and audit quality. The officials observed that one possible impact on audit quality that many US-listed companies may experience is the inability of an audit firm to access information and company personnel located in regions severely affected by the pandemic. The officials recognized that the situation remains dynamic and "the effects on any particular company may be difficult to assess or predict, because actual effects may depend on factors beyond the control and knowledge of issuers." The officials urged companies "to work with their audit

committees and auditors to ensure that their financial reporting, auditing and review processes are as robust as practicable in light of the circumstances in meeting the applicable requirements." The officials noted the possibility of regulatory relief (discussed below) and emphasized specifically "the need to consider potential disclosure of subsequent events in the notes to the financial statements in accordance with guidance included in Accounting Standards Codification 855, *Subsequent Events,"* which requires evaluation of events subsequent to the balance sheet date through the date the financial statements are issued.

Internal controls. Public companies should consider the impact of the coronavirus pandemic on their internal control over financial reporting. Where there is a significant disruption to operations in one or more company offices or there has been a move to a remote workforce, existing internal controls may no longer be effective and management may need to design and implement alternative controls. Even if current internal controls remain effective, the rapidly changing landscape may warrant the implementation of additional controls to address potential increased risks of a financial statement error and to ensure appropriate application of GAAP accounting to adjustments and disclosures arising from the coronavirus outbreak are in place. Public companies will need to disclose any such changes that have materially affected, or are reasonably likely to materially affect, their internal control over financial reporting in their upcoming quarterly and annual reports.

Should we update our guidance?

Companies that have released guidance regarding 2020 financial performance may consider whether to update or withdraw guidance in light of the response to the coronavirus pandemic. In light of the unpredictability of the impact of the coronavirus pandemic on results, companies may decide to forego or withdraw guidance until circumstances stabilize and a clearer picture emerges. Companies that decide to provide or update guidance will likely emphasize the unusual degree of uncertainty that surrounds the guidance and include appropriate cautionary language. Companies that experience disappointing quarterly results as a result of the coronavirus pandemic may consider alerting the market by pre-announcing results. The decision to provide, update or withdraw guidance will be fact specific for each company.

In addition, companies that have published 2020 guidance should evaluate the guidance on an ongoing basis. While there is no affirmative duty to update guidance under the US federal securities laws, in a public statement issued in early March, the SEC stated that "[d]epending on a company's particular circumstances, it should consider whether it may need to revisit, refresh, or update previous disclosure to the extent that the information becomes materially inaccurate." Moreover, in the SEC's February 2018 cybersecurity interpretive guidance, while noting the split among the circuit courts, the SEC reminded companies that a duty to update may arise for prior disclosures that have become materially inaccurate when investors are still relying on those prior disclosures. Accordingly, it may be advisable to update guidance where new events or information related to the coronavirus pandemic and its impacts render prior guidance misleading or otherwise materially inaccurate in order to avoid potential liability. Further, companies and insiders do have a duty to disclose or abstain from trading while in possession of material nonpublic information. Therefore, companies that are considering securities transactions (such as offerings or buy-backs), or that are in an open trading window for insiders, should consider whether the coronavirus impact on published guidance should be considered material nonpublic information. If the company is aware that it will likely miss its estimates, it should refrain from trading in company securities and close trading windows until all material nonpublic information is disclosed.

Should we address the coronavirus pandemic in our proxy statement?

Under the US federal proxy rules and Item 407(h) of Regulation S-K, companies are required to disclose the extent of the board's role in risk oversight. According to the SEC, this disclosure is intended to provide information about "how a company perceives the role of its board and the relationship between the board and senior management in managing the material risks facing the company." In other contexts (specifically cybersecurity and data privacy), the SEC has amped up its warnings about the need for timely and transparent disclosure, as well as the importance of both disclosure controls and internal accounting controls. Where a risk is material, the SEC believes that the board's role in oversight of that risk should be discussed, along with the company's program to manage that risk and how the board engages with management on risk issues. Companies should consider disclosing the pandemic as a material risk that the board is monitoring, identifying the committee, if any, to which primary oversight responsibility has been assigned, and the nature and frequency of management reporting to the board or committee.

How are our disclosure controls and procedures affected?

The SEC considers disclosure controls to be critical to a company's ability to make any required disclosure of material risks and incidents in the appropriate time frame. Disclosure controls and procedures should provide a method of discerning the impact that risks and developments related to the coronavirus pandemic may have on the company and its business, financial condition and results of operations, as well as a protocol for determining their potential materiality. Companies should consider whether their disclosure controls are adequate to identify COVID-19 related issues that may arise and to ensure that the information is reported to appropriate personnel, including up the corporate ladder, on a timely basis to enable senior management to make disclosure decisions. The principal executive officer and principal financial officer will ultimately need to certify the adequacy of these controls in each periodic report.

Could the coronavirus pandemic impact trigger a Form 8-K or Form 6-K filing?

Domestic public companies will need to consider whether any developments trigger mandatory filings on Form 8-K. For example, the following events would trigger a Form 8-K filing:

- the material acceleration of a financial obligation, for example, under a credit facility;
- the receipt of a notice of delisting arising from a failure to satisfy the financial or liquidity standards for continued listing; or
- a conclusion that there has been a material impairment of goodwill or other assets made other than in connection with the preparation, review or audit of financial statements required to be included in the company's next periodic report.

In addition, to the extent that the risks and impact of the coronavirus pandemic is determined to be material, companies may consider voluntary disclosure on Form 8-K or, in the case of foreign private issuers, Form 6-K, to maintain the accuracy and completeness of effective shelf registration statements and promptly advise the public of material information.

Should we close our trading window?

Companies should consider whether to open or close trading windows for insiders in light of the risks and impact of the coronavirus pandemic. To the extent such risks and implications are material to the company, directors, officers and other corporate insiders should not be permitted to trade in company securities until the company discloses the material nonpublic information. Similarly, companies that have stock repurchase programs should also carefully consider whether purchases under the program should continue outside any 10b5-1 repurchase plan already in place.

How should we disclose information regarding the risks of the coronavirus pandemic and its impact on our company?

Under Regulation FD, when a domestic public company or a person acting on its behalf discloses material nonpublic information to certain enumerated persons, it must make public disclosure of that information. Companies should have policies and procedures in place to ensure that any disclosures of material nonpublic information related to the coronavirus pandemic and its associated impacts are not made selectively and that any Regulation FD-required public disclosure is made simultaneously (in the case of an intentional disclosure as defined in the rule) or promptly (in the case of a non-intentional disclosure) and otherwise in compliance with the requirements of Regulation FD. In addition, given the scrutiny that will be paid to coronavirus-related information, companies should be mindful that details that may seem insignificant and granular may be material to investors.

What kind of relief is the SEC providing? What are the conditions?

Recognizing that circumstances surrounding the coronavirus outbreak could "prevent certain issuers from compiling [Exchange Act] reports within required timeframes," on March 4, the SEC issued an order that "provides 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," provided that certain conditions are satisfied. To avail itself of the relief, a company must be unable to file timely due to circumstances related to the coronavirus outbreak. The company must file a Form 8-K or, in case of a foreign private issuer, Form 6-K, by the later of March 16 or the original reporting deadline, summarizing, among other things, why the report could not be filed on a timely basis, that is, "why the relief is needed in their particular circumstances." The order also provides relief related to furnishing proxy soliciting materials to security-holders "when mail delivery is not possible." The SEC advised that it will continue to monitor the situation and "may, if necessary, extend the time period during which this relief applies, with any additional conditions the [SEC] deems appropriate and/or issue other relief."

For companies that rely on the order, the SEC staff has indicated that for purposes of Form S-3 and Form S-8 eligibility and satisfaction of the current public information requirements of Rule 144(c), the staff will consider the company current (and timely, as applicable) in its Exchange Act filing requirements if it was current (and timely, as applicable) as of the first day of the relief period and it files any report due during the relief period within 45 days of the filing deadline for the report. Companies will also be permitted to rely on Rule 12b-25 if they are unable to file the required reports on or before the extended 45-day due date available under the order.

Can we hold a virtual annual meeting?

In light of the coronavirus pandemic, many companies that have traditionally held in-person meetings are considering the advisability of holding a virtual-only annual meeting. While ISS and Glass Lewis have historically expressed concern regarding virtual-only meetings and Glass Lewis has issued adverse voting recommendations for members of the governance committees of companies that hold virtual-only meetings without adequate disclosures regarding shareholder participation rights, both ISS and Glass Lewis have indicated that, for this year, they will relax their policies with regard to virtual-only meetings.

Companies that are contemplating holding a virtual-only shareholder meeting for the first time will need to confirm with counsel that both state law and the company's governing documents, e.g., charter and by-laws, permit a virtual-only shareholder meeting. Note that Delaware, the state of incorporation for the vast majority of public companies, amended its corporation law in May of 2000 to permit Delaware corporations to hold their annual meetings entirely online, allowing large numbers of shareholders to attend meetings via the Internet.

Companies that determine to hold a virtual-only shareholder meeting will need to evaluate their proxy disclosure, including the related notices, to determine whether additional language is necessary and should begin working with their proxy services firm and related providers on their annual meeting planning as soon as possible. For example, the notice of meeting and the general information describing the meeting in the proxy should be updated to describe the means of remote communications shareholders will be using to participate in the meeting. State law may also require certain statements to be included in a notice for a virtual annual shareholder meeting.

Note there are several steps a company can take to address Glass Lewis guidelines and alleviate proxy advisory firm and shareholder advocacy group concerns regarding virtual-only meetings. Under its most recent voting guidelines, Glass Lewis states that it expects companies holding virtual-only meetings to disclose the specific ways in which shareholders will have the same rights and opportunities to participate as they would at an in-person meeting, noting the following categories of information as effective disclosure: (1) addressing the ability of shareholders to ask questions during the meeting, including time guidelines for shareholder questions, rules around what types of questions are allowed, and rules for how questions and comments will be recognized and disclosed to meeting participants; (2) procedures, if any, for posting appropriate questions received during the meeting, and the company's answers, on the investor page of their website as soon as is practical after the meeting; (3) addressing technical and logistical issues related to accessing the virtual meeting platform; and (4) procedures for accessing technical support to assist in the event of any difficulties accessing the virtual meeting.

Companies that have already filed their proxy statements and wish to convert from an in-person to a virtual-only

meeting or to change the physical location of the meeting should confirm the state law requirements surrounding distribution of a revised notice, including any timing and physical remailing obligations, with counsel. As the SEC announced on March 13, if a company wants to change the date, time or location of its annual meeting (including, changing to a virtual-only meeting), but has already filed and mailed its definitive proxy materials to shareholders, the SEC staff will take the position that the company will not be required to mail additional soliciting materials (including new proxy cards) or amend its proxy materials and can simply notify shareholders of the change so long as the company takes the following actions promptly after deciding to make the change so as to alert the market on a timely basis: "(1) issues a press release announcing such change; (2) files the announcement as definitive additional soliciting material on EDGAR; and (3) takes all reasonable steps necessary to inform other intermediaries in the proxy process (such as any proxy service provider) and other relevant market participants (such as the appropriate national securities exchanges) of such change." The additional definitive soliciting materials filed by Starbucks to announce their move to a virtual-only meeting, can be found here. The press release should also, from the perspective of Glass Lewis and others, state that the decision to switch to a virtual-only meeting was made in light of coronavirus and explain how the virtual proceedings will work, including confirming that shareholders will be able to ask questions during the meeting.

For companies that have not yet filed their proxy statements and are contemplating the possibility of converting from an in-person to a virtual-only meeting after the proxy statement is filed, we would recommend that these companies disclose in their proxy statements the possibility for such a change, along with a reminder to shareholders to retain their control numbers from proxy cards or voting instruction forms so that they can access the meeting if it is converted to a virtual-only meeting.

Do proponents of shareholder proposals need to attend the annual meeting in person?

Under Rule 14a-8(h), shareholder proponents, or their representatives, are required to appear at the annual meeting to present their proposals. Under the circumstances and in light of the potential difficulties of attendance in person, the SEC is encouraging companies to be flexible this proxy season, to the extent feasible under state law, by facilitating the ability of shareholder proponents to present their proposals by phone or through other alternatives. What's more, if a proponent was unable to attend due to the inability to travel or other hardships related to the coronavirus, the SEC staff would consider this to be good cause under Rule 14a-8(h), so, under those circumstances, companies would be wise not to attempt to assert Rule 14a-8(h)(3) as a basis to exclude a proposal submitted by the proponent for any meetings held in the following two calendar years.

Under the circumstances, the SEC staff makes a point in its recent guidance of encouraging all parties and intermediaries involved in the proxy process to be flexible, cooperative and collaborative "to facilitate issuers' obligations to hold annual meetings and disseminate timely, accurate, and clear proxy disclosures under the federal securities laws as well as to allow shareholders to exercise their voting rights under state law."

Coronavirus resource hub

This content is provided for general informational purposes only, and your access or use of the content does not create an attorney-client relationship between you or your organization and Cooley LLP, Cooley (UK) LLP, or any other affiliated practice or entity (collectively referred to as "Cooley"). By accessing this content, you agree that the information provided does not constitute legal or other professional advice. This content is not a substitute for obtaining legal advice from a qualified attorney licensed in your jurisdiction, and you should not act or refrain from acting based on this content. This content may be changed without notice. It is not guaranteed to be complete, correct or up to date, and it may not reflect the most current legal developments. Prior results do not guarantee a similar outcome. Do not send any confidential information to Cooley, as we do not have any duty to keep any information you provide to us confidential. When advising companies, our attorney-client relationship is with the company, not with any individual. This content may have been generated with the assistance of artificial intelligence (AI) in accordance with our AI Principles, may be considered Attorney Advertising and is subject to our legal notices.

Key Contacts

Chadwick Mills **San Francisco**	**cmills@cooley.com** **+1 650 843 5654**
Cydney Posner San Francisco	cposner@cooley.com +1 415 693 2132
Darren DeStefano Reston	ddestefano@cooley.com +1 703 456 8034
Eric Blanchard Boston	eblanchard@cooley.com +1 212 479 6565

This information is a general description of the law; it is not intended to provide specific legal advice nor is it intended to create an attorney-client relationship with Cooley LLP. Before taking any action on this information you should seek professional counsel.

Copyright © 2023 Cooley LLP, 3175 Hanover Street, Palo Alto, CA 94304; Cooley (UK) LLP, 22 Bishopsgate, London, UK EC2N 4BQ. Permission is granted to make and redistribute, without charge, copies of this entire document provided that such copies are complete and unaltered and identify Cooley LLP as the author. All other rights reserved.