PAUL HASTINGS

STAY CURRENT

April 2020

Follow @Paul_Hastings

COVID-19 Alert — Good Faith and the Corporate Disclosure: An SEC Enforcement and Litigation Perspective

By John P. Nowak, Kevin Broughel, Inna Coleman & Molly Wolfe

These are volatile times, and public companies certainly feel the strain and pressure to provide information to shareholders, employees, and the public about the impact of COVID-19 on employees and business operations. The ever-changing economic environment and added challenges of operating remotely add even more pressure to the decision-making process surrounding corporate disclosures. Amidst these challenges, in-house personnel should pause and consider how their disclosure decisions, and the process through which those decisions were made, might be viewed once the dust settles and COVID-19 is behind us.

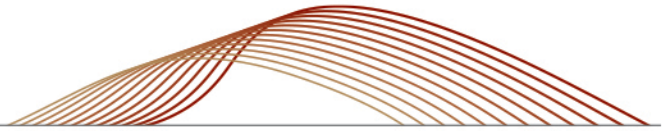
Earlier this week, SEC Chairman Jay Clayton and Director of the Division of Corporation Finance William Hinman stressed the importance of corporate disclosure during this crisis.[1] Chairman Clayton and Director Hinman specifically encouraged companies to make "forward-looking disclosure[s] and to avail themselves of the safe-harbors for such statements and also note[d] that [they] would not expect *good-faith* attempts to provide appropriately framed forward-looking information to be second guessed by the SEC." We also note that demonstrations of good faith efforts to provide forward-looking information and appropriate disclosures can play a pivotal role in officers' and directors' defenses against potential shareholder suits.

This Alert provides practical guidance from an SEC enforcement and litigation perspective regarding steps companies can take throughout the disclosure process to demonstrate good faith and to better position themselves if a regulatory inquiry or litigation were to arise in the future.

Helpful Reminders Regarding Good Faith and the Disclosure Decision-Making Process

Often times, the most contested issue during an SEC corporate disclosure investigation or related litigation is the state of mind of the individuals involved in the disclosure process. The central questions become: Were the executives and employees acting intentionally, recklessly or negligently in deciding to make certain disclosures? Or, on the other hand, were the executives and employees acting in good faith amidst extremely difficult circumstances?

In an SEC investigation, it is the responsibility of defense attorneys and regulatory attorneys to present to the SEC the context surrounding the circumstances of disclosure and identify evidence of



good faith on the part of those involved. Because disclosure decisions involving a company's response to COVID-19 are likely to be anything but routine, exhibiting good faith is of paramount importance. A showing of good faith is particularly important now, in light of Chairman Clayton's stance regarding second guessing good faith forward-looking disclosures.

To that end, we have identified a few areas of conduct that tend to indicate credible evidence of good faith and that can demonstrate reasonableness under the circumstances.

Involve Counsel – Internal and External

Should an SEC investigation surface in the future, reliance on advice of counsel (internal and external) and involvement of counsel are clear indicators of good faith. Therefore, advice of counsel should be sought and accessed frequently by those involved in the disclosure process. By involving counsel in the disclosure process, entities and individuals are able to consider issues candidly and receive legal advice in communications that are protected by the attorney-client privilege. Furthermore, outside counsel often has additional insight based on what other market participants and issuers are considering by way of disclosure. Given the potential impact of the disclosures, and the inherent difficulty of the current situation, it is also advisable to consult with regulatory or litigation counsel on the most sensitive topics.

Pick Up the Phone and Discuss the Issues

Because information regarding COVID-19 is moving at an extremely fast pace, and issues surface almost instantaneously, best practice is to discuss issues over the telephone or video conference. Working remotely removes the option to "walk down the hallway" to discuss issues with subordinates and department heads, and may prompt some individuals to email rather than discuss current issues live. However, phone or videoconference conversations allow all parties to fully evaluate and consider the complexity of the circumstances and the disclosure obligations, and thus should be encouraged.

Because of the speed at which information is flowing, and in an effort to fully engage and understand the nuances and issues of a particular disclosure, we recommend that entity personnel spend some time on the telephone or by videoconference discussing the issues before memorializing the record and the conversation. Moreover, for critical telephone conferences and issues, involve counsel so that all parties can receive the benefit and protection of legal advice and effectively vet pending concerns.

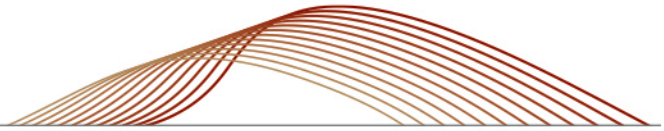
Collaborate with Others and Designate Personnel

A company's ability to demonstrate that disclosures were made in an informed, collective way significantly advances an argument of good faith in defending any SEC inquiry. Moreover, Chairman Clayton and Director Hinman, in their statement earlier this week, emphasized the importance of coordination at the firm level in connection with the disclosure process.[2]

Information flow relating to COVID-19 is likely coming from a variety of sources—human resources, sales, customers, the government, and the media, to name just a few. Collaborate with others in the organization to collect all relevant information, and designate personnel to be responsible for specific data points (employment, sales, etc.). This can be accomplished through a disclosure committee or otherwise.

Follow Designed Policies and Procedures

Effectively designed internal policies and disclosure controls should account for times of crisis and companies must take steps to ensure that those policies are being followed. To the extent that



circumstances require a modification of those policies or controls, companies are well-advised to consult counsel and document the circumstances and requisite amendments. Moreover, given the realities of shelter-in-place orders and remote work environments, corporations should evaluate the effectiveness of their disclosure controls and the flow of information within the corporation. Lastly, corporations should follow and implement disaster recovery plans and procedures, especially to the extent that they concern the effectiveness of financial and corporate disclosures.

Again, if there were ever an SEC inquiry or future litigation, it is best to be able to demonstrate that company personnel acted in good faith, consulted with counsel, involved others and collaborated to get to the right answer, and followed internal procedures.

Listen to Whistleblowers

In times of crisis, a potential whistleblower should never be ignored. Indications of wrongdoing or misconduct (intentional or not) may very well originate from within the organization. It is critical to ensure the appropriate policies and procedures are in place such that updates from a whistleblower hotline (or other similar structure) are gathered routinely, that the hotline is actively managed, and that the information received is assessed in a serious and timely manner. Active management of any and all whistleblower concerns is an important factor in demonstrating good faith in the face of any subsequent SEC inquiry or litigation.

Embrace Qualifying Statements

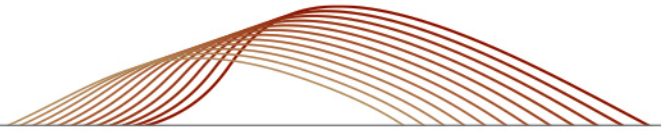
From an SEC enforcement and litigation perspective, when making challenging disclosures, especially forward-looking statements, we strongly recommend disclosures that contain qualifying language and additional risk disclosures. Such language can be critical in proving that a statement is not actionable as a false or misleading statement.

Practical Initial Steps to Take If Named In a Securities Fraud Complaint While Working Remotely

Nevertheless, even with the best-laid plans and diligence, companies and their officers and directors may be named as defendants in a securities class-action lawsuit premised on alleged disclosure misstatements or omissions. If such a complaint is filed, there are some common-sense principles that should be followed immediately. First, it is critical that a document preservation hold notice be issued as soon as possible. Chapters have been written about how to properly institute such a hold, but the key to remember under these circumstances is that all reasonable efforts should be made to preserve data and potentially relevant information. This step will also require that the company's information technology department put data holds in place to prevent inadvertent deletion of material. Engaging outside counsel can help with this process and alleviate unnecessary burdens.

In addition, if there are potential insurance policies that cover the claims, those policies should be reviewed and the insurance carriers notified in accordance with the terms of the policies. The failure to do so could have adverse consequences for coverage. Companies should also consider if separate counsel is warranted for individuals named in the lawsuit, if any. This is a fact-specific analysis that will turn on the particulars of the case and the potential for conflicts. Naturally, the disclosures that are at issue in the lawsuit should also be closely examined to assess the allegations and begin to prepare the defense of the case.

✧ ✧ ✧



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings New York lawyers:

Kevin P. Broughel
1.212.318.6483
kevinbroughel@paulhastings.com

Inna Coleman
1.212.318.6404
innacoleman@paulhastings.com

John P. Nowak
1.212.318.6493
johnnowak@paulhastings.com

Molly Wolfe
1.212.318.6765
mollywolfe@paulhastings.com

[1] Clayton, Jay and William Hinman, "The Importance of Disclosure – For Investors, Markets, and Our Fight Against COVID-19, SEC Public Statement" (Apr. 9, 2020), https://www.sec.gov/news/public-statement/statement-clayton-hinman.

[2] *Id.*