

# COVID-19 Regulatory Update: What the Cheesecake Factory Settlement With the SEC Means for Issuers

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On December 4, 2020, the Securities and Exchange Commission (SEC) announced a settlement with the Cheesecake Factory Inc. asserting that the company issued materially misleading disclosures about the risk that the COVID-19 pandemic posed to the company's operations.<sup>1</sup> The settlement is potentially significant in that it could reflect a movement beyond the run-of-the-mill fraud cases that the SEC has pursued against issuers in the early months of the pandemic and toward a more nuanced analysis of whether issuers are offering the public a full and fair assessment of their financial health.

The SEC's settled order with the Cheesecake Factory asserts that on March 23, 2020, the company furnished a Form 8-K to the SEC claiming that it was withdrawing previously issued financial guidance due to economic conditions caused by COVID-19. The March 23 8-K noted that the company was transitioning to an "off-premise model" (i.e., to-go and delivery) that was "enabling the Company's restaurants to operate sustainably at present under this current model." On April 3, 2020, the Cheesecake Factory furnished the SEC with another Form 8-K, which disclosed that "the restaurants are operating sustainably at present under this [off-premise] model."

The SEC asserts that the reality was very different, alleging that the March 23 and April 3 Form 8-Ks failed to disclose that "the Cheesecake Factory was excluding expenses

attributable to corporate operations from its claim of sustainability; that the company was, in fact, losing approximately \$6 million in cash per week; and that it had only approximately 16 weeks of cash remaining," even after accounting for the company's drawdown on a \$90 million revolving line of credit. The Cheesecake Factory settled—on a no-admit, no-deny basis—to violations of Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-11 thereunder and agreed to pay a \$125,000 penalty.

The Cheesecake Factory settlement marks a new development in the SEC's enforcement of securities laws violations in the wake of COVID-19. Prior to this settlement, COVID-19-related settlements with the SEC's Division of Enforcement primarily focused on cases of outright fraud, particularly with respect to issuers making misleading statements about developing COVID-19 tests and medical equipment or sales of personal protective equipment.<sup>2</sup> The Cheesecake Factory settlement, by contrast, involved a more nuanced analysis of how the company disclosed its operations and financial health as compared to the facts actually known to the company at the time the disclosures were made.

It is worth noting that the settlement with the Cheesecake Factory did not include fraud charges under Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, or under Section 17(a) of the Securities Act. The SEC may have determined that the evidence available did not

<sup>1</sup> Available at: <https://www.sec.gov/litigation/admin/2020/34-90565.pdf>.

<sup>2</sup> See <https://www.sec.gov/sec-coronavirus-covid-19-response>.

rise to the level of fraud or negligence, but it nevertheless felt compelled to send a message to issuers that they must take care to ensure that their disclosures create an accurate picture of their operations and financial health.

Cases such as that of the Cheesecake Factory generally require longer investigation timeframes, as disclosure cases generally require the collection of evidence from issuers to show what was actually known and not known

at the time certain disclosures were made. Consequently, we expect that the Cheesecake Factory case marks the beginning, not the end, of disclosure-related cases arising out of the COVID-19 pandemic.

***To see our prior alerts and other material related to the pandemic, please visit the Coronavirus/ COVID-19: Facts, Insights & Resources page of our website by clicking [here](#).***

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