

SEC Expands Scope of COVID-19-Related Enforcement Actions with Penalty Against Cheesecake Factory for Misleading Investors

WRITTEN BY

Jay A. Dubow | Ghillaine A. Reid | Casselle Smith

Who Needs to Know

Publicly traded companies, specifically those whose business was affected by the COVID-19 pandemic.

Why It Matters

The SEC announced its first enforcement action against a public company, The Cheesecake Factory, for misleading investors about the financial impact of the COVID-19 pandemic. This case marks a shift from the first wave of the Commission's COVID-19-related enforcement actions, which centered on fraudulent activity perpetrated by companies purporting to be directly involved in the COVID-19-response supply chain. This appears to be a "message" case and we expect other similar cases to follow.

The U.S. Securities and Exchange Commission (SEC or Commission) has announced its first enforcement action against a public company for misleading investors about the financial impact of the COVID-19 pandemic. On December 4, the Commission issued a \$125,000 civil penalty, along with a cease-and-desist order, against The Cheesecake Factory (Cheesecake) — settling charges that two of the company's Forms 8-K were materially false and misleading. This case marks a shift from the first wave of the Commission's COVID-19-related enforcement actions, which centered on fraudulent activity perpetrated by companies purporting to be directly involved in the COVID-19-response supply chain (e.g., manufacturing personal protective equipment, developing home testing kits, etc.).

Cheesecake's Forms 8-K at issue were furnished to the SEC on March 23 and April 3 — this was at the height of the pandemic's first surge in the U.S., and just days after mandatory stay-at-home orders started rolling out across the country. In its March 23 filing, Cheesecake withdrew its prior financial guidance and provided a brief business update on how the company was faring in light of the pandemic. The company optimistically represented that its new "off-premises" model (*i.e.*, operating only by take-out and delivery, with no in-person dining) was "enabling the Company's restaurants to operate sustainably at present."

The March 23 business update did not paint a completely rosy picture: (i) It disclosed that the company had drawn down \$90 million on a revolving credit line; and (ii) noted that Cheesecake had "curtailed its planned growth for the year and [was] evaluating additional measures to further preserve financial flexibility." According to the SEC, Cheesecake failed, however, to mention the concrete measures that the company had already taken: It had (i) issued a letter to each of its landlords advising that it would not be paying rent for April 2020, with no estimate as to when payments would resume; (ii) furloughed 41,000 employees who were still collecting benefits and

insurance; and (iii) reduced compensation for its executive officers, board of directors, and certain employees.

The SEC order suggests that the timing of Cheesecake's disclosures was critical in this case. Two days after the March 23 filing, news broke of Cheesecake's letter to its landlords. Two days after that (on March 27), Cheesecake updated its Form 8-K to reflect the additional pieces of information listed above. The following week — in its April 3 Form 8-K — Cheesecake again represented that it was “operating sustainably at present” under its off-premises-only model, as it had done in the March 23 filing. The SEC's order alleged that in each of these Forms 8-K, Cheesecake failed to disclose information on the company's cash position — that it was losing \$6 million per week and only had enough cash to support approximately 16 weeks of operations under the then-prevailing conditions.

On these facts, the SEC further alleged that Cheesecake's March 23 and April 3 Forms 8-K were false and misleading, and therefore violated the company's reporting requirement under Section 13(a) of the Securities Exchange Act and Rules 13a-11 and 12b-20 thereunder. The SEC imposed a \$125,000 civil penalty, which it said was reflective of cooperation credit and stopped short of charging Cheesecake with scienter-based securities fraud.

While we do not know the contours of the Enforcement Division's negotiations with Cheesecake in this matter, it may be important to note that the violative conduct at issue in this case occurred in the early weeks of the pandemic. Just days later, on April 8, SEC Chairman Jay Clayton and William Hinman (director, SEC Division of Corporation Finance) “urge[d] companies to provide as much information as is practicable regarding their current financial and operating status, as well as their future operational and financial planning.”^[1] This appears to be a “message” case, and we expect other similar cases to follow. We will be watching closely to see whether future settlements — those relating to more recent violative conduct — result in significantly harsher penalties, particularly when brought by what we expect to be a more aggressive Enforcement Division under the incoming Biden administration.

[1] “The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19” (April 8, 2020) available at <https://www.sec.gov/news/public-statement/statement-clayton-hinman>.

RELATED INDUSTRIES + PRACTICES

- [Securities Investigations + Enforcement](#)
- [White Collar Litigation + Investigations](#)