The Impact of Tariffs and Market Volatility on Risk Factors, MD&A, and Earnings Calls

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April 23, 2025

The recent flurry of activity regarding tariffs and the resultant market volatility should have public companies reviewing and analyzing their risk factors and MD&A sections in the preparation of their upcoming 10-Q filings for the first quarter. In addition, they should also be prepared to answer questions on these subjects (to the extent possible) during their earnings calls on their quarterly results.

Risk Factors

Companies should be reviewing the Risk Factors section in their last 10-K filing to determine whether any of them should be updated or if a new Risk Factor would be appropriate to include because of the ongoing tariff restructuring and the market volatility that has accompanied such actions. Some of the possible areas that could trigger the need to update one or more Risk Factors include:

- The magnitude of business subject to tariffs (both domestic and foreign) on the company's own goods or goods used in producing those goods
- The impact that tariffs could have on the company's supply chain
- The company's ability to raise the prices on its goods in response to the imposed tariffs and the resulting impact on the demand for its goods if it does raise the prices on its goods
- Whether the company would incur unrecoverable costs in trying to limit the effect of the tariffs
- The impact on future capital expenditures, acquisitions etc.
- The possibility of an economic slowdown or recession, which may reduce demand for the company's goods, limit its availability to the capital markets, increase the cost of capital due to increased interest rates, lower its equity valuation or adversely affect foreign currencies (companies may wish to revisit their "recession" risks from 2008-2009)

In reviewing their risk factors, companies should also be on the lookout for "hypothetical" risks that are no longer hypothetical. In *Huddleston v Herman & MacLean*, 640 F.2d 534, 544 (5th Cir. 1981), the Fifth Circuit admonished that "[t]o warn that the untoward may occur when the event is contingent is prudent; to caution that it is only possible for the unfavorable events to happen when they have already occurred is deceit."

MD&A

Here, too, companies should analyze the impact of tariffs and market volatility on their results and liquidity, particularly if they need to delay or abandon planned capital expenditures or acquisitions or if the company's access to capital becomes more expensive or limited.

Companies are obligated to address in the MD&A "known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations" and "known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way." Unfortunately, this is made more difficult since the tariff situation is so uncertain at this time, and if there is an economic slowdown, recoveries can take days or years depending on the circumstances.

Companies should bear in mind that in addition to the consequences of the current tariff/market upheaval, if they cannot conclude that the possibility of much higher tariffs taking effect in 90 days from "Liberation Day" is not reasonably likely to occur, then such a known trend or uncertainty would also need to be discussed if the consequences of such higher tariffs would be material to their results or liquidity.

In the past, some companies have tried to support their stock price by initiating a share repurchase program. Companies should be satisfied that they have ample liquidity to do so and that they are not in possession of material, nonpublic information at the time of such purchases. It would be safer if the company had previously adopted a Rule 10b5-1 plan when it is not in possession of material, nonpublic information.

Earnings Calls

While executives may wish to answer questions on these topics generally by saying that they are "closely monitoring" the situation, they may be better served by having answers and plans to such questions, if possible, to show that the company is staying abreast of the circumstances. As always, companies need to ensure that the entire communications team is providing consistent messages. If the situation continues to be volatile, it may be appropriate, under Regulation FD, to avoid reaffirming earnings guidance after an earnings call in subsequent private calls with analysts.

For questions regarding the impact of tariffs and market volatility on risk factors, MD&A, and earnings calls, please contact your GableGotwals attorney or a member of our Corporate & Securities Group.

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