A Senior Executive Is Seriously Ill. When Should a Company Disclose the News?

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The death of Oracle CEO Mark Hurd in October has highlighted a longstanding public company dilemma: whether and when to disclose the news that a senior leader has a serious health challenge.

Not only is the topic sensitive from a personal and privacy perspective, but there is no specific rule or duty that requires disclosure of a CEO's or other executive's adverse health information—unless the executive is incapacitated.[1] While commentators and news articles sometimes suggest companies should publicly disclose any serious health issue affecting a CEO, the law leaves substantial discretion for the board of directors to evaluate the specific facts, and allows for a non-disclosure approach when the CEO can continue to perform his or her key duties. This is partly because health falls into a category of

1 Although this article focuses on CEOs, the analysis and best practices apply to other critical executives or key employees.

information that has over time been treated differently from core business information for purposes of judging materiality—that is, information a reasonable investor would consider important—under the federal securities laws.

Not surprisingly, company executives and boards have chosen various approaches to disclosing high-profile health conditions. The three main paths companies have taken are full disclosure, partial disclosure and silence. This article explores the pros and cons of each approach given the complexities of defining "material" information in the context of health. It also explains the duties of the board and the CEO, which include keeping one another informed, and offers principles-based recommendations to limit risk exposure under securities laws.

What the Legal Framework Covers

U.S. securities laws do not specifically mandate disclosure of a CEO's illness or other health-related information. Public disclosure of a CEO's health condition becomes necessary only when there is "a present duty to disclose" and the information is considered "material"—the framework applicable to non-public information generally. Securities laws require companies to disclose material information in certain circumstances that trigger the "present duty" threshold—for example, where an insider is selling shares outside the parameters laid out in a so-called 10b5-1 plan for trading shares according to a pre-arranged schedule. In addition, Form 8K requires disclosure of the departure of individuals from specified executive roles.[2]

However, the determination of whether an executive's health issue is material is generally left to the board's judgment. Even then, there appears to be a gloss on the materiality test that weighs against disclosure when it comes to health information. Academics and commentators disagree about when a CEO's illness becomes material to investors and whether the U.S. Securities and Exchange Commission should mandate its disclosure. There is a dearth of case law on point; neither courts nor the SEC have concluded that adverse information about a CEO's health was so material that (in hindsight) it should have been disclosed. Because the courts have not provided standards by which to make decisions on these questions and there are no indications that the SEC will issue a rule or give further guidance in the near term, each company must navigate its particular set of facts and circumstances.

2 *See* Item 5.02 ("If the registrant's principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer, or any person performing similar functions, or any named executive officer, retires, resigns or is terminated from that position … disclose the fact that the event has occurred and the date of the event").

When Is a Health Condition So Material That a Company Needs to Disclose It?

Determining that information is "material" enough to trigger disclosure is not a straightforward task. Legally, information is material if there is a substantial likelihood that a reasonable investor would consider that information in deciding whether to buy or sell the company's securities. Existing case law indicates that just because investors might like to know about the CEO's health, that does not mean the information is material.[3] Below are some of the methods for assessing materiality.

- ***Weighing Probability and Magnitude.*** Under *Basic v. Levinson*, materiality is a fact-specific test that is measured by comparing the probability that an event will occur with the anticipated impact of that event on the corporation (also known as the probability-magnitude test). For instance, when an executive is permanently or temporarily incapacitated to the point of inability to perform the duties of her role, and her role (during the period of incapacity, if temporary) is reasonably believed to be critical to the success of a company over the long term, there is a strong argument that the materiality test has been met.

- ***Significant Stock Price Drops.*** Another way to look at materiality is whether public disclosure of the information would cause the stock price to drop significantly. Although no court has deemed a CEO's illness to be material, at least two high-profile CEO departures were followed by significant stock price drops. Commentators have opined that in those contexts, the CEO's illness must have been material: (1) CSX stock dropped 7% upon its announcement of the CEO's medical leave; and (2) Apple stock dropped over 5% (but soon rebounded) upon Steve Jobs' resignation as CEO.[4]

- ***The Materiality Gloss: Health Information as a De Facto Exception.*** Despite the legal framework discussed above, it is clear in practice that courts and commentators struggle to apply the materiality framework—developed in the context of business information like revenue forecasts and merger discussions—to an executive's personal medical information. A gloss—or commonly accepted legal interpretation—covers the materiality test, and that gloss weighs against finding that an executive's health condition that does not incapacitate the executive is so material as to require immediate disclosure, except in extreme

3 *See TSC Industries v. Northway*, 426 U.S. 438, 449 (1976); *see also Basic*, 485 U.S. at 231–32 and *In re Time Warner Securities Litigation*, 9 F.3d 259, 267 (2d Cir. 1993).

4 Allan Horwich, *The Securities Law Disclosure Rules of the Road Regarding Executive Illness*, 46 No. 1 Sec. Reg. L.J. art. 1 at 9 (2018).

cases. Put simply, executive health appears to be almost a de facto exception to materiality because those who consider the health disclosure issue are uncomfortable deeming an individual's personal medical information to be material even where the information might appear to matter to investors to some degree.

Privacy versus Disclosure: Companies Walk a Fine Line

Commentators have noted the tension between privacy rights and disclosure obligations under the federal securities laws.[5] Executive health is becoming a category of information that is deemed "immaterial" even though the information might be significant to investors. In the context of personal information, the materiality test may be overbroad and over-inclusive, which appears to have led decision makers to create a *de facto* exception for CEO health without actually calling it an exception.

Those who are uncomfortable deeming personal medical information to be material even where it would otherwise matter to investors may be relying on decisions about non-materiality related to other business matters. Health would not be the only exception to the materiality standard, as there are several other judicially created exceptions to the materiality analysis, including cases involving business-sensitive information, ubiquitous business conduct, deference to state courts and the misuse of sensitive information.[6] In these situations, courts seem to be choosing to not require disclosure of certain significant information by deeming it not material. The same approach has filtered down to executive health information.

In sum, decision makers enforcing a company's disclosure obligations appear to be making (whether consciously or unconsciously) policy choices to treat health information differently from typical business information. This may be influenced by privacy concerns, as well as the fact that medical science is inexact and the hard "facts" about a CEO's health are often unknowable. Predicting the outcome from a prognosis is no easy task for a doctor, let alone a board of directors, the courts or the SEC. This explanation lends further support to the conclusion that unless a CEO's health issue is so acute that it raises concerns of his or her incapacity or inability to perform critical duties, disclosure is not required.

5 *See* Andrew K. Glenn, Note "Disclosure of Executive Illnesses Under Federal Securities Law and the Americans with Disabilities Act of 1990: Hobson's Choice or Business Necessity?" 16 Cardozo L. Rev. 537 (1994).

6 *See* Dale A. Oesterle, "The Overused and Under-Defined Notion of 'Material' in Securities Law," 14 U. Pa. J. Bus. L. 167, 192–207 (2011).

Voluntary or Partial Information Can Lead to Increased Disclosure Obligations

Although there is no law or regulation that specifically requires a company to disclose a CEO's illness to investors (other than Item 5.02 of Form 8-K, which covers departure of certain executive officers), particularly when the executive continues to work, companies and boards have increased disclosure obligations—and face increased litigation risk—when they make a voluntary disclosure. The "half-truth" doctrine provides that if a company speaks, it must include all information necessary to make the statement not misleading.[7] Although the SEC and courts have not yet applied this doctrine to health information, they could do so, particularly when companies voluntarily choose to provide health information that turns out not to be entirely accurate, or if they make partial or incomplete disclosures that could be viewed as misleading.

Where a company has made CEO health-related disclosure, the board should engage in a periodic materiality assessment and stay apprised of conditions that would trigger a public disclosure if the CEO can no longer perform the duties of a chief executive—for example, if an executive's illness is physically incapacitating but the role requires extensive travel. Shareholders have brought derivative litigation in the wake of a company's disclosures about CEO illness and death, demonstrating that some litigation risks do exist.

Company Approaches Range from Full Disclosure to Putting Executive Privacy First

In determining whether and how to disclose a CEO's medical condition, companies are often guided by considerations other than mandatory disclosure requirements. Over the years, several boards and their CEOs have chosen to make voluntary public disclosures based on what they believed to be good corporate governance, transparent investor relations or assessments that the information would eventually become public.

Other companies that prioritized privacy followed the approach of keeping CEO health information closely guarded. The wide spectrum of disclosure approaches highlights the uncertainty of the law regarding how a board should balance the CEO's interest in privacy against the shareholders' desire to know all material information.

7 *See* 17 C.F.R. §§ 230.408, 240.12b-20 (2013) (codifying the "half-truth" doctrine in SEC Rules 408 and 12b-20 for public filing purposes); *see also Craftmatic Securities Litigation v. Kraftsow*, 890 F.2d 628, 641 (3d Cir. 1989) (reading "half-truth" doctrine into SEC Rule 10b-5).

Best Practices:

Because materiality is considered to be one of the most difficult judgment calls in complying with securities regulations and requirements, boards that are considering how best to handle potential health disclosures can mitigate the risks surrounding this decision through other disclosures:

- The board should consult counsel in the discussion and analysis of appropriate disclosure.
- The board should engage in succession planning while also strengthening its risk factor disclosures on the next Form 10-Q. The board should also remember that it must revisit the materiality disclosure analysis if the CEO's health declines or he or she is no longer able to perform key duties that are critical to the company's success.

Full Disclosure

Because of executives' personal beliefs or corporate policies, some companies have chosen to disclose the full scope of health issues affecting their CEOs or other top executives.

- ***Berkshire Hathaway.*** Berkshire Hathaway's CEO Warren Buffett rather famously boasts that he communicates with shareholders as if they are his family, adopting a transparent approach to deciding what information might be important to investors. In 2000, Berkshire Hathaway announced in a detailed press release that Buffett was going to have colon surgery. In 2012, the company again disclosed that Buffett was diagnosed with early stage prostate cancer and would undergo radiation treatment. This approach is primarily a reflection of Buffett's personal views on disclosure versus privacy, and falls on the most transparent end of the disclosure continuum with respect to CEO health.
- ***Google.*** Company co-founder Sergey Brin chose to disclose a health condition before any possible affirmative duty to disclose arose (indeed, before the health condition actually materialized) when he announced in 2008 that he has a gene mutation increasing his likelihood of contracting Parkinson's disease. The announcement was made in Brin's personal blog post and was not accompanied by any formal disclosures.
- ***General Motors.*** In 1998, GM publicly announced as soon as it was diagnosed that Harry Pearce, its CEO at the time, had leukemia. Like Buffett, Pearce has

expressed his personal belief that, with respect to a CEO's illness, "[t]here is an absolute requirement to make full disclosure. And by full disclosure I mean full public disclosure."

- ***United Airlines.*** Regardless of the CEO's personal views, disclosure is sometimes required. United's board responded to the sudden heart attack of Oscar Munoz in 2015 by issuing a press release and later announcing that the general counsel would serve as acting CEO. The company filed a Form 8-K disclosing Munoz's temporary medical leave (under Item 5.02 covering departure of certain officers). Although United was only required to disclose the change in leadership, it chose to provide updates on Munoz's heart transplant surgery, recovery and planned return to work in 2016.

Best Practices:

As noted earlier, the SEC and federal securities laws do not require publicly traded companies to disclose any and all material information. That said, when companies choose full disclosure, their board should:

- Develop a full communications plan and ensure that all material information being disclosed is complete and accurate.
- Ensure that either formal or informal controls are in place for the CEO to report updates on his or her health to the company so that the board may engage in a materiality assessment and update the disclosure if needed.
- Ensure that insiders refrain from trading in issuer securities unless they disclose all material information to the market.

Mixed Approach: Disclosing Partial Information

Some companies choose to disclose partial information about the CEO's health, balancing privacy with disclosure obligations.

- ***Time Warner.*** CEO Steven Ross kept his heart condition and cancer treatment confidential throughout the 1980s. Then in 1991, Time Warner publicly disclosed Ross's cancer and his need to undergo further treatment. A year later, Ross updated the disclosure to include details about the seriousness of his illness and his medical leave.

- ***Kraft Foods.*** The company announced in 2004 that CEO Roger Deromedi was hospitalized, but declined to provide details about his "undiagnosed medical condition," drawing criticism from the media and shareholders.

Best Practices:

If the company does choose to speak about the CEO's health, it or its board should:

- Adequately accompany any voluntary disclosure with meaningful caveats and cautionary statements about the executive's prognosis, including anything that could change the situation described.
- Ensure that either formal or informal controls are in place for the CEO to report updates on his or her health to the company so that the board may engage in a materiality assessment and update the prior disclosure if needed.
- Make disclosures about the CEO's health only after receiving full verification of the statement and condition from a medical professional, including the uncertainties in the prognosis.
- Expressly disclaim any obligation or intent to provide updates on the CEO's health. Although companies generally do not have a duty to update information that was accurate at the time it was disclosed, if the company states publicly that "we will let you know if the CEO's condition changes," the company would arguably have assumed a duty to update.
- Avoid commenting on third-party rumors, including about the CEO's health. If the company does comment, its statement must be accurate and not misleading.

Protecting Privacy: The Silent Treatment

Where the CEO continues to perform his or her duties and there is no mandatory requirement to announce a temporary replacement, several companies have opted not to disclose the CEO's health condition. A few examples follow, and we expect there are others that were never disclosed (even after the fact).

- ***Bear Stearns.*** During the financial crisis, CEO Jimmy Cayne kept his serious illness and hospitalization private.
- ***Intel.*** Former CEO Andrew Grove also chose not to disclose his cancer diagnosis for over a year, and later revealed that his treatments kept him out of the office for only three days and did not interrupt his normal work schedule.

- ***Reliance Group Holdings.*** This insurance company did not disclose that its CEO and major shareholder, Saul P. Steinberg, had suffered a stroke that left him partially paralyzed.

Best Practices:

One of the board's most important roles is to plan for succession in the event of a departure of a senior executive, whether that transition is planned or unexpected. If the company chooses to not disclose any information, key steps to take include:

- Put effective emergency/short- and long-term succession plans in place in the event that a change in leadership is required, and engage in a structured process to review the plans on an annual basis.
- Discuss further succession planning with counsel.
- Consider disclosing succession plans in order to reassure stakeholders and prevent major stock price impacts if the CEO announces an illness or takes a leave of absence.
- Revise key-person risk factor in the company's next Form 10-Q, as appropriate. The language should be updated to explicitly discuss the material impact of a departure or unavailability of key executives and the company's dependence on the CEO.

Internal Disclosures: Duties of the CEO, Executive Officers and the Board

Although public disclosure of a CEO's illness requires the board to apply the specific facts to the law, the general consensus of legal scholars and commentators seems to be that the CEO is legally obligated to inform the board generally about a serious medical condition so they can plan an adequate succession strategy.[8] CEOs who keep their boards in the dark have been criticized for thwarting succession planning. The duty to keep the board informed extends to other corporate officers who, if they thought the CEO was slipping in carrying out his or her duties, would have a duty to report a clear enterprise risk to the board if the CEO would not tell the board directly.

8 See Deborah Ball and Eric Sylvers, *The Wall Street Journal*, "Fiat Chrysler's Sergio Marchionne Was Seriously Ill for Over a Year Before Dying," (July 26, 2018); see also Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. Cin. L. Rev. 1187, 1195 (2003).

The board itself can also affirmatively set expectations that the CEO and other key executives disclose personal information that is material to the company. This means the board can decide what information they would like to know from the CEO, either formally (such as in a company's bylaws) or informally (such as in discussions with the CEO). The board could also use the company's code of ethics or the CEO's employment agreement to require the CEO to disclose material information to the board. The contractual obligation might include requiring that the CEO provide periodic updates on his or her condition to the extent it impacts the board's materiality analysis and mandatory disclosure requirements discussed above.

Accordingly, if there are obvious indications that the CEO is sick, missing work or getting medical treatment, the board has a duty to investigate to evaluate disclosure obligations. Directors, officers and spokespersons should also not make any representations that are inconsistent with the known facts (such as that the CEO is in good health), as these could conceivably violate federal anti-fraud protections.

Best Practices:

Management is obligated to keep the board informed and to actively seek out information, including the following:

- Officers have a duty to keep their boards informed of potential risks and liability faced by the company, which includes internally disclosing health-related information to directors who can then evaluate disclosure obligations and engage in adequate succession planning. Withholding relevant medical information from the board may be a breach of an officer's duty of good faith.
- Board members have a duty to investigate perceived "red flags." Upon becoming aware of any problem warranting board attention, directors should make further inquiry until they are reasonably satisfied that the issue has been handled appropriately. Directors should also revisit the materiality analysis and discussions on an ongoing basis to stay apprised if the circumstances have changed.

Summary of Key Takeaways

Although a company does not have a general duty to disclose an executive's health issues, a bright line rule is that if a senior executive is incapacitated and therefore unable to perform his or her duties, disclosure is required (particularly if the executive performs certain roles[9] or is otherwise reasonably believed to be critical to the success of the company). Otherwise, the board must evaluate the specific factual circumstances in light of the above legal framework to determine whether the information is material and whether there is a duty to speak. Voluntary disclosure is permissible but comes with risks.

Regardless of whether disclosure is required, the CEO should provide the board with sufficient information to engage in a materiality analysis and evaluate the company's disclosure obligations on an ongoing basis. Other officers and directors should also be cognizant of their duties to inform the board of any enterprise risks, and to investigate any perceived issues until they are reasonably satisfied that the situation is being handled appropriately.

The company should consider enhancing the key person risk factors on its next form 10-Q in order to mitigate any risks going forward. Most risk arises from partial disclosures or "half-truths"—which should be avoided. Sometimes silence with respect to executive health is the best policy.

9 *See* footnote 2 and accompanying text.

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