

2009

WHEN THE CORPORATE LUMINARY  
BECOMES SERIOUSLY ILL: WHEN IS A  
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DISCLOSE THAT ILLNESS AND SHOULD  
THE SECURITIES AND EXCHANGE  
COMMISSION ADOPT A RULE REQUIRING  
DISCLOSURE?

Allan Horwich

*Northwestern University School of Law*, [a-horwich@law.northwestern.edu](mailto:a-horwich@law.northwestern.edu)

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Repository Citation

Horwich, Allan, "WHEN THE CORPORATE LUMINARY BECOMES SERIOUSLY ILL: WHEN IS A CORPORATION OBLIGATED TO DISCLOSE THAT ILLNESS AND SHOULD THE SECURITIES AND EXCHANGE COMMISSION ADOPT A RULE REQUIRING DISCLOSURE?" (2009). *Faculty Working Papers*. Paper 174.  
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**WHEN THE CORPORATE LUMINARY BECOMES SERIOUSLY ILL: WHEN IS A CORPORATION OBLIGATED TO DISCLOSE THAT ILLNESS AND SHOULD THE SECURITIES AND EXCHANGE COMMISSION ADOPT A RULE REQUIRING DISCLOSURE?**

By Allan Horwich\*

ABSTRACT

Recent speculation and rumors about the health of senior corporate executives of public companies (most notably Steve Jobs of Apple Inc.) and the advanced age of many leaders in the corporate community prompt a consideration of when, if at all, there must be public disclosure of the ill health of a person whose involvement in a corporation is perceived as vital to the continued financial success or independence of that company. This Article addresses the application of various disclosure requirements under the Securities Exchange Act of 1934 to facts regarding the health of a corporate “luminary.” An adverse development in the health of a luminary that has, or may have, an adverse material impact on the company may not trigger an immediate disclosure obligation. There are, however, numerous situations where ill health with an adverse material corporate impact may have to be disclosed. In order to avoid uncertainty in this area – since there are competing views on the application of Exchange Act disclosure principles to personal health-related facts – this Article proposes a rule for adoption by the Securities and Exchange Commission that would impose a disclosure requirement in narrow circumstances.

\* Senior Lecturer, Northwestern University School of Law; Partner, Schiff Hardin LLP. Princeton University A.B.; University of Chicago Law School J.D. The author may be reached at a-horwich@law.northwestern.edu or ahorwich@schiffhardin.com. This Article speaks as of January 22, 2009 unless otherwise noted.

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Media interest in the health of Steve Jobs, chief executive officer (“CEO”) of Apple Inc.,<sup>1</sup> has brought to the fore the issue of when a public company<sup>2</sup> must disclose otherwise private

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<sup>1</sup> There was much published speculation about the health of Jobs in the summer of 2008, following up on Jobs’ earlier illness that had been cloaked in secrecy (*see infra* text accompanying notes 5-6). *See, e.g.*, Nick Wingfield, *At Apple Product Event, Jobs’s Health is Focus*, WALL ST. J., Sept. 10, 2008, at B1 (reporting that during a presentation of new Apple products Jobs addressed questions about his health through a slide that said “The reports of my death are greatly exaggerated,” but otherwise refused to discuss rumors about his health); Joe Nocera, *Apple’s Culture of Secrecy*, N.Y. TIMES, July 26, 2008, at C1, 2008 WLNR 13941135 (discussing Apple’s refusal to comment on rumors about Jobs’s health). Subsequently, Apple and Jobs broke their silence with an announcement that he was suffering from a hormone imbalance. Brad Stone, *Apple Chief Goes Public on Health*, N.Y. TIMES, Jan. 6, 2009, at B1, 2009 WLNR 239513. In little more than a week, Jobs took a medical leave of absence, stating that his health problem was “more complex” than first thought. Brad Stone, *Apple Chief Temporarily Steps Aside*, N.Y. TIMES, Jan. 15, 2009, at B1, 2009 WLNR 773593.

<sup>2</sup> In this Article the phrase “public company” means a company a class of whose common stock is registered with the Securities and Exchange Commission (“SEC”) for public trading under Section 12 of the Securities Exchange Act of 1934, ch. 404, § 12, 48 Stat. 881, 892 (codified as amended at 15 U.S.C. § 78l (2000 & Supp. IV 2004)) [hereinafter “Exchange Act”], or that is required to file reports with the SEC pursuant to Section 15(d) of the Exchange Act, 48 Stat. at 895 (codified as amended at 15 U.S.C. § 78o(d) (2000)). Companies with small market capitalization are allowed to use simplified reporting under the Exchange Act. *See* Smaller Reporting Company Regulatory Relief and Simplification, Securities Act Release No. 8876, 73

information regarding the health of an executive or other person, such as the lead creative director at an advertising firm, who is perceived as pivotal to the financial health and prospects of the corporation (referred to here as a “luminary”). This Article presents an analysis of a public corporation’s legal obligations to disclose facts about the health of luminaries<sup>3</sup> and then proposes that there be an express SEC rule requiring disclosure of adverse developments in the health of a luminary that materially affect her company.<sup>4</sup>

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Fed. Reg. 934 (Jan. 4, 2008). When referring to specific Exchange Act reporting requirements, this Article refers to the rules and forms applicable to larger companies.

<sup>3</sup> While a similar analysis may apply to other aspects of a luminary’s life that might have some bearing on the person’s ability to function effectively at the company, such as extramarital affairs that might expose the executive to blackmail, these aspects are not directly addressed in this Article.

<sup>4</sup> The first issue – the obligation to disclose executive illness under the federal securities laws – was addressed in an article published nearly fifteen years ago that focused on a clash between federal securities law disclosure requirements and the medical confidentiality provisions of the Americans with Disabilities Act of 1990 (“ADA”), Pub. L. No. 101-336, 104 Stat. 327 (1990), codified at 42 U.S.C. §§ 12101-12213 (2000). 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). With the passage of time and intervening regulatory developments, it is appropriate to revisit the disclosure issue. *See also infra* text accompanying notes 21-23 (discussing further the relevance of the analysis in the foregoing article). The second issue – whether there should be a specific mandate by the SEC on this topic – was addressed more recently in an article that recommended

## I. INTRODUCTION

In 2004, Jobs was treated for pancreatic cancer. His illness was not publicly disclosed when it was first diagnosed.<sup>5</sup> The fact and nature of his illness was disclosed only after he underwent surgery following nine months of treatment.<sup>6</sup> Other public companies have handled executive health issues differently. Time Warner Inc. immediately announced the cancer

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that there be guidance from the SEC but did not provide any specific proposal. Joan MacLeod Heminway, *Personal Facts about Executive Officers: A Proposal for Tailored Disclosures to Encourage Reasonable Investor Behavior*, 42 WAKE FOREST L. REV. 749, 790-92, 795 (2007) (proposing that the SEC provide “specific guidance on event-based . . . disclosures of executives’ personal facts in current reports . . . under [the Exchange] Act” but “leav[ing] the drafting of the text for a later day”).

<sup>5</sup> Nocera, *supra* note 1. See also Peter Elkind, *The Trouble with Steve*, 157 FORTUNE, No. 5, March 17, 2008, at 88, 2008 WLNR 4214390, at 1, 12 (reporting that the Apple board decided to make no disclosure of Jobs’s pancreatic cancer prior to his surgery – “For nine months Jobs pursued [alternative therapy before opting for surgery], as Apple’s board of directors and executive team secretly agonized over the situation – and whether the company needed to disclose anything about its CEO’s health to investors” – and concluding, “So Apple conducted business as usual, disclosing nothing and letting the tiny circle of insiders who knew about the situation continue to trade Apple shares”).

<sup>6</sup> Nocera, *supra* note 1; *Apple’s Chief Has Cancer Surgery*, CHI. TRIB., Aug. 2, 2004, News Section at 12, 2004 WLNR 19897962.

diagnosis of its then CEO Steven Ross<sup>7</sup> and disclosed his leave of absence when he required additional treatment.<sup>8</sup> When the CEO of McDonald's Corp. resigned because of health reasons, that company disclosed the reason.<sup>9</sup> In the latter situation, however, the fact of resignation was undoubtedly more important than the reason for it, where the reason had nothing to do with the CEO's prior performance. The "president, technology" of Google Inc. announced that he has a gene mutation that increases his likelihood of contracting Parkinson's disease, the acme of pre-emptive disclosure.<sup>10</sup>

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<sup>7</sup> Roger Cohen, *Chairman of Time Warner Treated for Prostate Cancer*, N.Y. TIMES, Nov. 27, 1991, at D15, 1991 WLNR 3038945.

<sup>8</sup> Adam Bryant, *Time Warner's Chief Takes Indefinite Leave*, N.Y. TIMES, June 15, 1992, at D1, 1992 WLNR 3315176.

<sup>9</sup> Leslie Wayne & Eric Dash, *Citing Cancer, Chief Resigns at McDonald's*, N.Y. TIMES, Nov. 23, 2004, at C1, 2004 WLNR 12126716. The individual died in less than two months. Melanie Warner, *Charles Bell, 44, Headed McDonald's*, N.Y. TIMES, Jan. 17, 2005, at B6, 2005 WLNR 620912.

<sup>10</sup> See Miguel Helft, *Google Co-founder has Genetic Code Linked to Parkinson's*, N.Y. TIMES, Sept. 19, 2008, at C2, 2008 WLNR 17804736. By contrast, one chief executive officer kept a diagnosis of that disease secret for nearly twenty years, after deflecting rumors about his health as symptoms manifested themselves in public, disclosing the fact only after he had transferred his responsibilities to his successor. See David Jones, *Life after Parkinson's*, BRIT. MED. J., June 22, 2002, at 234, available at <http://www.pubmedcentral.nih.gov/articlerender.fcgi?artid=1123472>.

The Apple approach of secrecy and “no comment” that prevailed until early 2009, however, is not unique. When the CEO of Kraft Foods Inc. was hospitalized, the reason was not disclosed<sup>11</sup> and a controversy arose over the lack of immediate disclosure of the details.<sup>12</sup> When the CEO of Bear Stearns & Co., Inc. fell seriously ill during a very difficult time for the firm, there was no disclosure of his life-threatening condition or even of his hospitalization, though he quickly recovered. His illness came to light only nearly a year later, after the firm had been sold.<sup>13</sup>

Interesting though such information may be in a celebrity-driven culture, where the health of pop culture stars is the subject of reporting in the most highly regarded news media,<sup>14</sup>

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<sup>11</sup> *Chairman Steps in at Kraft*, N.Y. TIMES, March 31, 2004, at C5, 2004 WLNR 4532516 (reporting that CEO had been admitted to the hospital several days earlier “with an undiagnosed medical condition”); *Head of Kraft Recovering*, N.Y. TIMES, Apr. 14, 2004, at C9, 2004 WLNR 5558493 (reporting that CEO was making a complete recovery from a viral infection accompanied by acute dehydration).

<sup>12</sup> Benjamin Pimentel, *Public Disclosure – Health of CEO’s Brings up Issues of Personal Privacy*, S.F. CHRON., Aug. 3, 2004, at C1, 2004 WLNR 7625982 (reporting “recent controversy over Kraft Foods Inc.” where the firm was “criticized for offering few details” about the hospitalization of its CEO).

<sup>13</sup> William C. Cohen, *The Rise and Fall of Jimmy Cayne*, FORTUNE, Aug. 18, 2008, at 90, 2008 WLNR 14524789 (reporting that Cayne, the CEO of Bear Stearns, “feared public disclosure about his health could further damage the firm”).

<sup>14</sup> *See, e.g., Arts, Briefly: A Bollywood Star is Hospitalized*, N.Y. TIMES, Oct. 13, 2008, at C2, 2008 WLNR 19475972 (reporting that actor Amitabh Bachchan, a star of more than 150

the public's or the media's fascination or curiosity do not create a *requirement* under the Exchange Act that either the corporate luminary herself or her employer disclose the information.<sup>15</sup>

The question addressed here is when, under the disclosure regime established by the Exchange Act and the SEC's rules, a public company must apprise the investing public of a serious adverse development in the health of someone who is a luminary that materially impacts the company. This issue may become of increasing importance as the population ages and more luminaries continue to serve their companies into a stage of their life<sup>16</sup> when they become

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films in India, had been hospitalized and was expected to be released in a "few days"); *Arts, Briefly: On Tour, Janet Jackson is Briefly Hospitalized*, N.Y. TIMES, Oct. 1, 2008, at B2, 2008 WLNR 18636782 (reporting that singer Janet Jackson was "hospitalized for several hours" resulting in cancellation of a concert).

<sup>15</sup> See *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993) ("a corporation is not required to disclose a fact merely because a reasonable investor would very much like to know the fact"); *Milton v. Van Dorn Co.*, 961 F.2d 965, 969 (1st Cir. 1992) ("The mere fact that an investor might find information interesting or desirable is not sufficient to satisfy the materiality requirement").

<sup>16</sup> It is now not uncommon for a luminary to remain at the helm of or otherwise be significantly involved in the company at an age when retirement had been the norm. For example, Warren Buffett, at age 77, remains the CEO of Berkshire Hathaway Inc. See *Berkshire Hathaway Inc. proxy statement dated March 17, 2003, at 2, available at* <http://www.sec.gov/Archives/edgar/data/1067983/000095013408004840/a39017ddef14a.htm>.

Maurice R. ("Hank") Greenburg was the chairman and CEO of American International Group

increasingly susceptible to life-threatening illness.<sup>17</sup> Some have stated that the principles of disclosure in this context are not clear.<sup>18</sup> One perspective is that disclosure is required whenever

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Inc. at age 78 before he retired (not for reasons of ill-health) in 2005. *See* American International Group Ins. proxy statements dated April 5, 2004, at 3, *available at* <http://www.sec.gov/Archives/edgar/data/5272/000095011704001279/a37136.htm>, and dated June 27, 2005, at 14, *available at* <http://www.sec.gov/Archives/edgar/data/5272/000095012305007827/y09671def14a.htm>. In addition, John Malone is the chairman of the board of Liberty Media Corporation at age 67 (*see* Liberty Media Corporation proxy statement dated April 23, 2008, at 13, *available at* <http://www.sec.gov/Archives/edgar/data/1355096/000104746908005075/a2184956zdef14a.htm>); Ralph Lauren is the chairman and chief executive officer of Polo Ralph Lauren Corporation at age 68 (*see* Polo Ralph Lauren Corporation Proxy Statement dated July 1, 2008, at 3, *available at* <http://www.sec.gov/Archives/edgar/data/1037038/000119312508146541/ddef14a.htm>); Rupert Murdoch is the chief executive officer of News Corporation at age 77 (*see* News Corporation proxy statement dated August 19, 2008, at 9, *available at* <http://www.sec.gov/Archives/edgar/data/1308161/000119312508180853/ddef14a.htm>); and Sumner Redstone is Executive Chairman of CBS Corporation at age 84 (*see* CBS Corporation proxy statement dated April 11, 2008, at 22, *available at* <http://www.sec.gov/Archives/edgar/data/813828/000104746908004563/a2184587zdef14a.htm>).

<sup>17</sup> *See, e.g.,* William Holstein, *A Drug Maker's Views of What Ails Health Care*, N.Y. TIMES, Sept. 8, 2007, at C2, 2007 WLNR 17536505 (quoting chief executive of major pharmaceutical company as stating, “The United States has an aging society. With increasing age, the frequency of certain diseases is increasing significantly.”).

a serious health problem occurs. The former vice-chairman of General Motors Corporation who suffered from leukemia while in that position stated that when a top executive of a major corporation becomes ill “[t]here is an absolute requirement to make full disclosure. And by full disclosure I mean full public disclosure.”<sup>19</sup> There is an opposing perspective that a right of

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<sup>18</sup> See, e.g., Stone, *Apple Chief Goes Public on Health*, *supra* note 1 (quoting former SEC commissioner as stating there was little agreement among legal scholars about the disclosure responsibilities when a CEO becomes ill); Stone, *Apple Chief Temporarily Steps Aside*, *supra* note 1 (reporting statement of an SEC spokesman that in general while there were no specific disclosure requirements regarding health of corporate officers and directors, companies need to assess whether health problems could have a material impact on results); Nocera, *supra* note 1 (“There are no hard and fast rules about how and when companies need to disclose information about the health of their chief executives.”); and Pimentel, *supra* note 12 (“There are no rules on what CEOs are supposed to disclose about their health,” quoting one commentator as saying, “Clearly, if someone is incapacitated, that’s something that needs to be disclosed” but “[t]he question is what and when and how much, and that’s always been a matter of some dispute”).

<sup>19</sup> Jonathan D. Glater, *Five Questions for Harry J. Pearce: An Honesty Policy on Executive Illness*, N.Y. TIMES, July 8, 2001, Sec. 3, at 34, 2001 WLNR 3358248. General Motors announced his illness when it was diagnosed. See George Gunset, *GM Says Executive Has Leukemia*, CHI. TRIB. June 6, 1998, 1998 WLNR 6513344. A search of the SEC EDGAR database of documents filed with the SEC, however, failed to identify any disclosure filed by General Motors. See also *Berkshire Hathaway Denies Buffett is Seriously Ill*, N.Y. TIMES, Feb. 11, 2000, at C20, 2000 WLNR 3269995 (reporting that securities analysts noted that if Warren

privacy excuses disclosure.<sup>20</sup> Indeed, it has been argued that a statutory right to confidentiality of medical information under the ADA may preclude disclosure about a luminary's health in some contexts notwithstanding the requirements of the Exchange Act.<sup>21</sup> Any conflict may

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Buffett of Berkshire Hathaway were seriously ill the “company would be obligated to report” that or risk facing shareholder suits).

<sup>20</sup> *See, e.g.,* Nocera, *supra* note 1 (referring to Apple policy that the health of its CEO is a “private matter”). In the Apple situation in 2004, one report recounted that the “Apple board decided to say nothing, after seeking advice on its obligations from two outside lawyers, who agreed it could remain silent.” Elkind, *supra* note 5.

<sup>21</sup> *See Glenn, supra* note 4, at 579, 588 (concluding that the medical confidentiality provisions of the ADA preclude corporate disclosure of an executive's illness, at least until the illness renders the person incapable of performing his job (citing 42 U.S.C. § 12112(c)(4)(C)), recommending that the SEC or the courts “adopt a safe-harbor rule for medical information which harmonizes both the ADA” and, for example, the Exchange Act and concluding that disclosure should be permitted when the employee can no longer perform his job). Neither the SEC nor the courts have adopted any safe harbor that reconciles any conflict between the ADA and the Exchange Act. Title II, Subpart F, Part C of The Health Insurance Portability and Accountability Act of 1996 (“HIPAA”), Pub. L. No. 104-191, 110 Stat. 1936, 2021-31 (codified at 42 U.S.C. §§ 1320d – 1320d-8 (2000)) also addresses the privacy of medical information. *See also* 45 C.F.R. Part 164, Subpart E (2007) (regulations implementing the privacy provisions of HIPAA). HIPAA, however, did not further complicate the issue of corporate disclosure about a luminary's health because the prohibitions there apply to disclosure by various health care and insurance entities, not one's employer.

evaporate when the luminary's ill health reaches the stage of materiality to the company's business.<sup>22</sup> Even to the extent there may be an unreconciled conflict between the disclosure regime under the Exchange Act and the confidentiality provisions of the ADA, it is important to know *when* that conflict emerges, that is, when, all other things being equal, there would be an obligation to disclose health information. In any event, this Article assumes that the luminary would not refuse to allow disclosure of her medical condition where disclosure by the corporation would (otherwise) be required under the Exchange Act<sup>23</sup> or that the luminary has (inadvertently) disclosed the medical condition herself, thereby triggering further disclosure.<sup>24</sup> There is no non-statutory right to privacy that excuses disclosure nor is disclosure invariably required. Resolution of whether disclosure is required is, instead, analyzed under well-established concepts, although the application of those principles in a particular case may be difficult.

## II. THE APPLICATION OF BASIC PRINCIPLES OF DISCLOSURE UNDER THE EXCHANGE ACT TO FACTS ABOUT THE HEALTH OF A LUMINARY

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<sup>22</sup> See *Glenn, supra* note 4, at 590. The materiality of the luminary's health is addressed *infra* Section III.B.2.

<sup>23</sup> It has been argued that a CEO, for example, may not be able to make an unbiased, objective assessment of whether disclosure of her own condition is required by the Exchange Act. Heminway, *supra* note 4, at 765-70. On the other hand, it may be argued with equal plausibility that a luminary would be loath to take an approach to disclosure that may subject her company, or indeed herself, to substantial damage civil liability or an SEC enforcement proceeding for failure to comply with Exchange Act disclosure requirements.

<sup>24</sup> See *infra* Section II.H.

There are two fundamental categories of disclosure requirements under the Exchange Act:<sup>25</sup> principles established in cases applying SEC Rule 10b-5<sup>26</sup> and the SEC's rules of periodic mandatory disclosure, promulgated primarily under Sections 13 and 15 of the Exchange Act.<sup>27</sup> This section of this Article presents and applies the principal disclosure rules and concepts.<sup>28</sup>

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<sup>25</sup> There are also disclosure issues under the Securities Act of 1933, such as under Section 11 (providing liability for materially deficient disclosures in registered offerings of securities) and Section 17(a) (pertaining to material misrepresentations and half-truths in the offer or sale of securities). 15 U.S.C. §§ 77k and 77q(a) (2000). *See, e.g., Glenn, supra* note 4, at 548-52, 558, 562 (discussing disclosure issues under Section 11). The regulatory program under the Exchange Act, however, is the primary basis for ongoing disclosure obligations of public companies. *See infra* Sections II.C.1 - II.C.3 and II.H.

<sup>26</sup> 17 C.F.R. § 240.10b-5 (2008).

<sup>27</sup> *Supra* note 2.

<sup>28</sup> This Article focuses on the extent of the obligation to disclose health-related information regarding a luminary. The consequences of a failure to comply with the disclosure requirements discussed here, such as private civil liability to investors or exposure to an SEC enforcement action or criminal prosecution, are beyond the scope of this Article. Either the violation of Rule 10b-5 or the violation of an SEC mandatory disclosure rule can give rise to one or more types of such proceedings. For a thorough discussion of these topics, see DONNA M. NAGY ET AL., *SECURITIES LITIGATION AND ENFORCEMENT CASES AND MATERIALS* chs. 2-4, 9, 11 (2008) [hereinafter NAGY]. For a discussion of the duty to disclose that focuses on issues arising in the context of private damage actions under Rule 10b-5, see Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose under Rule 10b-5*, 57 *VAND. L. REV.* 1639 (2004)

A. Silence is not Wrongful Unless there is a Duty to Speak

Standing mute – even about a matter that is material<sup>29</sup> – does not violate the Exchange Act unless there is a duty to speak.<sup>30</sup> The following subsections identify when a duty to speak arises.

B. A Knowing Materially False Statement about Health Violates Rule 10b-5

A cardinal principle of disclosure under the Exchange Act is that a knowing false statement that is material to an investment in securities may violate Rule 10b-5.<sup>31</sup> Thus, a

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[hereinafter LANGEVOORT]. After Jobs announced his leave of absence from Apple (*see supra* note 1), there was an unconfirmed report that the SEC had begun an investigation into Apple’s disclosures regarding his health. Brad Stone, *Apple Defies Expectations and the Economy*, N.Y. TIMES, Jan. 22, 2009, at B1, 2009 WLNR 1210705.

<sup>29</sup> The materiality of facts about health is addressed in Section III of this Article.

<sup>30</sup> “Silence, absent a duty to disclose, is not misleading under Rule 10b-5. ‘No comment’ statements are generally the functional equivalent of silence.” *Basic Inc. v. Levinson*, 485 U.S.224, 239 n.17 (1988). “We do not have a system of continuous disclosure. Instead firms are entitled to keep silent (about good news as well as bad news) unless positive law creates a duty to disclose.” *Gallagher v. Abbot Laboratories*, 269 F.3d 806, 808 (7th Cir. 2001).

<sup>31</sup> *See, e.g., Stoneridge Inv. Partners v. Scientific-Atl.*, 128 S. Ct. 761, 768 (2008) (stating that in a “typical § 10(b) private action a plaintiff must prove (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation and omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation”). “Scienter” is a “mental state embracing intent to deceive, manipulate, or defraud,” which most lower courts have interpreted to include

deliberately false material statement about the health of a corporation's luminary will be unlawful.<sup>32</sup>

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reckless conduct. *Tellabs, Inc. v. Makor Issues & Rights, Ltd*, 127 S. Ct. 2499, 2507 & n.3 (2007), quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193-94 & n. 12 (1976). *See also* *Aaron v. SEC*, 446 U.S. 680 (1980) (holding that the scienter requirement applies to SEC enforcement actions based on Rule 10b-5). The elements of causation and loss need not be established in an SEC enforcement proceeding for a violation of Rule 10b-5. NAGY, *supra* note 28, at 147. This Article does not address who may be held liable under the Exchange Act for a material omission or misrepresentation. The focus, however, is on corporate rather than disclosure by an individual in the context of specific requirements imposed on the public company. *See also infra* note 32 (addressing senior management responsibilities for certain disclosures).

<sup>32</sup> The extent to which the hypothetical fact patterns discussed in the Article entail scienter is beyond the scope of the analysis here. Because the CEO must attest to the accuracy of certain disclosures by the company (Exchange Act Rules 13a-14(a)-(b) and 15d-14(a)-(b), 17 C.F.R. §§ 240.13a-14(a)-(b) and 240.15d-14(a)-(b) (2008)), however, any materially false or incomplete statement in one of the attested reports about the health of the CEO that the CEO himself knows to be false or incomplete would undoubtedly entail corporate scienter. *See, e.g., Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 708 (7th Cir. 2008):

To establish corporate liability for a violation of Rule 10b-5 requires look[ing] to the state of mind of the individual corporate official or officials who make or issue the statement (or order or approve it or its making or issuance, or who furnish information or language for inclusion therein, or the like) . . . .

(internal quotations and citation omitted).

C. SEC Rules Impose Obligations to Disclose Specific Information or Information Necessary to Make the Required Disclosures Not Misleading

The SEC has adopted a number of rules that obligate a public company to report certain categories of information. Some of these rules are very specific, some are more general. Most commonly, these disclosures are made in the annual report on Form 10-K,<sup>33</sup> the quarterly report on Form 10-Q,<sup>34</sup> or the Form 8-K report, which is triggered by any one of several specific events.<sup>35</sup> The Forms 10-K and 10-Q identify specific items in Regulation S-K<sup>36</sup> that must be addressed, which vary depending on the report.

1. Form 8-K

Form 8-K mandates prompt<sup>37</sup> disclosure of a number of specific items. Item 5.02(b), for example, requires disclosure if any of certain officers retires, resigns, or is terminated.<sup>38</sup> Notably

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<sup>33</sup> SEC Rules 13a-1 and 15d-1, 17 C.F.R. §§ 240.13d-1 and 240.15d-1 (2008), respectively, and Form 10-K *available at* <http://www.sec.gov/about/forms/form10-k.pdf>.

<sup>34</sup> SEC Rules 13a-13 and 15d-13, 17 C.F.R. §§ 240.13d-13 and 15d-13 (2008), respectively, and Form 10-Q *available at* <http://www.sec.gov/about/forms/form10-q.pdf>.

<sup>35</sup> SEC Rules 13a-11 and 15d-11, 17 C.F.R. §§ 250.13d-11 and 15d-11 (2008), respectively, and Form 8-K *available at* <http://www.sec.gov/about/forms/form8-k.pdf>.

<sup>36</sup> 17 C.F.R. §§ 229.10-229.802 (2008).

<sup>37</sup> Generally a disclosure required by Form 8-K must be made within four business days of the triggering event. Form 8-K, General Instruction B.1, *available at* <http://www.sec.gov/about/forms/form8-k.pdf>, at 2.

<sup>38</sup> *Available at* <http://www.sec.gov/about/forms/form8-k.pdf>, at 15.

the form does not require disclosure of the death of a person otherwise covered by that item.<sup>39</sup> The SEC Staff has interpreted Item 5.02(b) to require disclosure if a person's duties are permanently or temporarily reassigned.<sup>40</sup> The SEC had proposed that the reason for a resignation be disclosed.<sup>41</sup> This was opposed by some who commented on the proposal on the ground that "requiring disclosure of reasons such as personal infirmity may cause unnecessary

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<sup>39</sup> The SEC Staff's interpretation bluntly states, in full: "Item 5.02(b) of Form 8-K does not require a registrant to report the death of a director or listed officer." See SEC Staff Interpretations Exchange Act Form 8-K, Question 217.04, available at <http://www.sec.gov/divisions/corpfin/guidance/8-kinterp.htm>. It is not clear if this is not an express requirement because the SEC believes that the death of a senior executive will otherwise be disclosed in a sufficiently public manner that the market will be informed of the event. When someone is appointed to the position vacated as a result of a death, that appointment must be disclosed under Item 5.02(c) of Form 8-K, implicitly disclosing the absence of the incumbent. Available at <http://www.sec.gov/about/forms/form8-k.pdf>, at 15.

<sup>40</sup> See SEC Staff Interpretations Exchange Act Form 8-K, Question 217.02, available at <http://www.sec.gov/divisions/corpfin/guidance/8-kinterp.htm>:

When a principal financial officer temporarily turns his or her duties over to another person, a company must file a Form 8-K under Item 5.02(b) to report that the original principal financial officer has temporarily stepped down and under Item 5.02(c) to report that the replacement principal financial officer has been appointed. If the original principal financial officer returns to the position, then the company must file a Form 8-K under Item 5.02(b) to report the departure of the temporary principal financial officer and under Item 5.02(c) to report the "re-appointment" of the original principal financial officer.

<sup>41</sup> Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, Securities Act Release No. 8106, 67 Fed. Reg. 42914, 42925 (June 25, 2002).

embarrassment to the departing officer.”<sup>42</sup> For this reason, among others, the SEC declined to adopt a requirement that the reason for a resignation be disclosed.<sup>43</sup> Of course, disclosing infirmity *after* the person has resigned is far less important to investors than disclosing an impairment *while the person still occupies the corporate position*, a situation not addressed by any Form 8-K item. Thus, health is at most addressed only indirectly in that the final corporate-related *effect* of the ailment – resignation or reassignment – must be reported.

Item 8.01 of Form 8-K provides for *discretionary* disclosure of any “information . . . that the registrant deems of importance to security holders.”<sup>44</sup> Because that item is not mandatory it does not illuminate what *must* be disclosed.<sup>45</sup> As noted earlier, there is no general, free-standing requirement to disclose a fact – on Form 8-K or otherwise – solely because it is material.<sup>46</sup>

## 2. Forms 10-K and 10-Q

Both the Form 10-K and Form 10-Q require certain disclosures prescribed by Item 303 of Regulation S-K, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” (“MD&A”).<sup>47</sup> For example, this item expressly requires the disclosure in the Form

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<sup>42</sup> Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, Securities Act Release No. 8400, 69 Fed. Reg. 15594, 15605 (Mar 25, 2004).

<sup>43</sup> *Id.*

<sup>44</sup> Available at <http://www.sec.gov/about/forms/form8-k.pdf>, at 19-20.

<sup>45</sup> Available at <http://www.sec.gov/about/forms/form8-k.pdf> at 19-20.

<sup>46</sup> See *supra* text accompanying note 30.

<sup>47</sup> See Form 10-K, Item 7 (available at <http://www.sec.gov/about/forms/form10-k.pdf>, at 9), Form 10-Q, Item 2 (available at <http://www.sec.gov/about/forms/form10-q.pdf>, at 5), and Regulation S-K, Item 303 (17 C.F.R. § 229.303 (2008)).

10-K of “known . . . uncertainties . . . that the registrant reasonably expects will have a material . . . unfavorable impact on net sales or revenues or incomes from continuing operations.”<sup>48</sup> There should be little doubt that this would encompass material uncertainties arising out of a known health problem suffered by a luminary. Thus, if the luminary’s inability to function is expected to materially adversely impact future results it should be disclosed.<sup>49</sup> One commentator has suggested, however, that if an

executive is not contractually obligated to a corporation, the illness may be immaterial as a matter of law because the anticipated impact of the executive’s loss should already be accounted for in the corporation’s stock price and market expectations. By definition, at-will employees are free to leave their position for any reason at any time without liability. Accordingly, a shareholder cannot reasonably complain about a corporation’s failure to disclose an illness even if the at-will executive ultimately leaves the corporation because of the undisclosed illness.<sup>50</sup>

This largely unsupported analysis is too facile, especially in the case of a luminary. First, it seems unlikely that one could tease out the difference (if any) in market price arising solely out of the absence of an employment contract with an executive in one company from the presence

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<sup>48</sup> Regulation S-K, Items 303(a)(3)(ii), 17 C.F.R. § 229.303(a)(3)(ii) (2008).

<sup>49</sup> See, e.g., *Glenn, supra* note 4, at 558-59 (“an executive’s illness may be material [if] that executive is so essential to a corporation’s financial health that her absence would affect the corporation’s liquidity”; “if an executive is the ‘driving force’ of a corporation, the future earning power of that corporation may be weakened by the executive’s illness”); Heminway, *supra* note 4, at 759 (“a terminal illness . . . is important not just as a statement of current fact, but also as information that may impact the future of the public company”).

<sup>50</sup> *Glenn, supra* note 4, at 559-60 (footnotes omitted).

of such a contract in another company in the same industry.<sup>51</sup> Second, apart from the fact that many luminaries will be under contract (albeit that employment contract may permit discharge without cause, though perhaps with some sort of payment to the employee in that event), it seems unlikely that someone so important to a company as a luminary will be perceived by the market to be such a transitory figure that the probability of his departure is routinely impounded in the price of the stock.<sup>52</sup> For example, it is not plausible that the market views Warren Buffett of Berkshire Hathaway or Steve Jobs of Apple as someone who may choose to leave their respective employers at any time.<sup>53</sup> By the nature of the concept as used here, a luminary is an integral part of an organization whose commitment to that organization – often as a founder – is typically viewed by the market as unlikely to be severed by either party. In any event, the same

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<sup>51</sup> The author does not provide any empirical evidence for the assertion and it is difficult to conclude that one could quantify *ex ante* the effect on a particular stock of the isolated factor of the probability that a particular executive, even a luminary, would choose to leave the company.

<sup>52</sup> In specific cases, to be sure, the fact that a luminary employed at-will has wanderlust or is being courted by other companies may have a stock price impact.

<sup>53</sup> For example, Jobs has no employment contract with Apple (*see* Apple Inc. proxy statement dated January 22, 2008, at 14, *available at* <http://www.sec.gov/Archives/edgar/data/320193/000119312508010038/ddef14a.htm>), but there is no evidence that his tenure at Apple is at risk – other than perhaps for reasons of health as discussed in this Article.

commentator recognizes that the calculus is different if the employee is contractually obligated to the corporation.<sup>54</sup>

Disclosure of the financial impact of the uncertainty created by a health problem has a parallel in the recommendation of the SEC more than twenty years ago that companies that were the subject of government defense contract procurement inquiries include in the MD&A appropriate disclosure “where the registrant reasonably expects that the government’s inquiry will have a material adverse effect on the company’s financial condition, liquidity, capital resources, net sales, revenues or income from continuing operations . . .”<sup>55</sup> A similar admonition applies where a luminary’s current health problem is expected to materially impair the company’s future performance because of her inability to make the kind of contribution that she has in the past, if there is no one to fill her shoes.<sup>56</sup>

The Form 10-K MD&A must also include, in addition to the specified items of liquidity, capital resources, results of operations, off-balance sheet arrangements, and contractual obligations, “such other information that the registrant believes to be necessary to an understanding of its financial condition, changes in financial condition, and results of

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<sup>54</sup> *Glenn, supra* note 4, at 560.

<sup>55</sup> Statement of the Commission Regarding Disclosure Obligations of Companies Affected by the Government’s Defense Contract Procurement Inquiry and Related Issues, Securities Act Release No. 6791, 1988 WL 10000026, at \*3 (Aug. 1, 1988).

<sup>56</sup> *See Heminway, supra* note 4, at 762-63 (noting that an executive’s absence is more likely to be considered important by investors if her functions are not adequately covered by others).

operations.”<sup>57</sup> A health-related disclosure might be required here only if the illness of the luminary had a material adverse impact on the historical results that are reported in the Form 10-K, for example if the principal designer of a computer game had been ill, thus delaying release of a new game with a substantial adverse effect on revenue for that period.

The Form 10-K must identify the company’s executive officers, in conformity with Item 401 of Regulation S-K.<sup>58</sup> Item 401, however, requires only basic biographical data (none of which refers directly to health or to any impairment in the officer’s capacity to perform the responsibilities of the position) and information regarding involvement in certain legal proceedings.<sup>59</sup>

### 3. Rule 12b-20

Any analysis of the completeness of a Form 10-K, 10-Q or 8-K must take into account the mandate of SEC Rule 12b-20, which provides:

In addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any,

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<sup>57</sup> Regulation S-K, Item 303(a), 17 C.F.R. § 229.303(a) (2008). The instruction for the disclosure in interim periods in the Form 10-Q does not contain that language. Item 303(b), 17 C.F.R. § 303(b) (2008).

<sup>58</sup> Form 10-K, Item 10, *available at* <http://www.sec.gov/about/forms/form10-k.pdf>, at 10.

<sup>59</sup> 17 C.F.R. § 229.401(b), (e), (f) (2008). Thus, while Item 401(e) requires, in some circumstances, disclosure of the nature of prior employment so that “[w]hat is required is information relating to the level of his professional competence,” no disclosure mandated by the item relates to a current physical or mental impairment. Here Rule 12b-20 may come into play.

*See infra* Section II.C.3.

as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.<sup>60</sup>

Thus, even if a disclosure expressly required by an item in one of those forms does not, standing alone, require inclusion of a luminary's health information, Rule 12b-20 instructs the company making the disclosure to assess whether what *is* required to be disclosed is rendered materially misleading by the omission of health information. For example, identifying someone as the chief executive officer in compliance with Item 10 of Form 10-K,<sup>61</sup> but not adding the fact that, at the time the document is filed, that person is substantially unable to perform the duties of a CEO because she is recuperating from brain surgery, is likely to be a material omission that violates Rule 12b-20. This is because identifying someone as the CEO inherently implies that at the time of the disclosure the person is able to perform the responsibilities commonly associated with that position.<sup>62</sup> Thus, Rule 12b-20 is a significant component of any analysis of health-

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<sup>60</sup> 17 C.F.R. § 240.12b-20 (2008).

<sup>61</sup> Available at <http://www.sec.gov/about/forms/form10-k.pdf>, at 10.

<sup>62</sup> See *Glenn, supra* note 4, at 589-90 (stating that identifying an individual as an executive represents that he is capable of performing the responsibilities of the position). Material falsity may be based on the implication of statements that are made. For example, in *In re Transkaryotic Therapies, Inc. Sec. Litig.*, 319 F. Supp. 2d 152, 161 & n.10 (D. Mass. 2004), the court held that a statement by a pharmaceutical company that the Food and Drug Administration "may request additional information, possibly including data from additional clinical trial" in fact "conceivably implies that the FDA's earlier request for additional information did not include a request for data from additional studies." Because the "FDA had in fact recommended additional clinical studies" what was disclosed was materially false by implication. In *Lyman v. Standard Brands Inc.*, 364 F. Supp. 794, 796-97 (E. D. Pa. 1973), the

related disclosures, with a focus on the materiality of the luminary's condition at the time of the disclosure.<sup>63</sup>

#### 4. The Proxy Statement

In accordance with Section 14(a) of the Exchange Act,<sup>64</sup> a proxy statement issued by a public company must comply with certain requirements.<sup>65</sup> As prescribed by Schedule 14A, a proxy statement for an annual stockholders meeting where directors will be elected must include

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court stated that when a corporation recommends shareholder ratification of the appointment of auditors that implies they are fit to perform the tasks of an auditor.

<sup>63</sup> For cases where Rule 12b-20 was applied, although not in the health context, see, e.g., *Ponce v. SEC*, 345 F.3d 722, 736-37 (9th Cir. 2003) (affirming SEC finding that accountant aided and abetted issuer's failure to correct filed documents as required by Rule 12b-20); and *SEC v. Fehn*, 97 F.3d 1276, 1289-90 (9th Cir. 1996) (affirming grant of injunction based in part on failure to include certain information in Form 10-Q based on non-compliance with Rule 12b-20).

<sup>64</sup> 15 U.S.C. § 78n(a) (2000).

<sup>65</sup> Rule 14a-3(a), 17 C.F.R. § 240.14a-3(a) (2008). To be more precise, those companies with securities registered under Section 12 of the Exchange Act must do so; a company that is "public" as defined in this Article (*see supra* note 2) solely by reason of the application of Section 15(d) of the Exchange Act is not expressly encompassed by the proxy rules. *See* 4 LOUIS LOSS ET AL., *SECURITIES REGULATION* 1734 (3d ed. rev. 2000) (only a company with securities registered under Section 12 of the Exchange Act must comply with the proxy solicitation requirements).

the information specified in Items 402 and 407 of Regulation S-K.<sup>66</sup> Item 402 requires extensive disclosure regarding executive compensation, but nothing in that item specifies any disclosure about an executive’s physical or mental fitness to serve.<sup>67</sup> If, however, some material adjustment had been made to a particular executive’s compensation for health reasons, disclosure would likely be called for, such as in the required “compensation discussion and analysis” where the company must describe “[h]ow the registrant determines the amount . . . for each element to pay”<sup>68</sup> and describe “[h]ow specific forms of compensation are structured and implemented to reflect the named executive officer’s individual performance . . . .”<sup>69</sup>

Item 407(b) requires identification in the proxy statement of any director who attended fewer than 75 percent of the aggregate of total board meetings and total meetings of committees on which he sat.<sup>70</sup> The rule does not, however, require an explanation why any director fell short in attending. The reason for non-attendance may be material if it had some bearing upon the director’s *capability* to serve as distinguished from, for example, conflicting business commitments, since most investors may assume, in the absence of further explanation, that the reason for poor attendance was conflicts.<sup>71</sup>

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<sup>66</sup> Items 7 and 8 of Schedule 14A, 17 C.F.R. § 240.14a-101 (2008).

<sup>67</sup> 17 C.F.R. § 229.407(b) (2008).

<sup>68</sup> Regulation S-K, Item 402(b)(1)(v), 17 C.F.R. § 229.402(b)(1)(v) (2008).

<sup>69</sup> Regulation S-K, Item 402(b)(2)(vii), 17 C.F.R. § 229.402(b)(2)(vii) (2008).

<sup>70</sup> Regulation S-K, Item 407(b), 17 C.F.R. § 229.407(b) (2008).

<sup>71</sup> Rule 14a-9 provides that no proxy solicitation subject to Regulation 14A shall omit any material fact “necessary in order to make the statements [in the written or oral proxy solicitation] not false or misleading.” 17 C.F.R. § 240.14a-9(a) (2008). Thus, if the non-disclosure of the

D. An Innocent Material Misstatement about a Luminary's Health Will Require Affirmative Corrective Disclosure

A timely, accurate statement about a luminary's health, such as an accurate denial of a rumor about a health issue, does not run afoul of the law.<sup>72</sup> By contrast, a materially false statement that was incorrectly believed to be true when made will generally create a duty to correct when the truth is learned by the speaker.<sup>73</sup> This duty exists only so long as the statement

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reason for the absences were deemed to render the unexplained statement of poor attendance materially misleading, Rule 14a-9 would require disclosure of the reason. In the case of Harry Pearce (*see supra* text accompanying note 19), General Motors disclosed that his subpar attendance at board meetings was due to illness. *See* General Motors Corporation proxy statement dated April 20, 1999, at iii, available at <http://www.sec.gov/Archives/edgar/data/40730/0000890163-99-000142.txt>.

<sup>72</sup> Apple issued a prompt denial of a false rumor that Jobs had suffered a heart attack. James Callan, *CNN's Citizen Journalism Goes "Awry" with False Report on Jobs*, BLOOMBERG.COM, Oct. 4, 2008, available at

<http://www.bloomberg.com/apps/news?pid=newsarchive&sid=atekONWyM7As>. The rumor appears to have originated with a teenage prankster. *See* David Scheer, *Teen Said to Have Faked Heart-Attack Story about Apple's Jobs*, BLOOMBERG.COM, Oct. 27, 2008, available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aHoYWf1H5Kys>.

<sup>73</sup> *See, e.g.,* Stransky v. Cummins Engine Co., 51 F.3d 1329, 1331 (7th Cir. 1995) (stating that a duty to correct arises "when a company makes a historical statement that, at the time made, the company believed to be true, but as revealed by subsequently discovered information actually was not"). For an analysis of the underpinnings of the duty to correct, see LANGEVOORT, *supra* note 28, at 1669-70, 1678-79. For a discussion of the caselaw on the duty to correct, see J.

in question is still “alive” in the investing marketplace.<sup>74</sup> Thus, if in response to a routine question from the press or a securities analyst a luminary responds that he is in peak health and the next week he gets the results of some medical tests taken prior to the statement that reveal a serious medical problem, the luminary, or the company, should correct the prior statement which is now known to have been inaccurate when made so long as the medical facts are material.<sup>75</sup>

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ROBERT BROWN, *THE REGULATION OF CORPORATE DISCLOSURE* § 3.04 (3d ed. 2008) [hereinafter BROWN].

<sup>74</sup> See *Ross v. A.H. Robins Co.*, 465 F. Supp. 904, 908 (S.D.N.Y.), *rev'd on other grounds*, 607 F.2d 545 (2d Cir. 1979). It is alive so long as it continues to be relied upon in the market. See *Overton v. Todman & Co.*, 478 F.3d 479, 486-87 (2d Cir. 2007) (finding element of duty to correct exists when the defendant “knows or should know that potential investors are relying” on the inaccurate statement); and *In re Harmonic Inc.*, 2002 WL 31974384, at \*18 (N.D. Cal. Nov. 13, 2002), *rev'd on other grounds sub nom. Knollenberg v. Harmonic, Inc.*, 152 Fed. App'x 674 (9th Cir. 2005) (“a duty to disclose generally arises only where necessary to correct a prior statement that remains viable in the market and was inaccurate at the time it was made”).

<sup>75</sup> One of the more common corrections of prior statements purportedly believed to be true when made that turn out not to have been true arise in the context of the restatement of financial statements. See, e.g., Report on Form 8-K of New Century Financial Corporation dated February 7, 2007, announcing that its financial statements for the first three calendar quarters of 2006 would be restated (*available at* [http://www.sec.gov/Archives/edgar/data/1287286/000129993307000769/htm\\_18068.htm](http://www.sec.gov/Archives/edgar/data/1287286/000129993307000769/htm_18068.htm)), the most recent of which had been released little more than two months earlier, on November 2, 2006. See Report on Form 8-K of New Century Financial Corporation dated November 2, 2006

E. If a Health-Related Statement was Accurate when Made, There is No Duty to Update the Statement Even if it is No Longer True

In some federal jurisdictions there is a somewhat ill-defined “duty to update” a statement that was true when made but is no longer accurate because of subsequent events.<sup>76</sup> Similar to the duty to correct, those courts that impose a duty to update do so only when the statement in question is still “alive” in the marketplace of investor information when it becomes no longer materially correct or complete.<sup>77</sup> The duty to update is applied where “the earlier statement, so long as it remains alive, operates as a continuing representation of its accuracy.”<sup>78</sup>

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(available at <http://www.sec.gov/Archives/edgar/data/1287286/000119312506222212/d8k.htm>).

A restatement disclosure, however, is independently driven in part by the express requirement in Item 4.02 of Form 8-K that mandates disclosure whenever the board of directors determines that prior financial statements should no longer be relied upon. See Item 4.02 of Form 8-K, available at <http://www.sec.gov/about/forms/form8-k.pdf>, at 13-14.

<sup>76</sup> *Time Warner*, 9 F.3d at 266-68 (“A duty to disclose arises whenever secret information renders prior public statements materially misleading, not merely when that information completely negates the public statements.”); *contra Stransky*, 51 F.3d at 1332-33 (holding that the language of Rule 10b-5 “implicitly precludes basing liability on circumstances that arise after the speaker makes the statements”).

<sup>77</sup> See, e.g., *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1432 (3d Cir. 1997) (“For a plaintiff to allege that a duty to update a forward-looking statement arose on account of an earlier-made projection, the argument has to be that the projection contained an implicit factual representation that remained ‘alive’ in the minds of investors as a continuing representation.”) Soon after *Burlington*, the Third Circuit expressed the duty to update in

In those jurisdictions where the duty to update is recognized, it is unlikely that the duty would extend to a statement about a person's health that was true when made and became inaccurate only as a result of subsequent developments. A statement about one's health is inherently a statement *only* about the present – what the *current* situation is; it is not implicitly forward-looking nor should it be interpreted as an evergreen “live” statement that would need to be corrected if the underlying facts changed.<sup>79</sup> Given the inherent uncertainty of health, no one

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somewhat broader terms, nevertheless limited to the situation of a change from an implied static situation:

In general, Section 10(b) and Rule 10b-5 do not impose a duty on defendants to correct prior statements - particularly statements of intent - so long as those statements were true when made. See *In re Phillips Petroleum*, 881 F.2d [1236] at 1245 [(3d Cir. 1989)]. However, “[t]here can be no doubt that a duty exists to correct prior statements, if the prior statements were true when made but misleading if left unrevised.” *Id.* To avoid liability in such circumstances, “notice of a change of intent [must] be disseminated in a timely fashion.” *Id.* at 1246.

*Weiner v. Quaker Oats Co.*, 129 F.3d 310, 316 (3d Cir. 1997).

<sup>78</sup> LANGEVOORT, *supra* note 28, at 1668.

<sup>79</sup> Most cases recognizing the duty to update apply it only to a projection, even if only implicit, about future circumstances, or to a representation that is deemed continuing. *See, e.g., Weiner*, 129 F.3d at 316-17 (finding that repeated statements regarding the company's capitalization ratio may have created a reasonable understanding that it was a continuing guideline that would remain in effect or that any change would be announced); *Burlington*, 114 F.3d at 1432 (stating that there is no duty to update unless the statement at issue “contained an implicit factual representation that remained alive in the minds of investors as a continuing representation”); *Time Warner*, 9 F.3d at 268 (stating that when a corporation announced a business goal and an intended approach for reaching the goal, the corporation may be obligated

could reasonably understand a statement about one's expectation of future good health as meaningful. This draws a very fine distinction. The statement, "I am very healthy" is a statement about the present and predicts nothing, so that there is no duty to update when the person becomes ill. If I have no complaints or evident symptoms of disease when I made the statement, I have not consciously misrepresented any facts. If I visit my doctor the next day and am told I almost certainly have a life-threatening condition, the duty to correct discussed in Section II.D may be implicated, not the duty to update, because the underlying condition was almost certainly present, though unknown, when I made the positive statement about my health.<sup>80</sup>

F. A Half-Truth about Health May be Unlawful

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to disclose other approaches that later come under active consideration). Thus, where there is no forward-looking or continuing element to the statement that allegedly has become false, even those courts that recognize a duty to update do not impose a duty. *See, e.g., Time Warner*, 9 F.3d at 267 (finding no duty to update where "the attributed public statements lack the sort of definitive positive projections that might require later correction").

<sup>80</sup> The distinction was explained in *Gallagher*, 269 F.3d at 810-11. A duty to correct arises when the statement was incorrect when made; the duty to update – where recognized – arises when subsequent events, no matter how soon after the disclosure, render the prior statement incorrect.

Rule 10b-5 renders unlawful a statement that omits a material fact necessary in order to make the statements actually made not misleading.<sup>81</sup> If the CEO were mentally incapacitated, a statement that the senior management team is poised to execute the company’s growth plan, if not outright false,<sup>82</sup> may be a misleading half-truth in failing to disclose that a primary member of that team is in fact not up to the task.<sup>83</sup> Similarly, a glowing “president’s letter” at the front of the annual report to stockholders that fails to note that the president in fact suffers from the early stages of dementia and did not actually read, much less compose, the letter could render the letter (and its signature) a half-truth, if not affirmatively misleading, subject only to the important issue of the materiality of the president’s mental condition.<sup>84</sup> Publication in the annual report of a picture of the management team that includes the CEO, taken some months earlier, when at the time of publication he is undergoing aggressive chemotherapy that materially interferes with his mental acuity, could also be a half-truth if not altogether misleading – the photograph is accurate, but it is incomplete in not disclosing the condition of the CEO that renders the message conveyed by the photograph misleading.

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<sup>81</sup> The second clause of Rule 10b-5 provides that it is unlawful “to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made not misleading . . . .” 17 C.F.R. §240.10b-5(b) (2008).

<sup>82</sup> *See supra* Section II.B.

<sup>83</sup> This particular example may invoke another doctrine, more appropriately addressed under the issue of materiality. *See infra* text accompanying notes 135-137.

<sup>84</sup> *See also supra* Section II.C.3 regarding the implicit representation of identifying the CEO. Materiality is addressed *infra* in Section III.

G. There is No Obligation to Correct a Rumor about a Luminary's Health that Was Not Fostered by the Company

Sometimes there are rumors about the health of a luminary.<sup>85</sup> A public company, however, has no duty to correct a rumor, unless the company, or someone acting on its behalf, was the source of the rumor.<sup>86</sup> Whether to make a statement to dispel inaccurate rumors from other sources is purely a business decision, not one compelled by the law. Once the company decides to address the rumor, however, it must take care that the statements made are neither affirmatively misleading nor a misleading half-truth.<sup>87</sup>

H. Regulation FD May Require Disclosure of a Luminary's Health If the Illness Is Selectively Disclosed

SEC Regulation FD ("Fair Disclosure")<sup>88</sup> requires public disclosure of information when the company or certain corporate officials<sup>89</sup> disclose previously undisclosed material information

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<sup>85</sup> See, e.g., Nocera *supra* note 1 ("rumors began swirling that Steve Jobs was sick again. They had started during the company's annual Worldwide Developers Conference, where Mr. Jobs looked unusually thin and haggard.").

<sup>86</sup> See, e.g., Eisenstadt v. Centel Corp., 113 F.3d 738, 744 (7th Cir. 1997) (stating that "[o]bviously a corporation has no duty to correct rumors planted by third parties"); and State Teachers Retirement Bd. v. Fluor Corp., 654 F.2d 843, 850 (2d Cir. 1981) ("A company has no duty to correct or verify rumors in the marketplace unless those rumors can be attributed to the company"). As with all disclosure issues, even if the company were the source of a false rumor there would be no duty to correct unless the rumor was *materially* false.

<sup>87</sup> Thus, in *Basic*, 485 U.S. 224, a claim may have been stated where the company issued false denials in response to a request for an explanation for unusual activity in its stock.

<sup>88</sup> 17 C.F.R. Part 243 (2000).

in a non-public manner to persons in one or more categories.<sup>90</sup> This is intended to preclude favoring some investors with information not available to others.<sup>91</sup> If a material disclosure is made on a selective basis by a covered person to someone in one of the specified categories, then public disclosure must be made by the company, either by filing a Form 8-K or by disseminating “the information through another method (or combination of methods) of disclosure that is reasonably designed to provide broad, non-exclusionary distribution of the information to the public.”<sup>92</sup> Thus, if material non-public information about a luminary’s health has been

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<sup>89</sup> Regulation FD, Rule 100(a), 101(c), 17 C.F.R. §§ 243.100(a), 243.101(c) (2000).

<sup>90</sup> Regulation FD, Rule 100(b)(1), 17 C.F.R. § 243.100 (b) (2000). The rule does not apply if, among other exclusions, the selective disclosure is made to a person who owes a duty of trust and confidence to the issuer or is made to a person who expressly agrees to maintain the information in confidence. *Id.*, Rules 101(b)(2)(i)-(ii), 17 C.F.R. § 243.1-01(b)(2)(i)-(ii) (2000).

<sup>91</sup> Selective Disclosure and Insider Trading, Securities Act Release No. 7881, 65 Fed. Reg. 51716, 51716 (Aug. 24, 2000) (“many issuers are disclosing important nonpublic information, such as advance warnings of earnings results, to securities analysts or selected institutional investors or both, before making full disclosure of the same information to the general public”). The underlying purpose of Regulation FD is to prevent the misuse of information. *See id.* (stating as a rationale for adopting Regulation FD that where selective disclosure has occurred “those who were privy to the information beforehand were able to make a profit or avoid a loss at the expense of those kept in the dark”).

<sup>92</sup> Regulation FD, Rules 101(a) and 101(e), 17 C.F.R. §§ 243.101(a), 243.101(e) (2000). If the selective disclosure was intentional, the required public disclosure must be simultaneous with the selective disclosure; if it was “non-intentional” then the public disclosure must be made

selectively revealed to a limited group of investors in a disclosure attributed to the company (or by the luminary herself if she is one of the persons whose act of disclosure is encompassed by Regulation FD),<sup>93</sup> the company would be obligated to make public disclosure of that information.

Regulation FD might apply if the ill-health of a luminary were revealed by the appearance of the individual, such as at a small social gathering where some company stockholders were present.<sup>94</sup> Regulation FD applies, however, only to disclosures by a “senior official of the issuer . . . or any other officer, employee or agent of an issuer who regularly

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as soon as reasonably practicable but in no event after the later of 24 hours or the commencement of the next day’s trading on the New York Stock Exchange. *Id.*, Rules 100(a) and 101(d), 17 C.F.R. §§ 243.100(a), 243.101(d) (2000). If Form 8-K is used to make a disclosure that is required under Regulation FD, Item 7.01 (*available at* <http://www.sec.gov/about/forms/form8-k.pdf>, at 19) is used.

<sup>93</sup> *See supra* text accompanying note 89.

<sup>94</sup> By its terms, Regulation FD applies to disclosure to someone who is a holder of the company’s securities “under circumstances in which it is reasonably foreseeable that the person will purchase or sell the issuer’s securities on the basis of the information.” Regulation FD, Rule 100(b)(1)(iv), 17 C.F.R. § 243.100(b)(1)(iv) (2000). These investors in attendance are the ones who would be benefited by disclosure of adverse information – the ill-health of a luminary – by being able to sell the securities before the public generally, and thus the market, had this information. Appearance in public, even in a larger group, does not satisfy the disclosure requirement of Regulation FD discussed *supra* text accompanying note 92.

communicates” with, for example, stockholders,<sup>95</sup> so that if the luminary whose appearance is revelatory is not such a corporate official nor was the corporation responsible for the appearance, Regulation FD would not be implicated.

No verbal statement need be made by anyone about the person’s health in order to trigger Regulation FD; there can be non-verbal disclosure.<sup>96</sup> In an article commenting on the current health of Steve Jobs, one investor was quoted as saying, “Because Steve Jobs has been appearing in public regularly, investors are getting a valuable form of disclosure.”<sup>97</sup> If a public appearance that conveys a positive impression is a “valuable form of disclosure,” then appearance, in a restricted setting, that conveys a negative impression is likewise a form of disclosure but troublesome because it is selective.<sup>98</sup> For example, if the luminary had undergone extensive

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<sup>95</sup> Regulation FD, Rule 101(c), 17 C.F.R. § 243.101(c) (2008).

<sup>96</sup> “Although Regulation FD pertains solely to disclosure of information, the challenged communication need not be an expressed verbal or written statement. Tacit communications, such as a wink, nod, or a thumbs up or down gesture, may give rise to a Regulation FD violation.” S.E.C. v. Siebel Systems, Inc., 384 F. Supp. 2d 694, 708 n. 14 (S.D.N.Y. 2005).

<sup>97</sup> Nocera, *supra* note 1.

<sup>98</sup> This analysis may seem harsh, almost cruel, essentially compelling a sick luminary who wishes to keep his health a secret to remain an invalid until he recovers, lest any appearance, even in a small social gathering, trigger a Regulation FD disclosure. Nevertheless, unless those with whom he comes into contact are under a duty of confidentiality (such as the medical professionals who tend to him under, for example, statutes that impose a duty of confidentiality upon the medical professionals (*see* 3 JACK B. WEINSTEIN & MARGARET A. BERGER, WEINSTEIN’S FEDERAL Evidence §§ 514.11 – 514.12 (Joseph M. McLaughlin ed., 2d

chemotherapy for a serious form of cancer and as a result his appearance changed noticeably, effectively revealing that he was quite ill, or at the very least that he had undergone debilitating

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ed. 2008)), the luminary's visitors could take advantage of the information in a way that is precluded by Rule 10b-5, under the prohibition on trading while aware of material non-public information. (For a general discussion of the scope of the prohibition, see Allan Horwich, *The Origin, Application, Validity, and Potential Misuse of Rule 10b5-1*, 62 BUS. LAW. 913, 915-17 (2007).) Regulation FD is intended to reduce the opportunities to exploit material non-public information in this way. *See supra* note 91. Note that SEC Rule 10b5-2(b)(2)-(3) (17 C.F.R. § 240.10b5-2(b)(2)-(3) (2008)) specifies when there is a duty of "trust and confidence" based on a pattern or practice of sharing confidences or certain family relationships (a rebuttable presumption in the latter category). This is similar to the phrase used in Section 101(b)(2)(i) of Regulation FD providing that disclosure to one who owes a "duty of trust or confidence" to the speaker does not violate that regulation. By its express terms, however, Rule 10b5-2 applies only to cases involved alleged misappropriation of material non-public information in violation of Rule 10b-5, with no reference to any application to Regulation FD. Rule 10b5-2(a) and Preliminary Note, 17 C.F.R. § 240.10b5-2(a) and Preliminary Note (2008). This absence of cross reference is puzzling, especially since both rules were promulgated in the same SEC release. *See Selective Disclosure and Insider Trading, supra*. For a discussion of the application of common law principles to determine whether there was a duty of trust and confidence among family members regarding business matters, see *U.S. v. Chestman*, 947 F.2d 551, 568-71 (majority opinion finding no duty among certain family members), 579-80 (opinion dissenting in part finding a duty), 582-83 (concurring opinion finding no duty) (2d Cir. 1991) (en banc) (reversing conviction in insider trading case).

medical treatment, this non-public appearance would convey information about his health, however nonspecific. If the appearance that the information conveyed, *i.e.*, the existence of some illness requiring aggressive treatment, was material, it could trigger the disclosure requirement of Regulation FD, depending on who is responsible for the disclosure.

I. A Stock Exchange Rule Requiring Disclosure of a Material Development Does Not Impose an Obligation under the Exchange Act

Stock exchange rules require prompt disclosure of material company developments by companies that have contracted with the exchange to list their stock on that exchange.<sup>99</sup> The

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<sup>99</sup> For example, the following rule applies to companies whose securities are listed on the New York Stock Exchange:

A listed company is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities. This is one of the most important and fundamental purposes of the listing agreement which the company enters into with the Exchange.

NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 202.05 (2006), *available at* [http://www.nyse.com/Frameset.html?nyseref=http%3A//www.nyse.com/regulation/listed/1182508124422.html&displayPage=/lcm/lcm\\_subsection.html](http://www.nyse.com/Frameset.html?nyseref=http%3A//www.nyse.com/regulation/listed/1182508124422.html&displayPage=/lcm/lcm_subsection.html). *See also* REGULATORY REQUIREMENTS OF THE NASDAQ NATIONAL MARKET, at 7 (Aug. 2008), *available at* <http://www.nasdaq.com/about/RegRequirements.pdf> (providing that all companies listed on the NASDAQ National Market are required “except in unusual circumstances” to “[d]isclose promptly to the public through any Regulation FD-compliant method (or combination of methods) material information which would reasonably be expected to affect the value of their securities or influence investors’ decisions”).

failure to comply with a stock exchange rule, however, does not in and of itself constitute a violation of the Exchange Act by the company.<sup>100</sup>

### III. THE MEDICAL CONDITION OF A LUMINARY MAY BE A MATERIAL FACT

With the principal exception of some items in Regulation S-K and in Form 8-K, disclosure issues under the Exchange Act revolve around whether a given fact is material.<sup>101</sup> Whether one of the disclosure principles or requirements discussed in Section II of this Article is triggered will thus depend upon whether the medical information about the luminary is material at the time.<sup>102</sup>

#### A. The Definition of a Material Fact

A fact is not material simply because someone would like to know the information, would find it of interest.<sup>103</sup> Material information is that as to which there is a substantial likelihood a reasonable shareholder would consider it important in making an investment decision.<sup>104</sup> Stated another way, a fact is material if there is a substantial likelihood that the

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<sup>100</sup> The violation of a stock exchange rule requiring corporate disclosure does not give rise to a private cause of action under Rule 10b-5. *See In re VeriFone Sec. Litig.*, 11 F.3d 865, 870 (9th Cir. 1993).

<sup>101</sup> For example, Item 5.03(a) of Form 8-K (*available at* <http://www.sec.gov/about/forms/form8-k.pdf>, at 16-17) requires disclosure of any bylaw amendment made by the company without any reference to whether the change is material.

<sup>102</sup> *See particularly supra* Section II.C.

<sup>103</sup> *See supra text accompanying* note 15.

<sup>104</sup> *Basic*, 485 U.S. at 231-32; *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

disclosure of the fact would be viewed by the reasonable investor as significantly altering the “total mix” of information.<sup>105</sup> Information need not be outcome determinative in the investor’s decision whether to buy or sell a security, it need only be considered important in the decision-making process.<sup>106</sup>

These concepts are more readily applied to so-called hard information, that is, historical or present facts. A somewhat different test has been applied to “soft” information, regarding predictions and other forward-looking statements. Whether a contingent fact is material will depend upon “a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.”<sup>107</sup> For example, whether merger negotiations at any point along the continuum of discussions is material will depend on the probability that there will in fact be a deal, as well as how significant the combination will be for the company in question.<sup>108</sup>

As with all assessments of materiality under the Exchange Act, whether a fact is material at a specific time requires an evaluation of the facts and circumstances at that time.<sup>109</sup>

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<sup>105</sup> *TSC Indus.*, 426 U.S. at 449 (applying concept to proxy solicitation under Rule 14a-9), applied to actions under Rule 10b-5 in *Basic*, 485 U.S. at 231-32.

<sup>106</sup> *TSC Indus. Inc.*, 426 U.S. at 449.

<sup>107</sup> *Basic*, 485 U.S. at 238, quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968).

<sup>108</sup> *Basic*, 485 U.S. at 239.

<sup>109</sup> *Id.* at 240; *see also Weiner*, 129 F.3d at 317 (stating that materiality determinations are “fact-specific,” which militates against dismissal of a claim at the pleading stage); *SEC v. Bausch & Lomb, Inc.*, 420 F. Supp. 1226, 1233 (S.D.N.Y. 1976), *aff’d*, 565 F.2d 8 (2d Cir.

## B. Application of the Materiality Tests to Health and Other Medical Information

### 1. Who is a Luminary?

The concept of a “luminary” used here focuses on someone who is especially integral to the success of the enterprise, so that her continued active, energetic involvement may be much more important than that of, for example, one member of a multi-person team in the executive suite where any of the team members could fill the shoes of any other who might be disabled from serving – temporarily or permanently – or leave the firm.<sup>110</sup> A number of commentators, for example, view Steve Jobs to be very important to Apple’s success, or at least the investment community’s perception of Apple, as both a creative force and inspiration to others within the company.<sup>111</sup> The same has been said – including by the company itself – regarding Martha

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1977) (“Each individual case must be viewed as a discrete set of circumstances and judged on its own unique facts.”).

<sup>110</sup> See, e.g., John Markoff, *Microsoft President is Dismissed*, N.Y. TIMES, Feb. 4, 1992, 1992 WLNR 3277054 (describing creation of “office of the president” at Microsoft Corporation, whereby three people would occupy the office that “would assume much of the responsibility for running the business”). “Generally, an executive’s absence is more likely to be considered important by a reasonable investor if his or her management or other functions are not adequately covered by others . . . .” Heminway, *supra* note 4, at 762. Another appropriate descriptive term is an “iconic” executive. *Id.* at 763.

<sup>111</sup> See, e.g., Nocera, *supra* note 1 (describing Jobs, perhaps with some hyperbole, as “the single most indispensable chief executive on the planet”); *Job’s Job*, THE ECONOMIST Aug. 2, 2008, at 68 (“Mr Jobs is arguably unique in the extent to which his identity and fate are

Stewart's importance to Martha Stewart Living Omnimedia.<sup>112</sup> Google has described several of its executives in the following terms: "Our future success depends in a large part upon the continued service of key members of our senior management team. In particular, our CEO, Eric Schmidt, and our founders, Larry Page and Sergey Brin, are critical to the overall management of Google as well as the development of our technology, our culture and our strategic direction."<sup>113</sup> Thus, the first step in the materiality analysis is to determine the importance of the individual to the firm. The concept of "luminary" used here refers to someone whose temporary or permanent loss would be very significant for the future financial results or stability and continuity of the company.

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intertwined with those of his company. Imagining Apple without Steve Jobs, or Mr Jobs without Apple, is difficult . . . .").

<sup>112</sup> In bold face type, the company stated, "Our success depends in part on the popularity of our brands and the reputation and popularity of our founder, Martha Stewart, and any adverse reactions to publicity relating to Ms. Stewart, or the loss of her services, could adversely affect our revenues, results of operations and our ability to maintain or generate a consumer base." Form 10-K of Martha Stewart Living Omnimedia, Inc. for the period ending December 31, 2007, at 12, *available at* <http://www.sec.gov/Archives/edgar/data/1091801/000095012308003028/y51525e10vk.htm>. *See also* Leslie Kaufman & Bill Carter, *Empire Not Much Affected, Yet, by Cloud over Martha Stewart*, N.Y. TIMES, June 25, 2002, at C1, 2002 WLNR 4025545 (discussing importance of Martha Stewart to the success of Martha Stewart Living Omnimedia ).

<sup>113</sup> Google Inc. Form 10-Q for the period ending June 30, 2008, *available at* <http://www.sec.gov/Archives/edgar/data/1288776/000119312508170309/d10q.htm>, at 46.

The SEC has faced the issue of defining what corporate employees are important enough so that disclosure should be made regarding them. For example, the SEC has determined that a company must disclose the compensation of specified executives.<sup>114</sup> The list could easily be expanded, or contracted, in the judgment of the SEC.<sup>115</sup> A health disclosure requirement should

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<sup>114</sup> See SEC Schedule 14A, Item 8 (17 C.F.R. § 240.14a-101, Item 8 (2008)), requiring disclosure of the information specified in, among other provisions, Item 402 of Regulation S-K (17 C.F.R. § 229.402 (2008)), in a proxy statement for the election of directors, *i.e.*, the annual stockholders meeting. Item 402 requires disclosure of extensive data regarding the compensation of the principal executive officer, the principal financial officer, and the three most highly compensated executive officers other than the foregoing. Item 402(a)(2)-(3). The required information includes salary, bonus, stock awards, and stock option awards, among other components of compensation. Item 402(c).

<sup>115</sup> The SEC is continuing to consider whether the proxy statement compensation disclosures should encompass other persons. When it adopted the major overhaul of compensation disclosure in 2006 the SEC stated:

[W]e remain concerned about disclosure with respect to employees, particularly within very large companies, whether or not they are executive officers, whose total compensation for the last completed fiscal year was greater than that of one or more of the named executive officers. If any of these employees exert significant policy influence at the company, at a significant subsidiary of the company or at a principal business unit, division, or function of the company, then investors seeking a fuller understanding of a company's compensation program may believe that disclosure of these employees' total compensation is important information. Knowing the compensation, and job positions within the organization, of these highly compensated policy-makers whose total compensation for the last fiscal year was greater than that of a named executive officer, should assist in placing in context and permit a better understanding of the compensation structure of the named executive officers and directors.

Our intention is to provide investors with information regarding the most highly compensated employees who exert significant policy influence by having

not necessarily apply to everyone who is encompassed by the compensation disclosure rules.<sup>116</sup> For example, a general counsel who happens to be among the most highly compensated officers is not likely to be a luminary. In some cases a luminary – such as someone whose creative skills have proven very valuable to the company but who has no managerial responsibilities – may not be among the most highly compensated executives.

## 2. When is Impaired Health of a Luminary a Material Fact?

The second step is to evaluate the significance of the medical condition. The appropriate perspective is to determine whether ill health that impairs the ability of the luminary to do what it is that makes him a luminary is material to the company. The ability of a luminary to (continue to) function *is* material by virtue of the definition of a luminary.

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responsibility for significant policy decisions. Responsibility for significant policy decisions could consist of, for example, the exercise of strategic, technical, editorial, creative, managerial, or similar responsibilities. Examples of employees who might not be executive officers but who might have responsibility for significant policy decisions could include the director of the news division of a major network; the principal creative leader of the entertainment function of a media conglomerate; or the head of a principal business unit developing a significant technological innovation. By contrast, we are convinced by commenters that a salesperson, entertainment personality, actor, singer, or professional athlete who is highly compensated but who does not have responsibility for significant policy decisions would not be the type of employee about whom we would seek disclosure.

Executive Compensation and Related Person Disclosure; Final Rule and Proposed Rule, Securities Act Release No. 8732A, 71 Fed. Reg. 53158, 53181 (Sept. 8, 2006) (footnote omitted). The SEC has not, however, expanded the scope of the disclosure requirement to meet this continuing concern.

<sup>116</sup> See *supra* text accompanying note 114..

On first consideration health may seem to be a qualitative factor, like integrity. Some cases have recognized that management integrity may be material.<sup>117</sup> More recent cases have emphasized that to the extent integrity may be material at all under the securities laws, it is only because of specific facts that may bear on integrity, not because a general assessment of integrity is material.<sup>118</sup> In the judgment of one author, what he calls “ethical materiality” has little traction today under the securities laws.<sup>119</sup>

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<sup>117</sup> See, e.g., *In the Matter of Franchard Corp.*, 42 S.E.C. 163, 169, 172 (1964) (addressing disclosures in a registration statement, finding facts regarding the diversion of funds to a company affiliated with the chief executive officer were “highly material to an evaluation of the competence and reliability” of management and were “germane to an evaluation of the integrity of his management,” which “is always a material factor.”)

<sup>118</sup> See *Greenhouse v. MCG Capital Corp.*, 392 F.3d 650, 660 (4th Cir. 2004), where the court stated, after discussing cases where facts were held to be material as bearing on integrity of management:

[T]he securities laws are only concerned with lies about material facts. Reading the law otherwise, as Appellants would have us do, simply reads materiality out of the statute. Under their theory, almost any misrepresentation by a CEO—including, perhaps, one about his or her marital fidelity, political persuasion, or golf handicap—that might cause investors to question management’s integrity could, as such, serve as a basis for a securities-fraud class action. The law simply does not permit such a result.

<sup>119</sup> Richard C. Sauer, “The Erosion of the Materiality Standard in the Enforcement of the Federal Securities Laws,” 62 BUS. LAW. 317, 330-32 (2007). See also Karl A. Groskaufmanis, *et al.*, *To Tell or Not to Tell: Reassessing Disclosure of Uncharged Misconduct*, in PLI 33RD ANNUAL INSTITUTE ON SECURITIES REGULATION, 469 (noting that the doctrine requiring disclosures based on “qualitative materiality” has been “sapped” by decided cases and “lacks

Ill-health of a luminary in this respect is more properly assessed as an impairment of an asset of the company than a concept bearing on qualitative stewardship. A luminary is a valuable asset of the entity – either because of her essential role in keeping a hand on the tiller of the corporate machinery or because of specific contributions to earnings through, for example, product development, marketing prowess or extraordinary acumen in making investment decisions. Even if “investors are primarily concerned about information that is directly related to the issuer’s financial performance,”<sup>120</sup> the essence of the concept of the luminary in many cases is his contribution to the corporate bottom line, not (just) to its profile.

Another perspective on the relevance of a luminary’s health is its impact on the luminary’s control or ownership of her stock where the luminary has significant stockholdings in the company. Thus, if a decline in mental capacity meant that someone other than the luminary would exercise control over a significant block of votes represented by the stock ownership or if the luminary’s death would effect a significant transfer in ownership, such as the controlling interest in the company, the luminary’s state of health may be very significant to stockholders.<sup>121</sup>

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vitality”) [hereinafter GROSKAUFMANIS]. *But see* BROWN, *supra* note 73, at § 5.04[3] & 5.04[3][a], at 5-62.1 (criticizing the finding of non-materiality in *Greenhouse*, and concluding that facts regarding managerial integrity may be material, even where there is no discernible impact of the information on earnings, though recognizing that determining when “improper behavior becomes relevant to management integrity remains elusive”).

<sup>120</sup> Sauer, *supra* note 119, at 327.

<sup>121</sup> *Cf. Franchard*, 42 S.E.C. at 173 (holding it was material that controlling stockholder had pledged his stock on onerous terms to secure personal loans because disclosure of that information “would have alerted investors to the possibility of a change in the control and

Of course, the materiality analysis in *Basic* focused on when negotiations of a merger, *i.e.*, change of control from the perspective of the shareholders of the target company, were material to those shareholders.<sup>122</sup> The comparable issue in the health context is when the condition of a controlling shareholder or luminary has deteriorated to the extent that the prospect that the control of the corporation will become “in play” is material.

The most difficult assessment is determining when a health condition crosses the threshold from immaterial to material under the circumstances discussed in the preceding paragraphs. Death is straightforward, yet no SEC rule requires disclosure of the death of a senior executive.<sup>123</sup> The early stages of an illness that do not yet impair ability are not material but, similar to the merger negotiations context,<sup>124</sup> somewhere between diagnosis and imminent death the state of health becomes material. There may be a limited parallel in the Form 8-K requirement to disclose the resignation of certain executives.<sup>125</sup> The trigger for disclosure there

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management of the registrant and apprised them of the possible nature of any such change” (footnote omitted)); *SEC v. Gaspar*, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,004, at 90,977-78, 1985 WL 521, at \*15 (S.D.N.Y. Apr. 15, 1985) (finding that fact that “aging founder of the company and owner of a substantial portion of its shares” who “had never before considered selling his shares” was for the first time “seriously . . . negotiating with a potential purchaser” was material).

<sup>122</sup> 485 U.S. at 226-40.

<sup>123</sup> *See supra* note 38.

<sup>124</sup> *See supra* text accompanying notes 107-108 .

<sup>125</sup> *See supra* text accompanying note 38.

is not the effective date of the resignation but the notice of a decision to resign.<sup>126</sup> The emergence of health-related facts establishing the imminent or impending need to step down may likewise be material where the eventual impact is material to the company.

This does not, of course, make the medical analysis any easier. A first-time, early stage melanoma, a form of skin cancer, that has not spread may be of almost no consequence in terms of the luminary's future with the company or his ability to function at the time or even prospectively.<sup>127</sup> In the case of pancreatic cancer, however, more than 50% of the cases are not diagnosed until the disease has metastasized and of those cases the five year survival rate is less than 2%.<sup>128</sup>

Thus, an assessment of the materiality of a health condition presents an issue of prognosis, where the probability/magnitude test of *Basic* should be applied:<sup>129</sup> (1) what would be the magnitude for the company, that is, significance, of a health-driven loss (including death) of

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<sup>126</sup> SEC Staff Interpretations Exchange Act Form 8-K, Question 117.01, *available at* <http://www.sec.gov/divisions/corpfin/guidance/8-kinterp.htm> (addressing the reporting obligations with respect to directors and certain officers). The reporting obligation

is triggered by a notice of a decision to resign, retire or refuse to stand for re-election provided by the director, whether or not such notice is written, and regardless of whether the resignation, retirement or refusal to stand for re-election is conditional or subject to acceptance.

<sup>127</sup> The five-year survival rate for melanoma confined to the primary site is more than 98%. *See* National Cancer Institute, Survival Epidemiology and End Results, Melanoma of the Skin, *available at* <http://seer.cancer.gov/statfacts/html/melan.html>.

<sup>128</sup> National Cancer Institute, Survival Epidemiology and End Results, Pancreas, *available at* <http://seer.cancer.gov/statfacts/html/pancreas.html>.

<sup>129</sup> *See supra* text accompanying notes 107-108.

the luminary; and (2) what is the probability that that will occur (an assessment that is likely to change over time, so that a circumstance that is not material today may become material as it evolves<sup>130</sup>). When both the magnitude and probability are high, then the situation is material and the disclosure duties discussed in Section II are implicated.

The probability analysis is likely to test the limits of medical science, especially because many physicians may decline to provide a very definitive prognosis except in the most advanced serious cases. Physicians often quote odds or median data based on those with the particular ailment.<sup>131</sup> Sometimes, of course, the prognosis is wildly off.<sup>132</sup> The issue is especially complex

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<sup>130</sup> As the Court stated in *Basic*, materiality “will depend *at any given time*” upon the balancing of magnitude and probability. 485 U.S. at 238, quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968) (emphasis added herein), *See, e.g.*, *In re Xcel Energy, Inc., Sec., Deriv. & “ERISA” Litig.*, 286 F. Supp. 2d 1047, 1060 (D. Minn. 2003) (stating in dictum that for purposes of claim under Rule 10b-5 materiality may evolve over time); GROSKAUFMANIS, *supra* note 119, at 463 (cautioning that the evaluation of the need to disclose potentially illegal conduct “often occur[s] in a very dynamic environment, where the facts are learned and the landscape changes over time” with an “evolution [that] can span several quarters (or even years)”).

<sup>131</sup> *See, e.g.*, Lawrence K. Altman, M.D., *Many Holes in Disclosure of Nominees’ Health*, N.Y. TIMES, Oct 20, 2008, at A1, A20, 2008 WLNR 19923732 (noting that if presidential candidate Sen. John McCain’s melanoma in 2000 were classified as Stage III instead of the reported Stage IIA, it would change his “statistical odds for survival” at 10 years from about 60 percent to 36 percent); Andrew Pollack, *Hints of Progress in Drugs Treating Brain Cancer*, N.Y. TIMES, May 23, 2008, at A20, 2008 WLNR 9767876 (discussing the brain tumor of Sen. Ted

in degenerative diseases which, though they are not curable, do not always progress quickly, or even noticeably.<sup>133</sup> Nevertheless, one can readily posit situations where the poor health of a

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Kennedy at the time the diagnosis was announced, stating “glioma has a grim prognosis. Half of [the] people with glioblastoma multiforme, the most common and deadliest of the gliomas, die within 15 months”).

<sup>132</sup> See, e.g., Jan Hoffman, *When Thumbs Up Is No Comfort*, N.Y. TIMES, June 1, 2008, Sec. ST, 2008 WLNR 10339603 (reporting, “The evolutionary biologist at Harvard, Stephen Jay Gould, whose doctors told him that eight months was the median survival rate of patients with his diagnosis, abdominal mesothelioma, . . . died from another form of cancer 20 years after the initial diagnosis”).

<sup>133</sup> Paradigm examples are Alzheimer’s disease and other forms of dementia. “Alzheimer’s disease is the most common cause of dementia, which is the loss of intellectual and social abilities severe enough to interfere with daily functioning. . . . Alzheimer’s disease [is] a progressive, degenerative brain disease [that] eventually leads to irreversible mental impairment that destroys a person’s ability to remember, reason, learn and imagine. Because early Alzheimer’s symptoms progress slowly, diagnosis is often delayed. . . . The disease’s course varies from person to person. Eight years is the average length of time from diagnosis of Alzheimer’s to death.” Mayo Clinic Staff, *Alzheimer’s Disease* (Jan. 12, 2007), available at <http://www.mayoclinic.com/print/alzheimers-disease/DS00161/DSECTION=all&METHOD=print>

luminary is a material fact, such as the stock market's reaction to Jobs' announcement he was taking a leave of absence.<sup>134</sup>

### C. The Role of Puffery in the Analysis of Health-Related Statements

The earlier discussion of the duty not to misrepresent material facts<sup>135</sup> would not be complete without addressing the concept of “puffery,” which may apply to general statements about one's health. Statements that are vague and general, often (but not solely) regarding a company's growth prospects or other forward-looking matters, are sometimes deemed “puffery” and thus not material, so that the statement, if inaccurate, does not violate Rule 10b-5.<sup>136</sup>

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<sup>134</sup> Apple stock dropped \$6 to \$79.33 in after hours trading on the day he announced that he was taking a leave. *See Stone, Apple's Job Takes Medical Leave, supra* note 1, Apple stock had also dropped on a 2008 rumor that Jobs had had a heart attack. *See infra* note 145. Similarly, Berkshire Hathaway stock dropped when there were rumors that Warren Buffett was seriously ill. *Berkshire Hathaway Denies Buffett is Seriously Ill*, N.Y. TIMES, Feb. 11, 2000, at C20, 2000 WLNR 3269995.

<sup>135</sup> *See supra* Section II.B.

<sup>136</sup> *See, e.g., In re Apple Computer, Inc.*, 127 Fed. App'x 296, 303-04 (9th Cir. 2005) (holding that CEO's statement that the company had created the “best Power Mac ever” was not actionable because it was only a “vague statement[ ] of optimism”); *In re Cable & Wireless, PLC Sec. Litig.*, 321 F. Supp. 2d 749, 766-67 (E.D. Va. 2004) (stating that “rosy affirmations” management attacked by plaintiffs are “loosely optimistic statements that are so vague, so lacking in specificity, or so clearly constituting the opinions of the speaker, that no reasonable investor could find them important to the total mix of information”); *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 207 (1st Cir. 1999) (finding that CEO's statements that several new products

Puffery is, however, in the eye of the beholder.<sup>137</sup> Thus, any judgment that a statement can be made with impunity because it is “mere puffery” is fraught with peril. Accordingly, a health-related statement that may be thought to be entirely benign as puffery (“I’m as healthy as a

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would help achieve revenue objectives and that the company would lead the market in certain aspects of its business were non-actionable puffery); *Raab v. General Physics Corp.*, 4 F.3d 286, 289 (4th Cir. 1993) (“The statements in the 1991 Annual Report that plaintiffs challenge include ‘[r]egulatory changes . . . have created a marketplace for the DOE Services Group with an expected annual growth rate of 10% to 30% over the next several years’ and ‘the DOE Services Group is poised to carry the growth and success of 1991 well into the future.’ ‘Soft,’ ‘puffing’ statements such as these generally lack materiality because the market price of a share is not inflated by vague statements predicting growth.”).

<sup>137</sup> *See, e.g., Kaltman v. Key Energy Services, Inc.*, 447 F. Supp. 2d 648, 660 (W.D. Tex. 2006) (finding that statement “[b]ased on current activity and anticipated increases in demand for our services, we expect to see continued improvement in our operating results over the next several quarters. . . . A prolonged, modest upcycle, which we believe we are currently in, should yield tremendous benefits to our stakeholder” was “not too generalized or vague” and thus not puffery); *In Re Sirrom Capital Corp. Sec. Lit.*, 84 F. Supp. 2d 933, 943 (M.D. Tenn. 1999) (finding that statements such as “the company was well-positioned to produce at least 25% annual growth” and “the balance sheet was as healthy as it had ever been” were “hard facts about the current state” of the corporation’s affairs and not “vague optimism”). For an extensive discussion of the puffing concept, see 5C ARNOLD S. JACOBS, DISCLOSURE AND REMEDIES UNDER THE SECURITIES LAWS § 12:10 (2008).

horse”) may, if not in fact true, give rise to a duty to correct because its unqualified character was found to be material.<sup>138</sup>

D. There Do Not Appear to be Have Been Any Decided Cases under the Federal Securities Laws Involving Health-Related Disclosure

This author has not found any reported decision under the Exchange Act where the health of a luminary has been an issue,<sup>139</sup> nor any settled case where the SEC contended that any disclosure rule was violated for failing to disclose or inaccurately disclosing a health condition.<sup>140</sup>

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<sup>138</sup> See *supra* Section III.C.

<sup>139</sup> *Glenn, supra* note 4, at 540 n.24, after stating in 1994 that there is an “absence of cases or other authority addressing . . . squarely” the disclosure of an executive’s illness, cites *Kas v. Financial Gen. Bankshares, Inc.*, 796 F.2d 508, 519-19 (D.C. Cir. 1986), as having held that the failure to disclose a principal shareholder’s ill health in a proxy statement was not material. In fact, the Court of Appeals expressly did not adopt the District Court’s ruling to that effect, and instead affirmed the grant of summary judgment in favor of the defendants on this issue on the ground that plaintiffs had failed to present evidence supporting their contention that the shareholder’s health resulted in the kind of mental impairment claimed by plaintiffs. 796 F.2d at 518. If the case is pertinent at all, it is for questioning that “failure to disclose facts indicating a potentially grave impairment of an individual’s judgment is legally immaterial” when the proxy statement sets forth a statement of a judgment reached by the person. *Id.*

<sup>140</sup> This author has not found any SEC enforcement case addressing health disclosure, and one journalist claims there have been none. Nocera, *supra* note 1 (“No company has been held to account by the S.E.C. for failing to disclose information about its chief executive’s health”).

#### IV. THE SEC SHOULD IMPOSE A RULE REQUIRING DISCLOSURE OF MEDICAL INFORMATION ABOUT A LUMINARY THAT IS MATERIAL TO THE COMPANY

The author is unaware of any statements by the SEC about imposing a health-related disclosure requirement with regard to luminaries.<sup>141</sup> The general proclivity – notwithstanding the persistent efforts of the media – to preserve the privacy of persons in the private sector, especially on matters of health, presents a high hurdle for an argument in favor of mandatory disclosure of certain health problems.<sup>142</sup> Often a serious illness is a closely kept secret until

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There has been an unconfirmed report of an SEC investigation regarding Apple’s disclosures regarding Jobs’ health. *Supra* note 28.

<sup>141</sup> One commentator has proposed adoption of a broad rule regarding certain matters pertaining to executives, including health, albeit without proposing any specific language. Heminway, *supra* note 4, at 791-95.

<sup>142</sup> The SEC has recognized the privacy concern implicated by a requirement to disclose the reasons, such a health, why an executive resigned. *See supra* text accompanying notes 41-42.

In at least one other context the SEC may have taken personal privacy concerns into account in not adopting a disclosure requirement. The SEC had proposed that the issuer of the securities in question disclose “[e]ach director’s and executive officer’s adoption, modification or termination of a contract, instruction or written plan for the purchase or sale of company equity securities intended to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c).” Form 8-K Disclosure of Certain Management Transactions, Securities Act Release No. 33-8090, 67 Fed. Reg. 19914, 19915 (Apr. 23, 2002). Rule 10b5-1 provides for establishing a contract or plan for trading in securities pursuant to specific directions or a formula, or granting uncontrolled discretion to another person to trade securities of the creator of the plan, as a means of avoiding a charge that trades were directed when the creator of the plan was aware of material

revelation is unavoidable.<sup>143</sup> Should the law require disclosure to the public when custom justifies secrecy within one's own home? In the case of Steve Jobs, the interest of the investment community in his health is not idle curiosity – as the reports referred to earlier reflect, his non-public information about the security or the issuer of the security and thus would run afoul of the prohibition of trading on the basis of material non-public information. Rule 10b5-1, 17 C.F.R. § 10b5-1 (2008). *See generally* Horwich, *supra* note 98, at 925-28. The proposed addition to Form 8-K to require disclosure of Rule 10b5-1 plans, which has never been adopted by the SEC, generated objections based on concerns about the privacy of the personal financial transactions of persons who use Rule 10b5-1. *See, e.g.*, Letter of John A. Seethoff, Deputy General Counsel, Finance & Operations of Microsoft Corporation, June 24, 2002, *available at* <http://www.sec.gov/rules/proposed/s70902/jaseethoff1.htm> (“We . . . believe officers and directors are entitled to a degree of privacy regarding entering into these plans. Accordingly, we respectfully urge that the SEC not require disclosure about insiders’ Rule 10b5-1 plans, other than reports of actual transactions in issuer equity securities executed under those plans as at present.”); and Letter of Stanley Keller, Chair, Committee on Federal Regulation of Securities, et al., July 12, 2002, *available at* <http://www.sec.gov/rules/proposed/s70902/skeller.htm> (“We do not believe there is a general expectation of privacy with respect to the existence of a Rule 10b5-1 Plan. However, we strongly believe that there is an expectation of privacy regarding the specific economic terms (especially price information) of a Rule 10b5-1 Plan.”).

<sup>143</sup> *See, e.g.*, Barron H. Lerner, *McQueen’s Legacy of Laetrile*, N.Y. TIMES, Nov. 15, 2005, at F5, 2005 WLNR 18424239 (reporting that when movie star Steve McQueen was diagnosed with mesothelioma, “[h]e kept the diagnosis a secret from all but his closest friends” and denied rumors he was ill).

involvement in the company is seen as very significant for its future success.<sup>144</sup> Because few could doubt that his untimely demise would have a significant adverse impact on Apple (and thus on the price of its stock<sup>145</sup>), *if* Jobs were seriously ill that would seem to be material to investors. His professed desire for privacy in the specific context of Apple should not be an overriding, dispositive factor.

The securities laws often require disclosures of matters that luminaries might prefer not be disclosed, when the disclosure is deemed to be sufficiently in the public interest because of its significance to investors. For example, most people are able to maintain the confidentiality of their salaries. The rules of the SEC, however, require the disclosure of every element of compensation of five highly paid executives of public companies.<sup>146</sup> Similarly, the SEC requires disclosure of certain transactions not only between the corporation and any director or executive officer of the corporation but also between the corporation and certain persons related to any director or executive officer when those persons have a material interest in the transaction.<sup>147</sup> In that context any desire for secrecy does not trump the public interest in the disclosure of

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<sup>144</sup> *See supra* text accompanying note 111.

<sup>145</sup> *See supra* note 134 regarding the change in the price of Apple stock after Jobs announced he was taking a leave of absence. Also, on the day of a false rumor that Jobs of Apple had suffered a heart attack the stock dropped more than 5%. *See Callan, supra* note 72.

<sup>146</sup> *See supra* note 114.

<sup>147</sup> *See* SEC Schedule 14A, Item 7 (17 C.F.R. § 240.14a-101, Item 7 (2008)), requiring disclosure of the information specified in, among other provisions, Item 404(a) and (b) of Regulation S-K (17 C.F.R. § 229.404(a)-(b) (2008), in a proxy statement for the election of directors, *i.e.*, the annual stockholders meeting.

information regarding compensation of officers of public companies and potential conflicts of interest.<sup>148</sup>

For the reasons discussed in Section III of this Article, determining whether a health situation is material is often difficult, so that imposing a requirement to disclose material adverse developments in a luminary's health that are likely to materially affect the company will frequently present difficult questions of judgment. For example, factor may militate against any disclosure requirement. Thus, when the SEC substantially expanded the number of items to be reported on Form 8-K, it created a safe harbor from liability under Rule 10b-5 for the failure to make a timely filing under certain items which "may require management to quickly assess the materiality of an event or to determine whether a disclosure obligation has been triggered."<sup>149</sup> Nevertheless, disclosure still must be made no later than the next quarterly filing, and the safe harbor does not provide protection from an SEC enforcement action for failure to comply with the requirements of Form 8-K.<sup>150</sup> Thus, the relief afforded was temporary – for a few months at

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<sup>148</sup> See Executive Compensation and Related Person Disclosure, Securities Act Release No. 8732A, 71 Fed. Reg. 53158, 53202 (Sept. 8, 2006) (discussing rationale of expansion of Item 404 to address disclosure of potential conflicts of interest).

<sup>149</sup> Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, Securities Act Release No. 8400, 69 Fed. Reg. 15594, 15606 (Mar. 25, 2004) (adopting Rules 13a-11(c) and 15d-11(c) (17 C.F.R. § 240.13a-11(c) and 240.15d-11(c) (2008), respectively).

<sup>150</sup> *Id.* (explaining that the safe harbor is available only until the relevant disclosure is required in the Form 10-K or Form 10-Q for the quarter in which the event occurred and stating that there is no safe harbor from SEC enforcement of the requirement to timely file Form 8-K)

most – and not pervasive. Even though materiality determinations are often difficult, the SEC’s rules are essentially unforgiving.<sup>151</sup>

*Premature* disclosure of a development that *may* be material can sometimes be avoided.<sup>152</sup> Hasty disclosure, such as announcement of a health problem that ultimately, even if unexpectedly, proves to be effectively treatable and eventually has no impact on the luminary’s ability to perform his job responsibilities, may needlessly depress the price of the company’s stock, thereby harming existing stockholders. Moreover, many illnesses may only be temporary, even if debilitating until cured.<sup>153</sup> This is an area, however, like others in the realm of SEC enforcement as well as private civil liability for damages, where hindsight may prove to be 20/20.<sup>154</sup> Thus, if a luminary dies and in that context it becomes known that she had been ill for

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<sup>151</sup> This author has argued, however, that in a proceeding under Rule 10b-5 where liability is predicated upon acting with scienter, whether or not a judgment about materiality was reckless is an element of the scienter determination. Allan Horwich, *The Neglected Relationship of Materiality and Recklessness in Actions Under Rule 10b-5*, 55 BUS. LAW. 1023, 1032-38 (2000).

<sup>152</sup> See BROWN, *supra* note 73, at § 6.01[3][b] (discussing ripeness and criteria that may permit a company to delay disclosure until information is more definitive).

<sup>153</sup> See, e.g., *supra* text accompanying note 13.

<sup>154</sup> See NAGY, *supra* note 28, at 71:

[C]onfounding assessments of probability [in ascertaining the probability of an event occurring as part of the materiality determination discussed *supra* text accompanying notes 107-108] is the fact that these assessments are typically made after the merger or other event in question has occurred (or failed to occur). The event’s occurrence contributes to the proposition that the probability at the relevant earlier point was higher than it may actually have been, just as the event’s non-occurrence has the opposite effect. This phenomenon – known as

some time, the company may be an easy target for an argument that disclosure should have preceded the death and that one of the disclosure obligations discussed in Section II of this Article was breached.

There is some bias against requiring disclosure of some information that is of a competitive advantage to companies in the same market as the public company that is required to make disclosure.<sup>155</sup> This is another factor to be weighed in deciding whether to impose a health-

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hindsight bias – can impact the fact-finding of a judge or jury (or even the SEC or the DOJ).

*See also* Mitu Gulati, Jeffrey J. Rachlinski & Donald C. Langevoort, *Fraud by Hindsight*, 98 NW. U. L. REV. 773, 774 (2004) (“In the context of securities regulation, hindsight can mistakenly lead people to conclude that a bad outcome was not only predictable, but was actually predicted by managers.” (footnote omitted)); GROSKAUFMANIS, *supra* note 119, at 463 (observing that an assessment of whether to disclose potentially illegal conduct is “prone to after-the-fact challenges made with the benefit of perfect hindsight”).

<sup>155</sup> *See* Regulation S-K, Item 101(c)(ii), 17 C.F.R. §229.101(c)(ii) (2008) (requiring disclosures, where Item 101 (Description of Business) must be complied with, of the status of a product in certain circumstances, but excusing “disclosure of otherwise nonpublic corporate information the disclosure of which would affect adversely the registrant’s competitive position); SEC Advisory Committee on Improvements to Financial Reporting Delivering Financial Information Subcommittee Update in Subcommittee Reports of the SEC Advisory Committee on Improvements to Financial Reporting, Securities Act Release No. 8918, 73 Fed. Reg. 29808, 29829-30 (May 22, 2008) (observing that, “Neither the Subcommittee nor investors want companies to give away the ‘crown jewels’ [referring to “competitive information”]. . . . [T]he Subcommittee preliminarily believes that if a particular [key performance indicator] could

related disclosure requirement. If a company were to disclose a luminary's illness to satisfy an affirmative SEC disclosure rule where but for that rule the information would not otherwise be disclosed, competitors may be able to take advantage of the perceived weakness of the disclosing company. Yet the vast trove of information that must be disclosed on Forms 10-K, 10-Q and 8-K routinely reveal information that is of a competitive benefit to the reporting company's rivals.<sup>156</sup>

There would be at least two potential undesirable consequences of requiring disclosure of a luminary's significant health issue. A person who is a candidate for a position that may place him in the position of a luminary may decline the promotion, for fear it will require public disclosure of an existing health issue. Even more important, a luminary may decline to seek medical advice regarding a symptom for fear that this will reveal something that must then be require the disclosure of competitively important information, the affected company could decline to disclose it.”).

<sup>156</sup> For example, the MD&A in the Form 10-K must disclose a variety of factors impacting the company, such as an impending change in the relationship between costs and revenues. Regulation S-K, Item 303(a)(3)(ii), 17 C.F.R. § 229.303(a)(3)(ii) (2008). Item 1.02 of Form 8-K requires disclosure of the termination of a material definitive agreement. Form 8-K, Item 1.02, *available at* <http://www.sec.gov/about/forms/form8-k.pdf>, at 4-5. There is a procedure, of limited scope, to obtain confidential treatment of something that is required to be disclosed in an Exchange Act report. *See* SEC Rule 24b-2, 17 C.F.R. § 240.24b-2 (2008); SEC Staff Legal Bulletin 1A (Feb. 28, 1997, July 11, 2000), *available at* <http://www.sec.gov/interps/legal/slbcf1r.htm>. As stated in the latter, however, “confidential treatment is generally not appropriate for information that is material to investors.”

disclosed.<sup>157</sup> Neither of these outcomes would be desirable in terms of recruiting the most qualified people for executive positions and for maintaining their health.

This section of this Article has identified factors that justify and factors that weigh against imposing a requirement that a public company disclose information about the health of a luminary that is material to the company. In this era of increasing transparency of facts regarding senior management and when lengthening life expectancy means that many people still in the work force, including luminaries, may experience serious illnesses that were once suffered primarily by the retired,<sup>158</sup> the balance – though not without question – weighs in favor of adopting such a requirement.

Following is the text of a proposed addition to Form 8-K:

Item 5.02A Serious Illness of Certain Directors, Employees and Consultants

(a) If a covered person, as defined in subsection (b) of this Item 5.02A, is known by the registrant to be suffering from a physical or mental illness that substantially impairs or is substantially likely within two years to substantially impair the capability of the covered person to perform the functions on behalf of or for the benefit of the registrant which the registrant has represented in any public disclosure that the covered person is performing, the registrant shall disclose the fact of the current or substantially likely impairment if that impairment has or is substantially likely to have a material adverse impact on the company.

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<sup>157</sup> These observations were prompted by a discussion of the failure of the major vice-presidential candidates in the 2008 campaign to disclose their medical records. Jeremy Manier, *Candidates Guard Details about Their Health*, CHI. TRIB. Oct. 19, 2008, Sec. 1 at 13, 2008 WLNR 19880464 (quoting one historian's concern that people may be driven away from public office by the lack of medical privacy and quoting a professor of medicine and bioethics expressing concern that candidates may be discouraged from seeking medical help if doing so will leave a record). To the same effect, *see* Heminway, *supra* note 4, at 774.

<sup>158</sup> *See supra* text accompanying note 17.

(b) A “covered person” for purposes of this Item 5.02A is a director of, employee of or independent contractor retained by the registrant who performs functions on behalf of or for the registrant that are not, at the time of the determination of impairment or substantially likely impairment, provided to the registrant by any other person, are fundamental to the financial performance of the registrant and, in the good faith judgment of the registrant, could not be performed by anyone currently employed by or retained by the registrant.

*Instruction to Item 5.02A*

In making a disclosure required by this Item 5.02A the registrant need only disclose the fact of an impairment within the scope of this Item 5.02A. The registrant is not required to, but may, provide the reasons for the impairment, the extent of the impairment and, in the case of an impairment that has not yet occurred but is substantially likely to occur, when the registrant anticipates that such impairment will occur. Any forward-looking information so disclosed is expressly covered by the safe harbor rule for projections. See Rule 175 under the Securities Act [17 C.F.R. § 230.175], Rule 3b-6 under the Exchange Act [17 C.F.R. § 240.3b-6] and Securities Act Release No. 6084 (June 25, 1979) (44 F.R. 33810).<sup>159</sup> Any decision by the registrant that disclosure is not required by this Item 5.02A shall be similarly protected by the standards set forth in the foregoing safe harbors.

Several points addressed in the proposed item are worth highlighting. First, this imposes a disclosure obligation only where the company knows the information about the health of the luminary. This does not impose an express requirement on the luminary to make disclosure to the company, or directly to the public, but once the company knows then disclosure is triggered if the other criteria are satisfied. Second, the “substantially likely” standard is intended to take into account the uncertainty of predicting the course of a disease, including the timing of its progression. This is a more stringent test than, for example, “reasonably likely.” Similarly, the impairment that triggers disclosure must be substantial. Third, some modicum of privacy is preserved by not requiring disclosure of the details of the impairment. To be sure, once there is disclosure of actual or impending impairment, there will likely be press and securities analyst

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<sup>159</sup> Comparable safe harbor language is used in the MD&A rule. *See, e.g.*, 17 C.F.R. §229.303(a), Instruction 7 (2008).

interest in the details. A company should be able to maintain a “no comment” position as it so desires, as many companies have done to date in addressing health-related rumors about luminaries.

Fourth, while there is no compelling basis for the two year time frame, it is close enough to facilitate reasonable predictions consistent with the state of medical science, yet not so remote as to be immaterial. This places much judgment in the hands of medical professionals, but the safe harbors for forward-looking statements referred to in the instruction should provide protection from hindsight basis.<sup>160</sup> Moreover, this protection is expanded here to cover both the disclosure and the decision that disclosure is not required, so that a good faith, reasonably based decision that disclosure was not required will protect the company. Fifth, disclosure is required only if the luminary’s impairment will in fact have a significant adverse impact on the company. Sixth, the definition of a “covered person” is deliberately narrow, affording the company some leeway (“believed by the registrant”; “good faith judgment”) in deciding who is a luminary. For this reason, the test is “fundamental,” not merely “material,” to the financial performance of the company.<sup>161</sup> Any such determination must, however, be made with the backdrop of the public perception of that person’s importance to the company.

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<sup>160</sup> See *supra* text accompanying note 154.

<sup>161</sup> The shelf registration rule differentiates between material information and “fundamental” information such that a company that files a shelf registration must expressly commit to update the registration with any facts that “represent a fundamental change in the information set forth in the registration statement.” SEC Rule 415(a)(3), 17 C.F.R. § 230.415(a)(3) (2008), and Regulation S-K, Item 512(a)(1)(ii), 17 C.F.R. § 229.512(a)(1)(ii) (2008).

Finally, the proposed item does not address a luminary whose principal connection is a significant or even controlling stock ownership. Other rules require the reporting of stock ownership,<sup>162</sup> and Rule 12b-20<sup>163</sup> should be adequate to address whether facts affecting the precarious nature of that ownership need to be disclosed.

## V. CONCLUSION

There is an almost morbid interest in the health of well known people, including at least some corporate executives. A curiosity does not, however, create materiality. Nevertheless, there are situations where the health or the medical condition of a luminary of a public company is a material fact. That the situation is material does not, however, mean that disclosure is invariably required under the current SEC disclosure rules and the principles that have developed in the application of Rule 10b-5. The task of securities counsel is to take special care so that

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<sup>162</sup> Any person who owns more than 5% of a class of securities registered under Section 12 of the Exchange Act must file a Schedule 13D containing certain information regarding that stock ownership, and update the filing whenever there is a material change in the information. *See* Section 13(d)(1)-(2) of the Exchange Act, 15 U.S.C. § 78m(1)-(2) (2000); SEC Rule 13d-1(a) and 13d-2(a), 17 C.F.R. §§ 240.13d-1(a) and 240.13d-2(a) (2008); and SEC Rule 13d-101 (Schedule 13D), 17 C.F.R. § 240.13d-101 (2008). Thus, Schedule 13D requires disclosure of certain information if the funds used to acquire the securities were borrowed. *Id.* Item 3. Item 6 requires disclosure of any understanding between the owner of the securities and

any other person with respect to any securities of the issuer, including . . . loan or option arrangements . . . . Include such information for any of the securities that are pledged or otherwise subject to a contingency the occurrence of which would give another person voting power or investment power over such securities except that disclosure of standard default and similar provisions contained in loan agreements need not be included.

<sup>163</sup> *See supra* Section II.C.3.

there is no misrepresentation of that fact and no failure to disclose that fact when to do so would render other statements made by the company materially misleading. Likewise, the company must appreciate the potential significance under Regulation FD of a disclosure, no matter how inadvertent, of the luminary's condition. The uncertainties in this area could be alleviated by SEC guidance, or adoption of a disclosure rule that directly addresses disclosure of poor health of a luminary that materially adversely affects the company.

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