Rules for Disclosing a CEO’s Unexpected Absence

By Harvey L. Pitt — February 24, 2009

Rudyard Kipling’s classic poem, “If,” written in 1895, talks about rewards to be reaped if we’re able to “keep our head[s] when all about [us] … are losing theirs.” The reality of corporate life, however, is that public companies can’t keep their heads, or their other key executives. Eventually, CEOs and senior executives die, suffer debilitating accidents or illnesses, become immersed in legal or ethical issues, retire, cease to be effective, or move on.

Given that reality, the difficulty confronting most public companies faced with losing their “head” is determining what’s really significant, what’s appropriate grist for public discourse, and what should be kept under wraps to protect the personal privacy of senior executives. In general, given the unpleasant nature of these sorts of matters, many companies choose not to discuss personal health or similar issues, unless or until forced to do so. While this approach avoids short-term stress, when key executives become unavailable their companies are left scrambling to determine whether and how to disclose that to the investing public.

A Long and Winding Road

The continuing health saga of Apple CEO Steve Jobs provides a cautionary tale about the effects of an erratic or ad hoc disclosure policy. Jobs is universally viewed as Apple’s heart, soul, and creative center. Apple is thus different from companies perceived as having professional managers who can readily be replaced by other professional managers. Jobs also, unfortunately, has significant health problems. In August 2004, he announced he’d been “cured” of, pancreatic cancer, although it’s been reported he actually was diagnosed nine months earlier. Those who understand cancer—especially pancreatic cancer—understand that the use of the word “cure” is almost always an overly optimistic assessment of any sufferer’s well-being, but mere mention of this disease certainly triggers appropriate listener concerns.

In June 2008, responding to widespread speculation based on Job’s gaunt appearance, Apple’s spokeswoman said Jobs suffered from “a common bug,” had taken antibiotics and was “on the mend.” Only a few weeks later, the New York Times revealed that Jobs actually underwent a surgical procedure earlier in the year for ongoing digestive difficulties, possibly a side effect of 2004 cancer surgery. In mid-December, Apple said Jobs wouldn’t be the keynote speaker at its MacWorld conference. This triggered yet another round of speculation about his health.
This speculation prompted a Jobs letter that, after noting the “very personal” nature of the information, disclosed he was suffering from a hormone imbalance, which was being treated in a “relatively simple and straightforward” way and that he would remain on the job during treatment. Little more than a week later, however, Jobs released an e-mail that indicated that, in the week since his prior missive, he’d learned his health issues were “more complex” and that (notwithstanding his prior statement) he’d take a leave of absence until the end of June.

Not surprisingly, these rapidly shifting disclosures inflicted financial whiplash on Apple’s shareholders, as they tried to digest each new scenario. Apple’s price dropped nearly 5 percent after the Times’ disclosure last July, declined more than 9 percent between the announcement Jobs wouldn’t be the MacWorld keynote speaker and the day before his announcement of his “relatively simple” hormone imbalance in early January, jumped over 4 percent following that announcement, and fell 9.5 percent after he disclosed his leave of absence later in the month. Also not surprisingly, these disclosures have generated a cloud of discussion about the real state of Jobs’ health and its significance to Apple, and only a slightly smaller one about whether, and how, this sort of information must, or should, be disclosed.

**Rules of the Road**

There’s no statute or SEC rule specifically requiring disclosures about executives’ health or personal affairs (for example, stroke, heart attack, drug addiction, alcoholism, divorce, et cetera). This isn’t surprising. Personal information is often treated on a one-off basis, rather than being the subject of formal disclosure policies, both by public companies and the government. It’s clear, however, that the federal securities laws require disclosure of the removal or departure of a CEO. That information is *per se* material. It’s equally clear that, if a CEO is unable to continue performing his/her assigned responsibilities for a significant period of time, that too must be disclosed. But, if a CEO suffers from a health or personal problem, yet can continue functioning, or won’t be out-of-pocket for a considerable period, that requires a discrete analysis of particular circumstances before public disclosure is required.

Consider this hypothetical: Ms. X, the CEO of PQR Corp., suffers what doctors describe as a “mild” stroke in June. Her doctors estimate she’ll need six weeks to recuperate fully and physically return to work, and opine vital brain functions aren’t impaired. She’ll also be able to work from home during recuperation. Is disclosure required? For personal reasons, Ms. X and her family may prefer that no disclosure be made of her stroke. They may look at both the nature of the illness, as well as its timing, and conclude that she could just as easily be off on a family vacation for those six weeks, for which disclosure presumably wouldn’t be required. PQR Company could accede to the family’s request that it keep the information confidential, at least until the operative assumptions change.

What’s key is how doctors assess the nature of Ms. X’s stroke, the likelihood, time, and extent of her recovery, and the immediate issues confronting Ms. X (as CEO) at the time of her disability. As long as the legitimate medical conclusion is that no substantial
impairment has occurred, that she’ll be able to resume work in a relatively brief period of time, and that recurrence is likely minimal, a decision not to disclose at this point, without more, wouldn’t violate the federal securities laws, even though shareholders clearly might like to know about it. But, that conclusion in specific circumstances doesn’t necessarily mean public companies have no obligation to disclose this sort of information—often they may, subject to the following general rules:

First, the underlying assumption is if a senior executive gives up his/her day-to-day duties for an appreciable period of time—for whatever reason—appropriate and timely disclosure will be made.

Second, public companies are required to disclose, on a quarterly basis, known risks and uncertainties that could materially affect future operating results. So, if an executive is integral to the company’s successful operation, something occurs that does, or could, impair his/her ability to function effectively, and the impairment is of significant duration or effect, disclosure must be made.

Finally, underpinning specific disclosure rules is a requirement companies disclose material information necessary to make statements they do make not misleading. In Mr. Jobs’ case, that means that once he or Apple elected to say anything about his health—thereby implicitly acknowledging his health’s materiality to Apple investors—they were obligated to get disclosure right in all material respects.

Critical to this last principle is determining whether information is “material.” Often, as in the case of medical conditions—where diagnosis and prognosis are likely to be unclear and there are no other indicators of investor sensitivity—application may not be quite that easy. In those cases, decision makers must consider a broad range of factors and prognosticate thoughtfully about the effect on “reasonable investors.” If an executive is integral to a company’s success, as Steve Jobs is to Apple, health-related information may be personal yet material. This is particularly true if the company and executive don’t deemphasize the executive’s importance, but instead actively promote the executive’s near-mythic status. More than half a century ago the Supreme Court decided “public figures” are not entitled to the same legal protections as others. It’s logical this concept should extend to some public company CEOs as well, effectively altering the balance of investor needs and privacy rights in favor of disclosure, at least for high-profile executives.

Mapping Disclosure Decisions

If a key executive dies or is incapacitated for a long term, disclosure decisions are clear-cut. When an executive suffers a serious but non-fatal health event, or something else occurs that may, but will not necessarily, impair performance, the decision is more complicated. This is true for a host of reasons, including that decision makers are generally dependent upon the executive for personal information, the course of a potentially debilitating condition (medical or otherwise) typically can’t be predicted with a high degree of accuracy, such conditions and decisions, by their nature, frequently are
emotionally charged, and decisions whether to disclose these events typically are made under crisis conditions.

Because these decisions can be complex and difficult, the information can vitally affect investors, and botched disclosures harm both the company and its executive, public companies need documented policies and procedures to determine if disclosure is necessary and, if so, what should be disclosed, by whom and how.

**Develop a Decision Matrix**

Companies should define, in advance, criteria for decisions regarding disclosure of this nature. These should be designed to determine the materiality of information to investors and should, at minimum, include the:

- executive’s importance (for example, is he, like Jobs, “the company”? Does he have particular expertise? Is he the lynchpin of a key partnering relationship?);
- severity of the event or condition;
- likelihood the disability will extend beyond the short term; and
- availability and suitability of, and state of disclosure regarding, succession planning.

**Adopt a Disclosure Process**

Even with a decision matrix in place, there must be a clearly defined process for obtaining input and acting on output. Such a process should, at a minimum:

- establish an inclusive team of decision makers regarding information of this nature, with ultimate decisions made by a company’s Board, rather than management or legal advisers;
- identify both internal and external spokespersons, to avoid suffering an “Al Haig” moment;
- limit the number of spokespersons to avoid conflicting statements;
- ensure access to advisers, including inside and outside legal and investor relations advisers, as well as company personnel with relevant expertise;
- ensure ongoing access to relevant information, including obtaining advance permission for access to medical or personal information, to permit verification of what’s being said by the senior executive or members of his/her family; and

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• re-assess disclosures frequently after initial disclosure is made, since disclosure isn’t static, especially once a decision’s been made to volunteer information a company wasn’t obligated to make.

Public disclosure of personal information about corporate executives is always difficult, but often necessary. Advance planning, though, can do much to reduce the stress and strain of such disclosures on both the company and the executive, enhance the quality of the disclosures made, and ameliorate the market’s negative reaction to such disclosure.

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