

---

---

## UNDRESSING THE CEO: DISCLOSING PRIVATE, MATERIAL MATTERS OF PUBLIC COMPANY EXECUTIVES

Tom C. W. Lin\*

“A company that is required to undress in public will pay more attention to its figures.”

—Christopher Cox, SEC Chairman<sup>1</sup>

### I. INTRODUCTION

In the summer of 2008, Steve Jobs, the iconic CEO of Apple Inc.,<sup>2</sup> came on stage in San Francisco to make one of his grand product announcements. But, without saying a word, his mere appearance—thin and hollowed—sent the company’s stock moving.<sup>3</sup> Apple shareholders and the marketplace began wondering whether his pancreatic cancer, which he was treated for in 2004, had returned.<sup>4</sup> The company refused to comment on Mr. Jobs’ health condition, stating that it was a “private matter.”<sup>5</sup> The Securities and Exchange Commission (the “SEC”) rules are

---

\* Associate, Davis Polk & Wardwell. J.D. University of Pennsylvania Law School. Cert. in Business & Public Policy, Wharton School of Business at the University of Pennsylvania. B.A., New York University. Special thanks to John Agozzino, Anita Allen, Regina Austin, Jill Fisch, Kristin Madison and Monica Pal for their comments and criticisms; and thanks to many others for helpful conversations on the topic. The views expressed herein are my own and do not necessarily reflect the views of Davis Polk & Wardwell, its partners, or any of its other attorneys.

1. Eric Dash, *More Pieces. Still a Puzzle*, N.Y. TIMES, Apr. 8, 2007, at A1.

2. See JEFFERY S. YOUNG & WILLIAM L. SIMON, *ICON STEVE JOBS: THE GREATEST SECOND ACT IN THE HISTORY OF BUSINESS* 238-46 (Wiley, John & Sons, Inc. 2005) (chronicling in brief the fall and rise of Steve Jobs as a modern day icon and business mogul).

3. See *Jobs’s Job*, ECONOMIST, Aug. 2, 2008, at 68 (discussing the effect of Jobs’ health on Apple’s financial outlook).

4. *Id.*

5. *Id.*

silent on such situations, there is little legal scholarship in this area,<sup>6</sup> and different companies have varying disclosure practices for executive illness.<sup>7</sup> Further clouding the matter, a New York Times reporter, after having an “off the record” conversation with Mr. Jobs, reported that while his health problems were “more than ‘a common bug,’ they weren’t life-threatening.”<sup>8</sup> What is an investor to do with this lack of clarity, this lack of material information?

Information—accurate, timely information—is at the bedrock of any free market.<sup>9</sup> The market for publicly traded securities in the United States is no exception;<sup>10</sup> in fact, it may be the prime example of an information-intensive and information-sensitive market.<sup>11</sup> The federal government, through the creation of the SEC and the enactments of the Securities Act of 1933<sup>12</sup> and Securities Exchange Act of 1934,<sup>13</sup> requires companies with publicly traded securities to make fair, timely disclosures of material information to the investing public.<sup>14</sup> The stated purpose of securities laws<sup>15</sup> is to “substitute a philosophy of full disclosure for the philosophy of *caveat emptor*.”<sup>16</sup> As a result, hundreds of thousands of rules and

---

6. See Peter Elkind & Doris Burke, *The Trouble with Steve Jobs*, FORTUNE, Mar. 5, 2008, at 88, available at [http://money.cnn.com/2008/03/02/news/companies/elkind\\_jobs.fortune/index.htm](http://money.cnn.com/2008/03/02/news/companies/elkind_jobs.fortune/index.htm) (explaining that the SEC has not yet taken action against any company for failing to disclose issues about a CEO’s health).

7. See Joe Nocera, *Apple’s Culture of Secrecy*, N.Y. TIMES, July 26, 2008 at C1 (noting that the chief executive of Intel did not inform shareholders of his prostate cancer diagnosis while McDonald’s immediately informed shareholders of its CEO’s colorectal cancer diagnosis).

8. *Id.*

9. See, e.g., George A. Akerlof, *The Market for “Lemons”: Quality Uncertainty and the Market Mechanism*, 84 Q. J. OF ECON. 488, 488-90 (1970) (analyzing the importance of accurate information through the prism of asymmetrical information in the used automobile marketplace).

10. See Jeffrey N. Gordon & Lewis A. Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761, 761-67 (1985) (highlighting the importance and costs of information in an efficient securities market).

11. See, e.g., Victor Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 341 (1979) (discussing the importance of how timely and accurate information in the securities market can lead to enhanced resource allocation.).

12. 15 U.S.C. §§ 77a-aa (2000) (originally enacted as Act of May 27, 1933, ch. 38, § 1, 48 Stat. 74).

13. 15 U.S.C. §§ 78a-nn (2000) (originally enacted as Act of June 6, 1934, ch. 404, § 1, 48 Stat. 881).

14. See Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 721 (2006) (“In efficient markets, information about the value of firms is incorporated quickly and accurately into stock prices.”).

15. Use of the term, “securities law,” in this Article refers to the federal securities laws, namely, the Securities Act and the Exchange Act. See *infra* Part III.

16. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963).

regulations—constantly examined and updated—require publicly traded companies to disclose everything from key contracts and financial statements to employee headcounts and perceived risks.<sup>17</sup> While more information has become available about publicly traded companies, arguably not enough information is available about the people who run those companies. The growing regulatory spotlight on public companies has created a penumbra over their boardrooms and executive suites.<sup>18</sup> What does the investing public have a right to know about a company's<sup>19</sup> executive officers?<sup>20</sup> Is a chief financial officer's divorce settlement<sup>21</sup> material information? What about a chief executive officer's sex life,<sup>22</sup> home purchase,<sup>23</sup> internet usage habits,<sup>24</sup> or financial status? How about a

---

17. See 17 C.F.R. § 229 (2008) (outlining how Regulation S-K under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Energy Policy and Conservation Act of 1975 spell out the various types of information that a public company must disclose in their respective filings with the SEC).

18. See Elkind, *supra* note 6 (alluding to the lack of clear guidance from the SEC on private but material matters, such as health issues involving public company executives); see, e.g., Linda Grant, *Shareholder Profit v. CEO Privacy: Recent Cases Renew Debate over Disclosure of an Executive's Illness*, L.A. TIMES, Jan. 22, 1993, at D1 (highlighting the absence of clarity in securities law for disclosure of executive illness). See generally Dash, *supra* note 1, at A1 (“‘Sunlight,’ remarked the Supreme Court Justice Louis D. Brandeis, ‘is said to be the best of disinfectants.’ One problem with too much sunlight, however, can be the blinding glare.”).

19. Use of the term, “company,” in this Article refers to a publicly traded company in the United States.

20. Use of the terms, “director,” “officers,” or “executive,” in this Article refers to such persons that serve on those publicly traded companies. See *infra* Part IV.A (defining the relevant persons that are the key subjects for the purposes of this Article).

21. See Katherine Yung, *Dean Foods Keeps Move in the Open: Company Says its CEO Will Sell Stock to Help in Divorce Settlement*, DALLAS MORNING NEWS, Aug. 28, 2003, at 2D (Reporting that the chairman and chief executive of Dean Foods Company announced that he was selling his shares in the company to facilitate his divorce settlement).

22. See Alan Cowell, *BP's Chief Quits Over Revelations About Private Life*, N.Y. TIMES, May 2, 2007 at C1 (reporting on the resignation of a prominent chief executive following the public disclosure of his sexual relationship with a gay companion.); see also Alex MacDonald, Benoit Faucon & Michael Williams, *BP's CEO to Resign Immediately Amid Revelations of Private Life*, WALL ST. J., May 1, 2007, available at <http://tech.groups.yahoo.com/group/safepipelines/message/10107> (“The storied tenure of John Browne, the CEO who turned BP PLC into one of the world's most-valuable oil companies, came to an unceremonious end today, after a British court allowed a U.K. newspaper group to publish a set of articles about the executive's long relationship with a young man.”).

23. See Crocker H. Liu & David Yermack, *Where are the Shareholders' Mansions? CEOs' Home purchases, Stock Sales, and Subsequent Company Performance*, SOCIAL SCIENCE RESEARCH NETWORK, Oct. 17, 2007, <http://ssrn.com/abstract=970413> (studying the impact of home purchases and stock sales by CEOs on the performance of their companies).

24. See David Kesmodel, *Whole Foods Sets Probe as CEO Apologizes*, WALL ST. J., July 18, 2007, at A3 (reporting that Whole Foods CEO, John Mackey, anonymously posted

chief executive officer's diagnosis of Alzheimer's disease? Or a venereal disease or other health matters?<sup>25</sup> What private information is material to the reasonable investor?<sup>26</sup> What does material mean in this context?<sup>27</sup> Should the SEC require more disclosure on material, private matters?

The issue about what types of material, private information should be disclosed will be of significant concern to academics and regulators, to Wall Street and Main Street, and to corporate titans and average citizens in the present and coming years<sup>28</sup> as the investing marketplace's voracious need for more information<sup>29</sup> confronts the executive's innate human desire to protect it.<sup>30</sup> The SEC has been silent on this issue and there has been little scholarship on the matter as well, but the changing investing landscape of the 21<sup>st</sup> century requires a critical examination of this issue. In 2006, it was reported that some 57 million American households, or about half of all American households, have some investment in the stock

---

messages on internet chat rooms advocating for his company and thrashing competitors, which led to a SEC investigation).

25. See Andrew K. Glenn, *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, 537-41 (1994) (examining the shortcoming of federal securities law concerning the disclosure of executive illness); see also Benjamin Pimentel, *Public Disclosure: Health of CEOs Brings up Issues of Personal Privacy*, S.F. CHRON., Aug. 3, 2004, at C1 (discussing the lack of guidance in terms of what CEOs are required to disclose about their health).

26. See Mark Maremont, *Scholars Link Success of Firms To Lives of CEOs*, WALL ST. J., Sept. 5, 2007, at A1 (discussing scholarship that studied the private events of CEOs and their relationship to company performance).

27. See *infra* Part III.C (discussing the concept of materiality in the context of securities law).

28. See Letter from Alan Greenspan to Representative Edward J. Markey, (July 28, 1998), *quoted in* Toby Lester, *The Reinvention of Privacy*, ATLANTIC MONTHLY, Mar. 2001, at 29 ("The appropriate balancing of the increasing need for information in guiding our economy to ever higher standards of living, and essential need of protection of individual privacy in such an environment, will confront public policy with one of its most sensitive tradeoffs in the years immediately ahead.").

29. See Press Release, SEC, SEC Provides Guidance to Open Up Use of Corporate Web Sites for Disclosures to Investors (July 30, 2008), *available at* <http://www.sec.gov/news/press/2008/2008-158.htm> [hereinafter SEC, Disclosure to Investors] ("Ongoing developments in technology have increased both the markets' and investors demand for more timely company disclosure on the Web, and in turn, raised new securities law issues for public companies to consider." (quoting SEC Chairman Christopher Cox)).

30. See Letter from Alan Greenspan to Representative Edward J. Markey, (July 28, 1998) *quoted in* Loretta Nott, Report for Congress, *The Role of Information in Lending: The Cost of Privacy Restrictions*, 1 (2003), *available at* [http://www.law.umaryland.edu/marshall/crsreports/crsdocuments/RL31847\\_05192003.pdf](http://www.law.umaryland.edu/marshall/crsreports/crsdocuments/RL31847_05192003.pdf) ("Too little information that can be used in marketing leads to a decline in the quality of the goods and services offered. Too much can be perceived as an inordinate incursion of privacy of person.").

---

---

market, through stocks, mutual funds, or retirement plans.<sup>31</sup> The growing participation of the general population in the securities market will also likely increase the desire for more information and the political will to act accordingly via legislation and rulemaking.<sup>32</sup> In the securities market context, a fundamental question must ultimately be answered: should there be more privacy or more disclosure when it comes to material, private matters of public company executives?

This article argues that practical and realistic answers to this question favor more meaningful, material disclosure and less privacy for executives while working within the existing regulatory framework.<sup>33</sup> Structurally, my argument proceeds as follows: Part II will consider why more disclosure about the private matters of public company executives may be desirable through an examination of the growing investor base, the enhanced position of the executive, and the equalizing role of regulated disclosure in the modern information age. Part III will discuss the disclosure (and non-disclosure) of private, material matters through the prism of the general disclosure obligations under the federal securities laws. Part IV will offer a model approach for disclosing material, private matters which works within the current federal regulatory framework and imposes limited additional burdens on public companies. Finally, Part V will address some of the key critiques and concerns about additional disclosures from executives, namely, those that relate to the burdens of new regulations, their impact on companies, and their effect on the privacy of executives.

## II. WHY MORE DISCLOSURE?

Why more disclosure? This query presumes that more disclosure

---

31. See Richard Cheney, Vice-President of the United States, Remarks at the Chicago Mercantile Exchange (June 23, 2006), available at <http://www.whitehouse.gov/news/releases/2006/06/text/20060623-12.html> (discussing the growth of the American economy and business investment).

32. See *infra* Part II.A (discussing the growing investor base as a reason for more disclosure about company executives).

33. It can be argued that existing securities law may already require such disclosure. However, it is difficult to discern with great certainty whether the drafters of the Securities Act intended for the Act to cover private, material matters of executives. The Act itself is silent on that point. However, the legislative history suggests that the Act was intended to cover “the type of information required to be disclosed...by competent bankers from their borrowers.” H.R. REP. NO. 85, 73d Cong., 1st Sess. 4 (1933). Arguably, a competent banker in 1933 (or presently) would likely find information, such as CEO’s diagnoses with Alzheimer’s disease, the type of information that should be disclosed, and reasonable minds exercising an abundance of caution can read Regulation S-K to require such disclosures, but historically disclosures have not included such private matters.

about public company executives is: (1) possible and (2) desirable. The first part of the presumption is true; the second part is arguably as true if such disclosure is qualified by materiality,<sup>34</sup> as is the case with most SEC-mandated disclosure.<sup>35</sup> More material disclosure about executives is desirable and perhaps necessary because the current regulatory regime and current disclosure practice give a growing base of investors, in an increasingly complex marketplace, insufficient information to make sound investment decisions.<sup>36</sup> Additionally, the role of the executive has changed; the enhanced premium that the growing market places on good executive officers and the discount it places on bad ones has increased the desirability of more material information about executives.<sup>37</sup> While such information may be garnered through alternative (and sometimes less reliable) means,<sup>38</sup> regulated principle-based disclosure<sup>39</sup> under the current

---

34. See *infra* Part III.C (discussing materiality in the context of securities law).

35. While greater transparency and disclosure from companies can lead to better corporate governance, the former does not necessarily guarantee the latter; and “more information” as a general principle may not always be desirable if not qualified by materiality. More information in an increasingly complex financial system can overwhelm and obfuscate an investor. See Zachary Karabell, *The Myth of Transparency*, NEWSWEEK (Atlantic Ed.), July 7, 2008, at 47:

The sheer volume of information that companies provide both in the United States and in other countries is so vast that it takes full-time analysts and regulators to parse it. Even then, there is a tacit understanding that much of what a company reports has to be taken on faith. Only if a company is investigated by a regulator is it truly possible to discover the veracity of the information it provides. In short, a company can be fully transparent and still be fraudulent.

36. See Vikram Pandit, *Toward a Transparent Financial System*, WALL ST. J., June 27, 2008, at A11 (“Transparency must also include public disclosures to investors about pertinent risk and financial information that give the market a chance to make informed judgments.”). *Contra* Karabell, *supra* note 35, at 47 (“[E]ven if companies disclose everything they are required to and more, they can still deceive and commit fraud.”).

37. See, e.g., Daniel Grebler, *Companies Should Be Open About Executive Health*, STAR TRIB. (Minneapolis), Feb. 10, 1993, at 2D (noting the rise of a company’s shares due to market uncertainty about an executive’s health status); Kenneth R. Sheets et al., *If the Boss Isn’t Around*, U.S. NEWS & WORLD REP., Jan. 19, 1987, at 42 (reporting on the rise of MCI’s shares after the company’s disclosure of its founder and chairman suffering a heart attack).

38. See Stephanie Clifford & Jenny Anderson, *S.E.C. Warns Wall Street: Stop Spreading the False Rumors*, N.Y. TIMES, July 14, 2008, at C1 (“Rumors have long been a part of Wall Street’s fabric, and to prove rumor-mongering is a difficult task, especially with 24-hour news and communications technology like instant messaging and text messaging. But Wall Street executives insist that false information is permeating the marketplace as never before.”).

39. Principle-based disclosure under the guidance of the SEC is to be distinguished with rigid line-item disclosure, which is useful for objective matters like employee headcount and company addresses, but less useful for subjective issues like the material private matters of executives. Principle-based disclosure necessarily allows for greater flexibility due to the

framework is arguably most cost-effective<sup>40</sup> and conducive<sup>41</sup> to an efficient, fair market.<sup>42</sup>

A. *A Growing and Diverse Investor Base*

In the latter half of the 20<sup>th</sup> Century, the number of securities investors in the United States grew significantly, and it continues to grow among unsophisticated individual investors.<sup>43</sup> This growth of the investor base is important to the issue of more executive disclosure because a growing investor base of unsophisticated investors makes more disclosure as a regulatory safeguard increasingly relevant;<sup>44</sup> and consequentially, the

---

varying significance of each CEO in relation to their companies. In 2006, the SEC adopted principle-based disclosure changes concerning executive compensation. Press Release, SEC, SEC Votes to Adopt Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters (July 26, 2006), <http://www.sec.gov/news/press/2006/2006-123.htm> [hereinafter SEC, Changes to Executive Compensation Disclosure]; see also Michael Bloomberg & Charles Schumer, *Sustaining New York's and the US' Global Financial Services Leadership*, at 89 (McKinsey & Co. report, 2007), available at [http://www.nyc.gov/html/om/pdf/ny\\_report\\_final.pdf](http://www.nyc.gov/html/om/pdf/ny_report_final.pdf) (“Nevertheless, reliance on principles and judgment over rules and the elimination of unnecessary differences in standards (provided that the integrity of the standards is not diminished) are two of the themes that should underpin the call for change for many aspects of the US regulatory environment.”).

40. See Goshen & Parchomovsky, *supra* note 14, at 716 (“Disclosure duties reduce their information gathering costs. Restrictions on fraud and manipulation simultaneously lower information traders’ cost of verifying the credibility of information, and improve their ability to make accurate predictions.”).

41. See, e.g., Andrea M. Matwyshyn, *Material Vulnerabilities: Data Privacy, Corporate Information Security, and Securities Regulation*, 3 BERKELEY BUS. L.J. 129, 199-200 (2005) (noting that making changes within the existing federal securities law regime can minimize costs); Michael P. Van Alstine, *The Costs of Legal Change*, 49 UCLA L. REV. 789, 793 (2002) (stipulating that costs are inherent to changes in legal rules); see also SEC, Disclosures to Investors, *supra* note 29 (discussing how clarifying existing rules to account for changes in the investing and technological landscape is cost-effective).

42. See, e.g., Press Release, Financial Industry Regulatory Authority, Self-Regulators Warn Against Spreading False Rumors and Other Abusive Market Activity (Mar. 31, 2008), available at <http://www.finra.org/PressRoom/NewsReleases/2008NewsReleases/P038211> (reminding companies of NYSE prohibitions on rumors that affect market conditions); Press Release, SEC, Securities Regulators to Examine Industry Controls Against Manipulation of Securities Prices Through Intentionally Spreading False Information (July 13, 2008), available at <http://sec.gov/news/press/2008/2008140.htm> (warning against the adverse impact of unregulated information sources).

43. Cheney, *supra* note 31.

44. Historically, courts, lawmakers and regulators have focused on protecting the individual investor. See, e.g., *Schlesinger Inv. P’ship v. Fluor Corp.*, 671 F.2d 739, 743 (2d Cir. 1982) (“The Williams Act was meant to protect the ordinary investor.”); H.R. REP. NO. 73-85, pt. 1, at 2 (1933) (“The purpose of the legislation . . . is to protect the public with the least possible interference to honest business.”).

growing investor base also gives lawmakers and regulators greater political capital to promulgate new disclosure requirements to uplift and sustain individual investors' confidence in the securities markets.<sup>45</sup>

During the 1920s, approximately 20 million large and small shareholders took advantage of post-war prosperity and set out to make their fortunes in the stock market.<sup>46</sup> Fueled by easy credits, get-rich schemes, and irrational exuberance, many investors jumped head-first into an unregulated, dangerous marketplace. It is estimated that, of the \$50 billion in new securities offered during this period, half became worthless.<sup>47</sup> In 1929, the stock market crashed, losing over half of its market capitalization in the span of a few weeks.<sup>48</sup> In the aftermath of the Great Crash of 1929, the nation fell into the Great Depression, and the world soon fell into an economic slump. Millions of jobs were lost, and billions of dollars in equities evaporated.

While only about 20 million investors were invested in the stock market in the 1920s, today that number is much larger. Recent reports have shown that over half of American households are now invested in the stock market either directly through personal brokerage accounts or indirectly through retirement plans.<sup>49</sup> A majority of the investors in the early part of the 20th century consisted primarily of the wealthy and financially sophisticated; whereas today's investor base is more economically-diverse and less sophisticated. Moreover, these less sophisticated investors are making investment decisions in the face of "mounting complexities of global trends in business, markets and the economy."<sup>50</sup> Just as doctors are required to provide patients with ample material information so that patients can exercise their judgment to provide informed consent in making a medical decision,<sup>51</sup> public companies are required to provide investors

---

45. See John Marshall Cook, *The Securities Enforcement and Penny Stock Reform Act of 1990: The Cost of Flexibility*, 6 ADMIN. L.J. AM. U. 359, 391 n.235 (1992) ("The concept of market confidence revolves around the individual investors. If individual investors are not confident that the market is running smoothly, they will be reluctant to invest.").

46. SEC, *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, available at <http://sec.gov/about/whatwedo.shtml> (last visited Oct. 21, 2008).

47. *Id.*

48. See JOHN KENNETH GALBRAITH, *THE GREAT CRASH 1929 88-100* (Houghton Mifflin Co. 1997) (1954).

49. Investment Company Institute, *Half of America Households Own Equities*, Nov. 10, 2005, available at [http://www.ici.org/shareholders/dec/05\\_news\\_equity\\_rpt.html](http://www.ici.org/shareholders/dec/05_news_equity_rpt.html).

50. Pandit, *supra* note 36, at A11.

51. *ZeBarth v. Swedish Hosp. Med. Ctr.*, 499 P.2d 1, 8 (Wash. 1972):

Informed consent, therefore, is the name for a general principle of law that a physician has a duty to disclose what a reasonably prudent physician in the medical community in the exercise of reasonable care, would disclose to his



with ample material information so that investors can exercise their judgment in making an investment decision.

As with the genesis of federal securities law, the birth of a broader and more diverse investor base has resulted in greater political will to enact new legislation and regulations to protect unsophisticated investors in the marketplace.<sup>52</sup> The Sarbanes-Oxley Act of 2002<sup>53</sup> (“Sarbanes-Oxley”) was enacted in response to the wave of corporate scandals involving major companies, such as Adelphia, Enron, Tyco International and WorldCom, which decimated billions of dollars in market capitalization, destroyed pension funds, and undermined public confidence in the securities market.<sup>54</sup> Sarbanes-Oxley was one of “the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt.”<sup>55</sup> More recently, in 2006, the SEC adopted new rules to require more disclosure on executive compensation.<sup>56</sup> The rules were adopted partially in response to scandals involving stocks-option backdating by executives<sup>57</sup> and perceived excessive compensation

---

patient as to whatever grave risks of injury may be incurred from a proposed course of treatment so that a patient, exercising ordinary care for his own welfare, and faced with a choice of undergoing the proposed treatment, or alternative treatment, or none at all, can, in reaching a decision, intelligently exercise his judgment by reasonably balancing the probable risks against the probable benefits. Failure to impart such information to the patient is by the great weight of authority deemed negligence rendering the physician liable for injuries proximately caused thereby. (citation omitted).

52. See, e.g., H.R. REP. NO. 73-1383, pt. 2, at 5 (1934) (discussing the need to protect individual investors in an increasing complex financial, economic system); H.R. REP. NO. 73-85, pt. 1, at 2 (1933) (“The purpose of the legislation . . . is to protect the public with the least possible interference to honest business.”); Ralph K. Winter, *On “Protecting the Ordinary Investor,”* 63 WASH. L. REV. 881, 882-83 (1988) (highlighting the protection of ordinary investors as a primary goal of securities law).

53. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of the U.S.C.).

54. See Kathleen F. Brickey, *Enron’s Legacy*, 8 BUFFALO CRIM. L. REV. 221, 225-28 (2004) (chronicling the major corporate scandals around the time of the collapse of Enron); Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (and It Just Might Work)*, 35 CONN. L. REV. 915, 922-27 (2003) (discussing the genesis of the Sarbanes-Oxley Act); cf. Robert W. Hamilton, *The Crisis in Corporate Governance: 2002 Style*, 40 HOUS. L. REV. 1, 5 (2003) (positing that Congress acted in an imprudent and reactionary manner when implementing the Sarbanes-Oxley Act). See generally Brian Kim, *Recent Developments, Sarbanes-Oxley Act*, 40 HARV. J. LEGIS. 235 (2003) (providing an overview of the Sarbanes-Oxley Act).

55. Elisabeth Bumiller, *Bush Signs Bill Aimed at Fraud in Corporations*, N.Y. TIMES, July 31, 2002, at A1.

56. See SEC Final Rule, Executive Compensation and Related Person Disclosure, 17 C.F.R. §§ 228-29, 232, 239-40, 245, 249, 274 (2006).

57. See Charles Forelle & James Bandler, *The Perfect Payday*, WALL ST. J., May 18, 2006, at A1 (“The analysis [here] bolsters recent academic work suggesting that backdating

packages for executives.<sup>58</sup> Such rulemaking and legislation would have been unlikely had the investors directly affected by the scandals not consisted of a large number of middle-class households and unsophisticated individual investors with faltering confidence in the marketplace.<sup>59</sup> In 2006, publicly traded U.S. companies accounted for over \$12 trillion in market capitalization; therefore, even “a small loss in investor confidence can translate to a very large loss in social welfare.”<sup>60</sup>

Additionally, the growing investor base and its growing demand for more timely information have also spawned various sources for business information.<sup>61</sup> As a result, there has been a proliferation of business information sources from television to websites to blogs to satellite radio—all dedicated to satisfying the growing demand for more information.<sup>62</sup> Unfortunately, not all of these alternative sources are as reliable for the less sophisticated, growing investor base as regulated disclosure.<sup>63</sup>

### B. *The Rise of the Executive*

More disclosure about public company executives is desirable in part because the role—perceived or actual—of the executives, and particularly

---

was widespread, particularly from the start of the tech-stock boom in the 1990s through the Sarbanes-Oxley corporate reform act of 2002. If so, it was another way some executives enriched themselves during the boom at shareholders' expense.”)

58. See SEC, Changes to Executive Compensation Disclosure, *supra* note 39 (“By taking up these critical issues and addressing them in record time, the Commission has once again shown its responsiveness to the continually evolving needs of American investors.”); Raghuram G. Rajan & Julie Wulf, *Are Perks Purely Managerial Excess?*, 79 J. FIN. ECON. 1 (2006) (arguing against the perception of corporate perks as purely managerial excess); David Yermack, *Flights of Fancy: Corporate Jets, CEO Perquisites, and Inferior Shareholder Returns*, 80 J. FIN. ECON. 211 (2006) (studying the association between CEO perquisites, focusing on use of corporate planes, and shareholder returns).

59. See Cook, *supra* note 45, at 391 n.235 and accompanying text (arguing that additional disclosure requirements will help boost investor confidence); Cunningham, *supra* note 54, at 922-27 (postulating that public pressure on elected officials led to the swift passage of the Sarbanes-Oxley Act).

60. Howard H. Chang & David S. Evans, *Has the Pendulum Swung Too Far?*, REGULATION, Winter 2007/2008, at 48, 51.

61. See SEC, Disclosure to Investors, *supra* note 29 (“Ongoing developments in technology have increased both the markets' and investors' demand for more timely company disclosure on the Web . . .”).

62. See GIDEON HAIGH, FAT CATS: THE STRANGE CULT OF THE CEO 97 (2005) (“New business media, like CNNfn, CNBC, and Bloomberg Television, seemed to be willing the market higher on behalf of the eager new investment generation.”).

63. Compare Clifford & Anderson, *supra* note 38 (discussing the spread of rumors), with *infra* Part II.C (discussing the benefits of regulated disclosure as a source of reliable information in an environment with a myriad of information sources).

the chief executive officer has transformed in the 21<sup>st</sup> century economy.<sup>64</sup> Many executives, namely CEOs, have become celebrities and acquired cult status. Investing in securities, in some ways like sports, has become quotidian activity for the masses. Like athletes,<sup>65</sup> CEOs are lionized or denigrated for their successes and failures, often getting too much credit for successes and too much blame for failures.<sup>66</sup> Compounding this perception (or misperception), business news reporting has on some level become more superficial and personality driven. Fifty years ago, the average American might have been hard-pressed to name the CEO of General Electric or General Mills. Today, many average Americans know of Steve Jobs,<sup>67</sup> Howard Schultz,<sup>68</sup> Martha Stewart,<sup>69</sup> Warren Buffett,<sup>70</sup> and Bill Gates.<sup>71</sup> For better or for worse, CEOs have become a greater factor in the investment calculus of a growing investor base. During the 1990s, a “survey found that 95 percent of respondents were influenced in stock

---

64. See HAIGH, *supra* note 62, at 95-98 (discussing the changed role and perception of CEOs towards the end of the 21<sup>st</sup> century).

65. *Id.* at 8 (analogizing modern executives to sports stars).

66. See Narayana N. R. Murthy, Chairman, Infosys Technologies Ltd., Robert P. Maxon Lecture at George Washington University: Good Corporate Governance—A Checklist or a Mindset? 3 (Feb. 6, 2006) (transcript available on the George Washington University School of Business website at <http://www.business.gwu.edu/global/MaxonLecture020606.pdf>):

The decade of 1990s [sic] was the era of the stock-option-fattened, superman-superwoman CEOs who could do no wrong in the eyes of their admiration-heavy boards, and who were seen as demigods. Lax oversight by boards made these CEOs more or less omnipotent, and corporate allies were required to primarily serve their interests.

See, e.g., CHRISTOPHER BYRON, TESTOSTERONE INC.: TALES OF CEOs GONE WILD ix-xiv (John Wiley & Sons, Inc. 2004) (discussing the bad behavior of certain public company CEOs); Julie Creswell, *Pressing for Independent Advice From Consultants*, N.Y. TIMES, Apr. 8, 2007, at C9 (acknowledging companies' difficulties in finding independent executive compensation advice because the industry is so incestuous).

67. See generally YOUNG & SIMON, *supra* note 2 (documenting the life of Steve Jobs, the CEO of Apple Inc.).

68. See generally HOWARD SCHULTZ & DORI JONES YANG, POUR YOUR HEART INTO IT: HOW STARBUCKS BUILT A COMPANY ONE CUP AT A TIME (Hyperion, 1997) (chronicling the creation of Starbucks by its founder and CEO, Howard Schultz).

69. See generally CHRISTOPHER M. BYRON, MARTHA INC.: THE INCREDIBLE STORY OF MARTHA STEWART LIVING OMNIMEDIA (2002) (discussing the story of Martha Stewart, the CEO of Martha Stewart Living Omnimedia Inc.).

70. See generally ROGER LOWENSTEIN, BUFFETT: THE MAKING OF AN AMERICAN CAPITALIST (1995) (chronicling the life of Warrant Buffett, CEO and founder of Berkshire Hathaway).

71. See generally STEPHEN MANES & PAUL ANDREWS, GATES: HOW MICROSOFT'S MOGUL REINVENTED AN INDUSTRY—AND MADE HIMSELF THE RICHEST MAN IN AMERICA (1993) (discussing the story of Bill Gates, co-founder and former CEO of Microsoft).

selection by the CEO's profile and reputation."<sup>72</sup> It would be hard for one to imagine Martha Stewart Living Omnimedia without Martha Stewart,<sup>73</sup> Apple without Steve Jobs,<sup>74</sup> Starbucks without Howard Schultz, or Berkshire Hathaway without Warren Buffett. Consequentially, it would be hard—rightly or wrongly—for one to imagine the continued success of these companies without their founders or CEOs. Many charismatic executives, particularly CEOs, are no longer considered temporary stewards of great enterprises. Instead, they are viewed as oracles, titans, and alchemists, without whom their companies (and their companies' stock valuations) would perish.<sup>75</sup>

As a result of the new heft of CEOs' crowns in the modern economy, their compensation has also increased.<sup>76</sup> "CEO compensation surged 535 percent in the 1990s" alone.<sup>77</sup> While the CEO role has become more important to a growing number of investors, and while CEOs themselves have been handsomely compensated for their new influence,<sup>78</sup> yet the SEC

---

72. HAIGH, *supra* note 62, at 98.

73. See Cynthia A. Caillavet, *From Nike v. Kasky to Martha Stewart: First Amendment Protection for Corporate Speakers' Denials of Public Criminal Allegations*, 94 J. CRIM. L. & CRIMINOLOGY 1033, 1039 n.36 (2004) (noting the vital role of Martha Stewart's personage to her company).

74. See Nocera, *supra* note 7 (discussing the affect of the rumors in 2008 about Steve Jobs's health and the lack of disclosure and statements from Apple on the market's ability to properly value the company's shares and evaluate future prospects of the company).

75. See Murthy, *supra* note 66 (discussing good corporate governance). Compare Nocera, *supra* note 7 (describing the indispensability of Steve Jobs to Apple), with Letter from Warrant E. Buffet, Chairman, Berkshire Hathaway, Inc., to the Shareholders of Berkshire Hathaway, Inc. (February 2008), <http://www.berkshirehathaway.com/letters/2007ltr.pdf>:

Of course, a terrific CEO is a huge asset for any enterprise, and at Berkshire we have an abundance of these managers. Their abilities have created billions of dollars of value that would never have materialized if typical CEOs had been running their businesses.

But if a business *requires* a superstar to produce great results, the business itself cannot be deemed great. A medical partnership led by your area's premier brain surgeon may enjoy outsized and growing earnings, but that tells little about its future. The partnership's moat will go when the surgeon goes. You can count, though, on the moat of the Mayo Clinic to endure, even though you can't name its CEO.

76. See HAIGH, *supra* note 62, at 11 (discussing astronomical growth in executive compensation during the 1990s partially as a result of the increased use of stock options as a form of compensation); Rajan & Wulf, *supra* note 58 (finding it incorrect to treat managerial perks solely as excess compensation); Yermack, *supra* note 58 (discussing prerequisites of CEOs, specifically their personal use of company planes).

77. HAIGH, *supra* note 62, at 11.

78. See Yermack, *supra* note 58 (discussing the largess of executive compensation packages and perks despite inferior shareholder returns).

has not meaningfully updated the regulations to reflect the new reality by calling for more material disclosure from these executives.<sup>79</sup> Such heightened status from the investing public should also come with heightened accountability to the investing public, and sensible additional disclosure from public company executives would be a responsible step in that direction. Therefore, current rules or existing practices under current rules must be redesigned for the new reality to provide for more transparency and accountability in the executive suites.<sup>80</sup>

C. *Regulated Disclosure: Efficient and Fair*

If more disclosure about executives is desirable and needed, regulated principle-based disclosure under the current framework is arguably most efficient and fair, despite the proliferation of alternative information sources.<sup>81</sup> Regulated disclosure would allow the most accurate information (due to fear of liability) to be disseminated simultaneously to the largest number of people and create uniformity of process.<sup>82</sup> In 2000, the SEC promulgated Regulation Fair Disclosure (“Reg FD”). Reg FD was promulgated to address the problem of selective disclosures by companies so that material information becomes available to the public simultaneously or promptly after it has been disclosed to selected parties.<sup>83</sup>

Some would argue that additional disclosure is not required because modern media will shed more light and scrutiny on public company executives.<sup>84</sup> The proliferation of blogs, perpetual news cycles, business

---

79. See Nocera, *supra* note 7, at C1 (“There are no hard and fast rules about how and when companies need to disclose information about the health of their chief executives. . . . No company has ever been held to account by the S.E.C. for failing to disclose information about its chief executive’s health . . .”).

80. See generally John Schwartz, *Transparency, Lost in the Fog*, N.Y. TIMES, Apr. 8, 2007, at C1, available at <http://www.nytimes.com/2007/04/08/business/yourmoney/08fog.html> (discussing the lack of understandable disclosure regarding executive compensation).

81. See John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 733-34 (1984) (advocating for mandatory disclosure as a means of minimizing wasteful resource spending in data gathering); Goshen & Parchomovsky, *supra* note 14, at 738 (“Mandatory disclosure duties reduce the cost of searching for information.”).

82. See Nocera, *supra* note 7, at C1 (providing examples of varying disclosure practices by companies regarding the health of their executives).

83. See Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716 (Aug. 24, 2000) (adopting the new SEC rules).

84. For example, Dealbook, <http://dealbook.blogs.nytimes.com/>, and Dealbreaker, <http://dealbreaker.com>, cover rumors in the marketplace and the comings and goings of CEOs. In 2007, Dealbreaker released the golfing habits and scores of then Merrill Lynch CEO, Stanley O’Neal. Posting of Bess Levin to Dealbreaker,

news channels, corporate websites, and chat rooms has undoubtedly created more scrutiny for public company executives.<sup>85</sup> However, absent regulated disclosure, information of varying quality<sup>86</sup> and relevance<sup>87</sup> will be disseminated sporadically and selectively, thereby creating information uncertainty in the marketplace that will result in pricing inefficiencies.<sup>88</sup> Principle-based regulated disclosure of information about executives, like other information required under the current federal framework, allows all investors to receive a reasonable modicum of high-quality information at the same time without regard for connections, wealth, size, or buying power; and it creates a uniform process for disclosing such private matters consistent with the SEC's promulgation of Reg FD.<sup>89</sup> Because each

---

[http://dealbreaker.com/2007/10/stan\\_oneal\\_has\\_got\\_his\\_priorit.php](http://dealbreaker.com/2007/10/stan_oneal_has_got_his_priorit.php) (Oct. 26, 2007, 14:37 EST) (displaying the dates and scores of Stanley O'Neal's golf outings).

85. See, e.g., Clifford & Anderson, *supra* note 38 (examining rumor-spreading on Wall Street); Andrew Ross Sorkin, *Psst! Hear the Rumor of the Day?*, N.Y. TIMES, July 8, 2008, at C1, available at [http://www.nytimes.com/2008/07/08/business/08sorkin.html?\\_r=1&ref=business&oref=slogin](http://www.nytimes.com/2008/07/08/business/08sorkin.html?_r=1&ref=business&oref=slogin) (discussing the spreading of rumors).

86. In the absence of regulated disclosure, rumors and less reputable information can carry greater weight and lack a meaningful counter-weight, such as disclosure through the SEC to refute them, thereby resulting in serious adverse effects on the marketplace. Moreover, principle-based disclosure regulations can serve as a powerful signaling mechanism for the market in instances where a company lacks disclosure about certain adverse events or risks. For example, assuming that the SEC articulated the principle that companies must disclose when CEOs are diagnosed with cancer, the absence of such disclosure by companies should comfort investors that are concerned about a cancer-stricken CEO. See Clifford & Anderson, *supra* note 38, at C1, C3 ("Rumors [which] have long been a part of Wall Street's fabric, and to prove rumor-mongering is a difficult task, especially with 24-hour news and communications technology like instant messaging and text messaging. . . . Since Wall Street firms are highly leveraged businesses that need outside financing, confidence is crucial, and rumors can overshadow the strength of their businesses, executives say."); Matthew Karnitschnig & Susanne Craig, *Fed Acted on Lehman Rumor*, WALL ST. J., Aug. 21, 2008, at C1 ("In an apparent attempt to prevent a repeat of the cascading rumors that helped sink Bear Stearns Cos., the Federal Reserve last month quietly called one major bank to see if it had pulled a credit line from Lehman Brothers Holdings Inc., people familiar with the matter said.").

87. The advent and proliferation of business weblogs have led to coverage for both meaningful as well as trivial matters concerning executives. For example, in 2008, the weblog, Dealbreaker.com, reported the golf handicap of some of Wall Street's top CEOs. See *When Executives Hit the Links: Does Golf Affect Stock Prices?*, [http://dealbreaker.com/2007/07/when\\_executives\\_hit\\_the\\_links.php](http://dealbreaker.com/2007/07/when_executives_hit_the_links.php) (July 9, 2007, 14:47 EST) (discussing the possible relationship between a CEO's golf score and the company's change in stock price).

88. See *False Report Sends UAL Shares Plunging, Posting of Micheline Maynard to Dealbook*, N.Y. TIMES, <http://dealbook.blogs.nytimes.com/2008/09/08/false-report-sends-ual-shares-plunging/> (Sept. 8, 2008, 12:05 EST) ("Shares of United Airlines plunged Monday morning when a false rumor swept financial markets that the struggling carrier had filed for bankruptcy protection.").

89. See *Selective Disclosure and Insider Trading*, *supra* note 83 (adopting new rules

---

---

company and each executive is unique, principle-based regulated disclosure provides flexibility to the companies to decide what disclosure is appropriate.<sup>90</sup>

Aside from fairness and efficiency, there are collateral benefits of regulated disclosure. One benefit is that it can result in more efficient use of resources in the greater marketplace by reducing information-gathering costs, which some argue creates no additional value to the marketplace.<sup>91</sup> Another benefit of regulated disclosure is that as companies become more aware of certain material, such as private matters concerning their executives, they may improve their succession planning, when appropriate. Finally, another benefit of regulated disclosure is that it may de-stigmatize certain human conditions to the extent that executives with these conditions continue to thrive in their roles post-disclosure.<sup>92</sup>

#### D. *The Senile Sage & The Mad Queen*

While the foregoing arguments advocating more disclosure concerning public company executives may be persuasive, it is instructive to examine the issue of such disclosure in the realm of two hypothetical CEOs to highlight the practical implications and difficulties surrounding the issue. The following two characters are fictitious but based on composites of real world executives.

##### 1. The Senile Sage

Winston B. Welchers (a.k.a. Mr. W) is the chief investment officer, chief executive officer, and chairman of Orange Inc., a holding company that owns subsidiaries that engage in a wide range of diverse businesses, from furniture stores to oil storage to gold mining. Orange Inc. also owns over one hundred insurance and reinsurance entities. Corporate returns and

---

that address the issue of selective disclosure of material, non-public information).

90. See *infra* Part IV.C (discussing the meaning of “material” for federal securities laws).

91. See Coffee, *supra* note 81, at 733–34 (1984) (postulating that trading gains do not create additional real wealth, while information gathering “consumes real resources.”); Sanford J. Grossman & Joseph E. Stiglitz, *On the Impossibility of Informationally Efficient Markets*, 70 AM. ECON. REV. 393–400 (1980) (proposing a model “in which there is an equilibrium degree of disequilibrium: prices reflect the information of informed individuals (arbitrageurs) but only partially, so that those who expend resources to obtain information do receive compensation”).

92. For example, a CEO who is battling cancer, yet continues to thrive in her position, post-diagnosis and post-disclosure, may remove some of the stigma associated with cancer survivors serving and succeeding as senior executives.

equities returns on Orange Inc. have bested the S&P 500 Index<sup>93</sup> in eighteen of the past twenty years. Mr. W is lauded as an oracle and innovator for his equity investments and his ability to cut costs and create organic growth in his subsidiaries. Stock analysts often speak of the “W premium” placed on Orange Inc.’s stock simply because of Mr. W’s presence at the helm.<sup>94</sup> Mr. W is seventy-seven years old and many expect him to step aside very soon. However, Mr. W has no intention of retiring until he is incapable of doing his job. Because of Mr. W’s past and continued success, no clear succession plan has been implemented, and he is under little pressure to implement one.<sup>95</sup>

Recently, blogs and chat rooms became abuzz with rumors that Mr. W was diagnosed with early symptoms of Alzheimer’s disease last year. The rumors persisted for several days, causing Orange Inc.’s stock to drop precipitously. After eight days of rumor, innuendo, and speculation, the Wall Street Journal reported that the company confirmed that Mr. W was indeed suffering from early dementia and would step down immediately. The story also indicated that board of directors and senior management of the management had only confirmed Mr. W’s illness in the past two days. Upon the break of the story, Orange Inc. lost 25% of its market capitalization as investors fled over uncertainty about the company’s future leadership. Within two weeks, five class action lawsuits were filed and the SEC, the Department of Justice, and the State Attorneys General from five states all commenced formal investigations.

## 2. The Mad Queen

Mary Gigs McQueen (a.k.a. Mrs. Q) is the founder, chief technology officer, and chief executive officer of MQ Enterprises Inc., an integrated media, technology, and merchandising company. MQ Enterprises produces magazines, television shows, household items, and consumer electronics under the “Q” brand. Last year, the company had over ten billion dollars in total revenue. Mrs. Q is lauded as a lifestyle and technology visionary with

---

93. See Standard & Poor’s 500-stock Index (S&P 500), MORGAN STANLEY, <http://www.morganstanleyindividual.com/customerservice/dictionary/default.asp?letter=S#I DAT4GPD> (as of January 31, 2009).

94. It is widely believed in the investing world that certain CEOs, by their mere reputation, add value or a premium to their company’s stock price. See, e.g., EMILY ROSS & ANGUS HOLLAND, 100 GREAT BUSINESSES AND THE MINDS BEHIND THEM 271 (Sourcebooks, Inc. 2006) (2004) (“Berkshire Hathaway has a significant Buffett premium built into [its] price.”).

95. See Geraldine Fabrikant, *A Maestro of Investments in the Style of Buffett*, N.Y. TIMES, Apr. 23, 2007, at C1 (discussing the difficulties in replacing an executive who acts both as chief executive officer and chief investment officer).



a Midas touch. Her face graces the cover of every issue of her three magazine publications and she hosts two television shows. Additionally, the “Q” digital entertainment player was lauded as a revolutionary product that created a two billion dollar portable digital entertainment market.

Recently, MQ Enterprises saw its stock plummet forty percent based on some news about Mrs. Q. According to news reports, last year Mrs. Q’s husband, Mr. Q, filed for divorce and requested sole custody of their two young sons. In sealed court papers concerning the divorce and custody proceedings that recently leaked online, it is alleged, *inter alia*, that Mrs. Q used cocaine, was questioned by the U.S. Attorney as part of an insider trading investigation, and has been diagnosed with ovarian cancer.<sup>96</sup> Additionally, court documents reveal that Mrs. Q has substantial holdings through intricate partnerships in some of MQ Enterprises’ chief competitors and has allegedly used business ideas, including those for critical patents, of her husband without giving him proper credit.<sup>97</sup> As part of the divorce settlement, Mr. Q is demanding half of Mrs. Q’s majority stake in MQ Enterprises, which could change control of the company.<sup>98</sup> None of the foregoing was previously known to the company’s board of directors or senior management. The New York State Attorney General has launched an investigation into any potential wrongdoing by Mrs. Q and MQ Enterprises.

While the foregoing scenarios about Mr. W and Mrs. Q may seem implausible, the individual circumstances of each scenario are not only plausible, but likely exist or have occurred in the business world. In 2003, the ubiquitous Martha Stewart, the then-CEO of Martha Stewart Living Omnimedia, Inc., was charged for making materially false statements of fact regarding her sale of ImClone securities to sustain the market value of her company.<sup>99</sup> In 2004, Charles Bell, the newly elected CEO of McDonald’s Corporation, resigned after being diagnosed with cancer and died shortly thereafter.<sup>100</sup> In 2007, the career of John Browne, the CEO

---

96. *See generally* W. Bruce Johnson, Robert P. Magee, Nandu J. Nagarajan & Harry A. Newman, *An Analysis of the Stock Price Reaction to Sudden Executive Deaths: Implications for the Managerial Labor Market*, 7 J. ACCT. & ECON. 151 (1985) (studying the association between unexpected deaths of senior corporate executives and the common stock price of their respective corporations).

97. *See generally* Liu & Yermack, *supra* note 23 (discussing the impact of securities transactions by CEOs on the performance of their companies).

98. *See, e.g.*, Yung, *supra* note 21, at 2D (highlighting the advantages of a CEO disclosing personal reasons, such as a divorce settlement, to sell stock in his company).

99. *United States v. Stewart*, 305 F. Supp. 2d 368, 370 (S.D.N.Y. 2004).

100. Press Release, McDonald’s Corporation, McDonald’s Former President and CEO Charlie Bell Dies of Cancer (Jan. 17, 2005), [http://mcdonaldsemail.com/corp/news/corppr/2005/cpr\\_01162005.html](http://mcdonaldsemail.com/corp/news/corppr/2005/cpr_01162005.html).

who turned British Petroleum PLC into one of the world's most valuable oil companies, came to an unceremonious end after a British court allowed a United Kingdom newspaper group to publish a set of articles about the executive's long relationship with a young man.<sup>101</sup> The hypothetical and the real world cases both illustrate that the current rules or traditionally-accepted practices under the current rules could be enhanced by requiring additional disclosures from public company executives.<sup>102</sup>

### III. THE GENERAL DISCLOSURE OBLIGATIONS OF THE FEDERAL SECURITIES LAWS

Congress built the SEC on the excesses of the Roaring Twenties and on the ruins of the Great Depression by enacting two pieces of landmark legislation: the Securities Act of 1933<sup>103</sup> (the "Securities Act") and the Securities Exchange Act of 1934<sup>104</sup> (the "Exchange Act"). The chief purpose of the Securities Act is "to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes."<sup>105</sup> The Securities Act requires the registration of any offer and sale of securities using the "means or instruments of transportation or communication in interstate commerce."<sup>106</sup> The Securities Act, through the registration process, attempts to ensure that investors receive truthful, accurate, and material information about the issuer and the securities being offered by mandating certain line item disclosures<sup>107</sup> and more meaningful narrative disclosures through Regulation S-K.<sup>108</sup> Whereas the Securities Act governs the issuance of securities, the Exchange Act governs the

---

101. MacDonald et al., *supra* note 22 at A1.

102. It is worth noting that, had there been stronger executive disclosure requirements in place at the respective times of our hypothetical and real-world cases, the impact of those events may not have been softer or different save for a temporal difference. Mrs. Stewart's company's stock would have dropped upon the news of her charges regardless of whether the news came from company disclosures or from media outlets. Nonetheless, regulated disclosure would result in better corporate governance, which is in part about being forthright on a timely basis with shareholders and with the marketplace regardless of the consequences.

103. 15 U.S.C. §§ 77a-aa (2000) (originally enacted as Act of May 27, 1933, ch. 38, § 1, 48 Stat. 74).

104. 15 U.S.C. §§ 78a-mm (2000) (originally enacted as Act of June 6, 1934, ch. 404, § 1, 48 Stat. 881).

105. 15 U.S.C. § 77a (2000).

106. 15 U.S.C. § 77e (2000) (originally enacted as Act of May 27, 1933, ch. 38, § 1, 48 Stat. 74).

107. 15 U.S.C. § 77aa (2000).

108. 17 C.F.R. § 229 (2008).

subsequent trading and sales of those securities.<sup>109</sup> The Exchange Act, through its broad anti-fraud provision<sup>110</sup> and its periodic reporting requirements,<sup>111</sup> attempts to ensure that investors in the secondary market for securities receive truthful, accurate, and material information about the issuer and the securities being offered. While the Securities Act and the Exchange Act both require some disclosure about management executives and other significant employees,<sup>112</sup> certain types of private, material information, such as those involving our hypothetical CEOs Mr. W and Mrs. Q, are not likely to be disclosed under traditional disclosure practice because the SEC has never taken enforcement action or issued guidance concerning the disclosure of private facts, such as serious illness.<sup>113</sup>

A. *Disclosure and Fraud Under the Securities Act*

The Securities Act requires that most public offerings of securities in the United States undergo a registration process with the SEC.<sup>114</sup> As part of the process, the issuer publicly files a registration statement with the SEC.<sup>115</sup> The registration statement and the accompanying prospectus must include certain disclosures outlined in the registration form itself and in Regulation S-K.<sup>116</sup> In terms of disclosure about company executives and other significant employees, the SEC requires a brief summary of their experiences and backgrounds as well as of related party transactions and legal proceedings.<sup>117</sup> Nonetheless, there are no explicit requirements to disclose private, material matters, such as serious illness<sup>118</sup> or significant changes in personal financial situation.<sup>119</sup> Moreover, decades of disclosure

---

109. 15 U.S.C. §§ 78a-mm (2000) (originally enacted as Act of June 6, 1934, ch. 404, § 1, 48 Stat. 881).

110. See *supra* Part III.B (discussing Rule 10b-5 under the Exchange Act).

111. Securities Exchange Act of 1934 § 13(a)(1), 15 U.S.C. § 78m(a)(1) (requiring public companies to “keep reasonably current the information and documents required to be included in or filed with an application or registration statement” required by Section 12 of the Exchange Act).

112. 17 C.F.R. § 229.401 (2008) (requiring the disclosure of a company’s directors, officers, and certain key employees).

113. See Elkind, *supra* note 6 (“The SEC requires that any public company disclose material information to investors so that they can include it in their calculation of whether to buy or sell a stock. But there are no specific guidelines governing health issues, and the SEC has never taken action against a company in this area.”).

114. See 15 U.S.C. § 77g (2000) (outlining the information required for registration).

115. *Id.*

116. 17 C.F.R. § 229 (2008).

117. 17 C.F.R. § 229.401 (2008).

118. See Glenn, *supra* note 25, at 541-42 (noting the absence of clearly settled federal law mandating the disclosure of executive illness).

119. See, e.g., Yung, *supra* note 21, at 2D (describing the disclosure by a CEO that he

practice traditionally have not resulted in the disclosure of such private, material matters.<sup>120</sup>

In addition to the explicit disclosure requirements, disclosure resulting from the Securities Act also arises because of its antifraud provisions under Sections 11, 12, and 17. Section 11 of the Securities Act creates liability for registration statements that “contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading.”<sup>121</sup> A finding of liability is likely for the issuing company in the event that there are materially false statements or omissions in the registration statement because the issuing company is strictly liable for such false statements or omissions.<sup>122</sup> Under Section 11, a plaintiff does not have the burden of proving reliance on the materially false statement or omission, and the defense cannot use the absence of such reliance as an affirmative defense.<sup>123</sup>

Section 12 of the Securities Act broadens the scope of liability to cover communications made outside the registration statement in connection with a securities offering.<sup>124</sup> Section 12 makes liable any person who offers or sells a security “by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading[.]”<sup>125</sup> Unlike Section 11, Section 12 offers an affirmative defense for parties that “did not know, and in the exercise of reasonable care could not have known, of such untruth or omission.”<sup>126</sup>

Section 17 of the Securities Act is the general antifraud provision that governs all securities transactions—public and private—and serves as a

---

sold stock in his company to pay a divorce settlement).

120. *Cf.* Elkind, *supra* note 6 (“The SEC requires that any public company disclose material information to investors so that they can include it in their calculation of whether to buy or sell a stock. But there are no specific guidelines governing health issues, and the SEC has never taken action against a company in this area.”).

121. 15 U.S.C. § 77(k) (2008).

122. *See, e.g.*, Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983) (Liability against the issuer of a security is virtually absolute. . . .); Degulis v. LXR Biotechnology, Inc., 928 F. Supp. 1301, 1314 (S.D.N.Y. 1996) (“Sections 11 and 12(2) provide for strict liability. . . .”); *In re Worlds of Wonder Sec. Litig.*, 694 F. Supp. 1427, 1434 (N.D. Cal. 1988) (“[P]laintiffs need only show a material misstatement or omission to establish their prima facie case.”).

123. 15 U.S.C. § 77(k) (1998).

124. *See* 15 U.S.C. § 77(l) (2008) (covering liabilities arising from prospectuses and communications).

125. *Id.*

126. *Id.*

shield for purchasers and a sword against sellers.<sup>127</sup> Section 17(q) states that:

It shall be unlawful for any person in the offer or sale of any securities or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 USCS § 78(c)]) by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—

- (1) to employ any device, scheme, or artifice to defraud, or
- (2) to obtain money or property by means of any untrue statement of a material fact or any omission 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; or
- (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.<sup>128</sup>

The elements of proof under Section 17 are similar to those of its more prominent regulatory cousin, Section 10(b) of the Exchange Act,<sup>129</sup> which was based in part on Section 17.<sup>130</sup> As a result, many plaintiffs join their Section 17(a) actions with Section 10(b) actions.<sup>131</sup> However, it should be noted that there are meaningful differences between Section 10(b) and Section 17(a). Namely, scienter is necessary in actions under Section 10(b) and Section 17(a)(1),<sup>132</sup> but not required in actions under Sections 17(a)(2) and 17(a)(3).<sup>133</sup>

#### B. *Disclosure and Fraud Under the Exchange Act*

The Exchange Act requires, inter alia, that “[c]ompanies with more

---

127. 15 U.S.C. § 77(q) (2008).

128. 15 U.S.C. § 77(q)(a) (2008).

129. 15 U.S.C. § 78(j) (2008); *see infra* Part III.B.

130. *See* Harry S. Gerla, *Issuers Raising Capital Directly From Investors: What Disclosure Does Rule 10b-5 Require?*, 28 J. CORP. L. 111, 115 (2002) (“Rule 10b-5 was copied from section 17.”).

131. *See* Landry v. All Am. Assurance Co., 688 F.2d 381, 386 (5th Cir. 1982) (“Perhaps the main reason for the somewhat awkward development of the law under § 17(a) of the 1933 Act is the fact that it has traditionally lived in the shadow of another area of securities law: Rule 10b-5.”); Spatz v. Borenstein, 513 F. Supp. 571, 578 (N.D. Ill. 1981) (“[P]laintiffs have often ‘boot-strapped’ § 17(a) allegations to their 10b-5 claims.”).

132. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) (holding that scienter is required for 10(b) actions); Aaron v. SEC, 446 U.S. 680, 701-02 (1980) (holding that scienter is required for 17(a)(1) actions).

133. Aaron v. SEC, 446 U.S. 680, 701-02 (1980) (holding that scienter is not necessary for 17(a)(2) and 17(a)(3) actions).

than \$10 million in assets whose securities are held by more than 500 owners must file annual and other periodic reports” and make them available to the public.<sup>134</sup> This requirement also extends to companies that are listed on the national securities exchanges.<sup>135</sup> Required reports, such as 10-Ks, 10-Qs and 8-Ks, are often incorporated by reference into the registration statement and prospectus in the event of a securities offering and become part of the offering documents.<sup>136</sup>

In addition to the bright-line disclosure requirements, the Exchange Act also encourages disclosures through a broad antifraud provision under Rule 10b-5, which states that:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

To employ any device, scheme, or artifice to defraud,  
To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or  
To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.<sup>137</sup>

Generally, to prevail on a Rule 10b-5 claim, a plaintiff must prove that the defendant acted with scienter in making the false statement or omission of material fact in connection with the purchase or sale of a security which caused the plaintiff economic loss after the plaintiff justifiably relied on such statements and omissions.<sup>138</sup> Since its promulgation in 1942, the

---

134. SEC, The Laws That Govern the Securities Industry, <http://sec.gov/about/laws.shtml> (last visited Nov. 25, 2008); *see also* 17 C.F.R. § 240.12g-1 (2001) (exempting issuer from registration requirements if total assets do not exceed \$10 million).

135. *See* Securities Exchange Act of 1934, 15 U.S.C. § 78m(a) (1994) (requiring companies registered on a national securities exchange to file reports with the SEC and the exchange); Securities Exchange Act of 1934, 15 U.S.C. § 781(b) (1994) (outlining the requirements to register a security on a national securities exchange).

136. *See* 15 U.S.C. § 78m(a) (1994) (requiring the filing of annual reports and other information as prescribed by the SEC rules and regulations); 17 C.F.R. § 240.13a-1 (outlining the periodic disclosure requirements of Exchange Act registered companies); 17 C.F.R. § 249.310 (Exchange Act Form 10-K), 17 C.F.R. § 249.308a (Exchange Act Form 10-Q); 17 C.F.R. § 249.308 (Exchange Act Form 8-K).

137. 17 C.F.R. § 240.10b-5 (1998).

138. *See, e.g.,* Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341 (2005) (“[T]he action’s basic elements include . . . scienter.”); San Leandro Emergency Medical Group Profit

scope of the rule has been greatly expanded by the lower courts.<sup>139</sup> Many securities law practitioners and scholars consider it to be the most important liability rule—a supernova in the securities laws universe.<sup>140</sup>

C. *What is “Material”?*

Looming prominently in the disclosure and antifraud provisions of the federal securities laws is the specter of materiality. What is “material”? In *TSC Industries, Inc. v. Northway, Inc.*, the leading case on the subject, the Supreme Court held that:

An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote . . . . Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the “total mix” of information made available.<sup>141</sup>

This definition was later broadly adopted for securities law purposes in *Basic, Inc. v. Levinson*.<sup>142</sup> Because of the “total mix” concept in the definition of materiality, each misstatement and omission is generally considered on an individual basis in light of the specific facts and circumstances surrounding it. Questions of materiality usually require juries to make “delicate assessments of the inferences a ‘reasonable investor’ would draw from a given set of facts and the significance of those inferences to him.”<sup>143</sup> Nonetheless, case law in this area has created some

---

Sharing Plan v. Philip Morris Companies, Inc., 75 F.3d 801, 808 (2d Cir. 1996) (“[A] plaintiff must plead that the defendant made a false statement or omitted a material fact, with scienter, and that plaintiff’s reliance on defendant’s action caused plaintiff injury.”); *Bruschi v. Brown*, 876 F.2d 1526, 1528 (11th Cir. 1989) (“The elements of a Rule 10b-5 cause of action are: (1) the defendant made a false statement or omission of material fact, (2) with scienter, (3) upon which the plaintiff justifiably relied, and (4) that proximately caused the plaintiff’s damages.”).

139. See, e.g., *SEC v. Zandford*, 535 U.S. 813, 818-35 (2002) (alluding to the expansion of the rule and its jurisprudence).

140. See, e.g., William K.S. Wang, *Trading on Material Nonpublic Information on Impersonal Stock Markets: Who Is Harmed, and Who Can Sue Whom Under SEC Rule 10b-5?*, 54 S. CAL. L. REV. 1217, 1217-71 (1981) (highlighting the growing number of actions under Rule 10b-5); Julie A. Herzog, *Fraud Created the Market: An Unwise and Unwarranted Extension of Section 10(b) and Rule 10b-5*, 63 GEO. WASH. L. REV. 359, 367-70 (1995) (critiquing the wide reach and impact of the application of Rule 10b-5).

141. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 448 (1976).

142. 485 U.S. 224, 231-32 (1988) (adopting the previously mentioned definition of “material” in a securities law context).

143. *TSC Industries*, 426 U.S. at 450; see also John M. Fedders, *Qualitative Materiality: The Birth, Struggles, and Demise of an Unworkable Standard*, 48 CATH. U. L. REV. 41, 45-48 (1998) (discussing the difficulties and subjectivity involved in determining materiality).

interpretative guidance.

For one, some courts have held that if the alleged misstatement or omission is clearly insignificant, then it would be considered immaterial as a matter of law.<sup>144</sup> This can be the case where the alleged misstatement or omission “present[s] or conceal[s] such insignificant data that, in the total mix of information, it simply would not matter.”<sup>145</sup> In terms of significance, and materiality as a matter of law, some courts are of the view that actionable statements need some level of specificity and not only be puffery.<sup>146</sup> “Alleged misrepresentations can be immaterial as a matter of law if they . . . are so vague and of such obvious hyperbole that no reasonable investor would rely upon them.”<sup>147</sup> Therefore, customary statements by company officials such as “our core metrics remain strong,” “we are always looking for potential acquisitions,” and “we [continue] to be focused on growth,” are generally considered mere puffery.<sup>148</sup>

Additionally, some courts have held that alleged misstatements or omissions are not materially misleading if the market possesses the correct information.<sup>149</sup> For example, if a company executive in an interview fails to fully describe a topic related to the company, such a misstatement or omission may not be material if the company has made available more complete and correct information on that topic as part of its periodic filings with the SEC.<sup>150</sup> Similarly, an inadvertent misstatement of a widely-known, verifiable fact may not be actionable since corrective mechanisms exist in the markets.<sup>151</sup>

---

144. *See, e.g.*, *Recupito v. Prudential Secs., Inc.*, 112 F. Supp. 2d 449, 454 (D. Md. 2000) (“[I]f the alleged misstatements or omissions ‘are so obviously unimportant to an investor that reasonable minds cannot differ on the question of materiality, the court may rule them immaterial as a matter of law.’” (quoting *Klein v. Gen. Nutrition Cos.*, 186 F.3d 338, 342 (3d Cir. 1999))); *cf. Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 162-63 (2d Cir. 2000) (reversing a district court decision for determining immateriality as a matter of law based on a single data point).

145. *Chambers v. AMDOCS Ltd.*, 390 F.3d 542, 548 (8th Cir. 2004).

146. *See, e.g., In re N. Telecom Ltd. Sec. Litig.*, 116 F. Supp. 2d 446, 466 (S.D.N.Y. 2000) (“[S]ingle, vague statement[s] that are essentially mere puffery.”); *City of Monroe Employees Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 671 (6th Cir. 2005), *cert. denied*, 546 U.S. 936 (2005) (holding that vague statements not subject to verification by proof are generally deemed non-actionable puffery).

147. *Chambers*, 390 F.3d at 548.

148. *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 869-70 (5th Cir. 2003).

149. *See, e.g., Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 368 (5th Cir. 2004) (holding that publicly available information filed with the SEC served as a corrective mechanism for alleged misstatements).

150. *See Ieradi v. Mylan Labs., Inc.*, 230 F.3d 594, 599-600 (3d Cir. 2000) (holding that failure to disclose certain terms of significant contracts is not material when disclosure in the company’s 10-Q alludes to such terms).

151. *See id.*



Similarly, some courts have held that alleged misstatements and omissions can be neutralized and negated by ample cautionary language in disclosure documents; this is the so-called “bespeaks caution” doctrine.<sup>152</sup> Regulation S-K requires that periodic filings such as the annual report on Form 10-K and the prospectuses contain, where appropriate, “risk factors” relating to the company or its offering.<sup>153</sup> Public companies, in relying on the “bespeaks caution” doctrine, include ample cautionary language in their disclosure documents in the hope of shielding themselves from future liability. While cautionary language can provide a shielding blanket for public companies, the language must be specific and properly constructed in order to be meaningful and effective. Broad sweeping cautionary statements will offer little warmth against the cold stare of hindsight in a civil action. Effective and meaningful cautionary language must be sufficiently specific<sup>154</sup> and directed at forward-looking statements.<sup>155</sup>

While the body of law since *TSC Industries, Inc.* has offered many guideposts for gauging materiality, there still remains some difficulty and subjectivity in the determination of materiality.<sup>156</sup> This lack of objective clarity may be frustrating to some, but it may also be necessary because each company is different; a determination of materiality must be examined through the unique lens of each company.

---

152. See *Halperin v. eBanker USA.com, Inc.*, 295 F.3d 352, 360-61 (2d Cir. 2002) (holding that “cautionary language address[ing] the relevant risk directly” negates an allegedly material omission); *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1120 (10th Cir. 1997) (same); *Gasner v. Board of Supervisors*, 103 F.3d 351, 358 (4th Cir. 1996) (same); *Saltzberg v. TM Sterling/Austin Assocs.*, 45 F.3d 399, 400 (11th Cir. 1995) (same); *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1413-15 (9th Cir. 1994) (same); *Rubinstein v. Collins*, 20 F.3d 160, 166-68 (5th Cir. 1994) (arguing that cautionary language might render predictive statements immaterial but is not per se dispositive under the “bespeaks caution” doctrine); *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371-73 (3d Cir. 1993) (applying the “bespeaks caution” doctrine where cautionary language was tailored specifically to address uncertainty forming the basis for plaintiffs’ claim).

153. Regulation S-K, Item 503, 17 C.F.R. § 229.503 (2008).

154. See *Grossman*, 120 F.3d at 1120 (requiring sufficiently specific risk disclosures or cautionary language to nullify any potentially misleading statements); *In re Westinghouse Sec. Litig.*, 90 F.3d 696, 707-08 (3d Cir. 1996) (same); *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1213-14 (1st Cir. 1996) (holding that the “bespeaks caution” doctrine was not applicable because of ambiguity in cautionary language); *Fecht v. Price Co.*, 70 F.3d 1078, 1082 (9th Cir. 1995) (stating that the “bespeaks caution” doctrine is only applicable where the information in the document, taken as a whole, is sufficiently cautionary).

155. See, e.g., *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 948 (9th Cir. 2005) (“[E]xtension of the bespeaks caution doctrine to statements of historical fact is inappropriate.”); *EP Medsystems, Inc. v. EchoCath, Inc.*, 235 F.3d 865, 874 (3d Cir. 2000) (“By its terms, the ‘bespeaks caution’ doctrine, like the safe harbor provision in the Reform Act, is directed only to forward-looking statements.”).

156. See *Fedders*, *supra* note 143, at 46 (discussing the lack of clarity in framework for determining materiality in the securities law context).

*D. What Does This Mean for Mr. W, Mrs. Q, and Other Executives?*

Based on the previous discussion of the general disclosure obligations under the federal securities laws, it is not entirely clear what legal consequences Mr. W and Mrs. Q would face as a result of their misstatements and omissions. Arguably, Mr. W's and Mrs. Q's illnesses and legal problems are of the type that "there is a substantial likelihood that a reasonable shareholder would consider it important," and therefore are material and should be disclosed for securities law purposes.<sup>157</sup> However, "[n]o company has ever been held to account by the SEC for failing to disclose information about its chief executive's health[.]"<sup>158</sup> Furthermore, since neither of their companies were aware of their respective private issues, such material misstatements and omissions may not be actionable, and investors will have nowhere in federal securities law to which they can turn for their grievances. The scienter requirement under Section 10b-5 and Section 17(a)(1),<sup>159</sup> and the knowledge requirement under Section 12<sup>160</sup> may lead or have led companies to adopt a benign willful ignorance policy toward the material, private acts of their executives—"speak no evil, hear no evil, see no evil."

Current federal securities laws along with historic and widely-accepted practices under such laws offer little clear guidance as to what a company should do, besides not disclose, when it comes to facts like those involving Mr. W and Mrs. Q.<sup>161</sup> The absence of clarity under the current regulatory model has created a dangerous opaqueness for the investing public with disclosure practices varying from company to company:<sup>162</sup>

When Intel . . . CEO Andy Grove was diagnosed with prostate cancer in 1995, he made no formal disclosure—Grove chose to write about it instead in a 1996 article for *Fortune*. On the other

---

157. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 439 (1976).

158. Nocera, *supra* note 7 at C1.

159. *See Aaron v. SEC*, 446 U.S. 680, 701-02 (1980) (holding that scienter is required for 17(a)(1) actions); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976) (holding that scienter is required for 10(b) actions).

160. 15 U.S.C. 771 (2006).

161. *See, e.g., Elkind, supra* note 6 (reporting the troubling lack of SEC guidance on material, private matters involving executives).

162. *See Nocera, supra* note 7, at C1 ("In 1995, when Andrew S. Grove, then the chief executive of Intel, received a diagnosis of prostate cancer, he informed the company's board and management. But he never told the company's shareholders . . . . On the other hand, when Charles H. Bell received a diagnosis of colorectal cancer shortly after he became the chief executive of McDonald's in 2004, the company quickly released the news. Mr. Bell resigned from the company that November, and died two months later."); *Elkind, supra* note 6 (discussing Apple's struggle with whether disclosure was required for CEO's pancreatic cancer diagnosis).

---

---

hand, Berkshire Hathaway's Warren Buffett . . . issued a press release in June 2000 days after he learned he would need surgery to remove benign polyps along with part of his colon, even though the procedure was considered routine.<sup>163</sup>

The absence of clarity and guidance under current regulations has essentially turned back the regulatory clock, retrofitting the philosophy of caveat emptor for the philosophy of disclosure.<sup>164</sup> A new, workable model approach that addresses the competing desires of the corporation, the executives, and the investing public is needed. The following part proposes one such model approach.

#### IV. A MODEL APPROACH

There is no pure solution in any realistic, workable approach for additional executive disclosure of private, material facts. Good practical solutions will likely be thematically inelegant, internally inconsistent, and often cross-cutting. Weighing the executive's desire for privacy against the investing public's thirst for more material information<sup>165</sup> is a delicate, difficult, but necessary balance if capital markets are to function better. However, the fulcrum of this balance is neither unique nor rare in modern society. Consumers sacrifice personal privacy for the sake of market efficiency and higher standards of living.<sup>166</sup> Every online transaction, every direct deposit, and every credit card purchase is the result of a model based on a careful balance between individual privacy and market efficiency. In creating a workable model approach, privacy concerns must be cautiously considered, and some flexibility and deference must be given to companies as the facts and circumstances of each case are unique. The model approach offered here is outlined by addressing three key questions: (1) *Who should disclose?*; (2) *What should be disclosed?*; and (3) *How to disclose?* As discussed in greater detail below, this Article advocates a model approach that would first require principle-based disclosure by senior executives of material private information to their board of directors

---

163. Elkind, *supra* note 6.

164. See SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963) ("A fundamental purpose, common to [the federal securities laws], was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.")

165. See SEC, Disclosure to Investors, *supra* note 29 ("Ongoing developments in technology have increased both the markets and investors demand for more timely company disclosure on the Web[.]").

166. See JAMES B. RULE, PRIVACY IN PERIL: HOW WE ARE SACRIFICING A FUNDAMENTAL RIGHT IN EXCHANGE FOR SECURITY AND CONVENIENCE 94-112 (2007) (critiquing the tradeoff of individual privacy for convenience in modern American life).

---

---

or appropriate committee. Second, the approach requires that such disclosure be made available to the investing public within the current federal securities framework after the board independent of the disclosing executive determines that such disclosure is material and should be disclosed.

A. *Who Should Disclose?*

The obligation to disclose material information should rest with all executives and senior officers of the company. “Executive” and “senior officer” in this instance means such persons as defined by Rule 16a-1(f) under the Exchange Act as an “officer” of the company.<sup>167</sup> Rule 16a-1(f) defines “officer” as

[A]n issuer’s president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer. Officers of the issuer’s parent(s) or subsidiaries shall be deemed officers of the issuer if they perform such policy-making functions for the issuer. In addition, when the issuer is a limited partnership, officers or employees of the general partner(s) who perform policy-making functions for the limited partnership are deemed officers of the limited partnership. When the issuer is a trust, officers or employees of the trustee(s) who perform policy-making functions for the trust are deemed officers of the trust.<sup>168</sup>

Admittedly, this class of persons obligated to disclose is both under-inclusive and over-inclusive. It is under-inclusive because it fails to capture certain influential and highly-compensated individuals that are not senior officers but may have a material impact on the company. For example, key creative talents in the entertainment divisions of conglomerates and critical engineers of technology-intensive companies would be excluded from making material disclosures.<sup>169</sup> On the flip-side, it

---

167. See Exchange Act Rule 16a-1(f), 17 C.F.R. § 240.16a-1(f) (2008) (defining terms relevant to Section 16 of the Exchange Act).

168. *Id.*

169. This approach is consistent with the SEC’s rules concerning executive compensation disclosures. Under those rules the SEC, after significant pushback from corporations, decided to exclude from the required compensation disclosures “employees having no responsibility for significant policy decisions within the company, a significant subsidiary, or a principal business unit, division or function would be excluded when

is over-inclusive because it captures certain officers whose disclosures may not have a material impact.

While our “senior officers” net inadvertently captures some small fish and lets some big fish escape, it is nonetheless preferable because it is faithful to the current framework. Working within the current framework is operationally more feasible and less burdensome for companies because it minimizes legal costs for compliance and adoption.<sup>170</sup> Since certain disclosure is already required under federal securities laws from senior officers, broadening the scope and depth of their existing disclosure would be less burdensome than having additional requirements for new parties not accustomed to making such disclosures.<sup>171</sup>

### B. *What to Disclose?*

The disclosure of private information about anyone is a sensitive area that must be given due consideration.<sup>172</sup> Disclosure of private information about senior executives is arguably more sensitive because of the positive and negative externalities that such information may have on a company’s stock and the investments of individual investors.<sup>173</sup> Inappropriate amounts of information and inappropriate types of information can obfuscate the market’s ability to properly evaluate a company and can needlessly expose an individual’s private matters to the public.<sup>174</sup> Under our model approach,

---

determining which employees are among the most highly compensated.” See SEC, Changes to Executive Compensation Disclosure, *supra* note 39 (discussing important changes for disclosure requirements and reasoning behind those changes).

170. See, e.g., Alstine, *supra* note 41, at 789-91 (examining the costs related to companies complying with new regulations under modern rulemaking regimes).

171. In the lead up to the implementation of the landmark Sarbanes-Oxley Act, companies spent billions of dollars trying to comply with the regulations. Those costs could have been minimized had legislators made greater efforts to work within the existing system to provide additional safeguards for the public. As a result, in the years following the implementation of Sarbanes-Oxley, lawmakers continue to refine and amend the law to achieve a better regulatory equilibrium. See, e.g., Chang & Evans, *supra* note 60, at 51 (“One study by Ivy Zhang estimated that the U.S. stock market lost \$1.4 trillion in value, which is over 10 percent of annual U.S. GDP, as a result of the legislative events leading up to the passage of Sarbanes-Oxley. A ballpark estimate of the implementation costs of Sarbanes-Oxley is around \$100 billion so, assuming the \$1.4 trillion figure is correct, most of the estimated costs are indirect costs from the legislation.”).

172. See Joan MacLeod Hemingway, *Personal Facts About Executive Officers: A Proposal For Tailored Disclosures To Encourage Reasonable Investor Behavior*, 42 WAKE FOREST L. REV. 749, 764-70 (2007) (discussing the various difficulties, sensitivities, and biases involved in making private facts concerning executives public).

173. See, e.g., Elkind, *supra* note 6 (discussing the tension between privacy and shareholder interests in connection with disclosing an executives health conditions).

174. See David Monsma & Timothy Olson, *Muddling Through Counterfactual Materiality and Divergent Disclosure: The Necessary Search for a Duty to Disclose*

we assume that the SEC would provide principle-based guidance on the types of events that should be disclosed if they are likely to have a material impact.<sup>175</sup> As examples of such guidance, the SEC could state that where an executive's private acts could present a potential conflict with their company's interests then they should present such information to their board, or the SEC could state that an executive's diagnosis for a terminal illness is information that should be disclosed to the board. But regardless of the details of the underlying principles, a thematically-unified regulatory approach would have the virtue of enhancing the overall consistency and predictability of disclosures.<sup>176</sup> Moreover, once the marketplace adjusts their disclosures to reflect the principles, industry standards will likely be enhanced as companies adopt what they perceive as "best practices."

As a baseline consideration, what should be disclosed is information that is directly related to the executive deemed material for timely disclosure by the company's board of directors or delegated committee. Examples of the type of information that should be disclosed about senior executives are diagnoses of a fatal illness,<sup>177</sup> certain threatened criminal investigations, and certain meaningful outside investments.<sup>178</sup> It should be noted that many companies already have internal policies<sup>179</sup> that mandate

---

*Material Non-Financial Information*, 26 STAN. ENVTL. L.J. 137, 142 (2007) ("Not all information that is interesting to investors and analysts is material to the financial condition of a company[.]").

175. Business leaders tend to favor a more flexible, principle-based regulatory regime, like those in the United Kingdom, rather than a rigid rules-based regime. See Bloomberg & Schumer, *supra* note 39, at 17 ("Business leaders increasingly perceive the UK's single, principles-based financial sector regulator—the Financial Services Authority (FSA)—as superior to what they see as a less responsive, complex US system of multiple holding company and industry segment regulators at the federal and state levels.").

176. Bloomberg & Schumer, *supra* note 39, at 106 (discussing the benefits from certainty in the realm of enforcement from a unified regulatory scheme).

177. See Johnson, Magee et al., *supra* note 96, at 151-74 ("[C]ertain characteristics of managerial employment arrangements and of the labor market for managers make shareholder wealth dependent upon continued employment of an incumbent manager"); see also Morten Bennedsen, Francisco Perez-Gonzalez, and Daniel Wolfenzon, *Do CEOs matter?*, available at <http://www.mcombs.utexas.edu/faculty/Francisco.Perez-Gonzalez/valueceo.pdf> ("[P]ersonal shocks that are the most. . . meaningful for CEOs. . . [include] the death of children and spouses. . .").

178. For example, if an executive decides to invest his entire net worth in a vineyard, his or shareholder should be made aware of such an investment to the extent that the board determines that it will have a material impact on that executive's ability to perform his or her duties. See Liu & Yermack, *supra* note 23 at <http://ssrn.com/abstract=970413> (studying the impact of private investment decisions of CEOs on the performance of their companies).

179. See generally General Electric, *Governance Principles* (2008) available at [http://www.ge.com/company/governance/principles/governance\\_principles08.pdf](http://www.ge.com/company/governance/principles/governance_principles08.pdf) (containing principles relating to directorship); Time Warner Inc., *Corporate Governance Policy* (2008), available at

such disclosures and the SEC already requires the disclosure of certain transactions by executives.<sup>180</sup> Codifying this principle and practice to make such disclosures standard would lead to better corporate governance in the marketplace.

Given our proposed approach, it is likely that certain information that may have a material impact on the executive or the company should not need to be disclosed. For example, a CEO with a seriously ill spouse or child may be adversely affected in his capacity to serve optimally as a senior officer.<sup>181</sup> However, the disclosure of a spouse or child's serious illness would likely fall outside the purview of required disclosure under our model approach. Distinction should be made between the executive/principal and other parties because the executive is a duty-bound senior officer of the company, while other parties, such as friends and family members of the executive, are only tangentially connected to the company. In most circumstances, disclosure from non-principals should not be mandated as it may be too invasive regardless of the impact on the related executive.

### C. *How to Disclose?*

Disclosure should be done via a two-step process. First, the disclosing senior officer should disclose in a timely manner the private information to the board of directors or the appropriate committee.<sup>182</sup> Second, once the board determines that such information is material and should be made available to the public, it should be timely disclosed within the existing disclosure framework.<sup>183</sup>

---

[http://www.timewarner.com/corp/corp\\_governance/pdf/Corporate\\_Governance\\_Policy\\_0208.pdf](http://www.timewarner.com/corp/corp_governance/pdf/Corporate_Governance_Policy_0208.pdf) ("Corporate Governance Review and Disclosure").

180. Regulation S-K requires executives to disclose transactions involving "related persons, promoters, and certain control persons." See 17 C.F.R. 229.404 (2008) (requiring disclosure of certain relationships and transactions).

181. See Maremont, *supra* note 26, at A1 (reporting that a study which indicated a decline in a company's profitability following the death of its CEO's spouse or child); Bennedson et al., *supra* note 177 ("[P]ersonal shocks that are the most . . . meaningful for CEOs . . . [include] the death of children and spouses . . .").

182. All companies listed on the New York Stock Exchange and NASDAQ Stock Market are required to have Audit Committees and Corporate Governance Committees consisting entirely of independent directors to make objective decisions related to the company and its executives. Such committees, or a special committee designated by the board of directors, can weigh the materiality of the executive's disclosure and determine whether it merits disclosure to the public. See NYSE Listed Company Manual, Section 303A (addressing the corporate governance standards for listed companies); FINRA NASD Manual, NASD Rule 4350 ("Audit committees are required to have a minimum of three members and be comprised only of independent directors.").

183. The second step admittedly gives the board great latitude in unveiling or shielding

The first step of this process—disclosure to the board—already occurs in many companies with good corporate governance and forthcoming executives, so it should be minimally burdensome from an administrative perspective.<sup>184</sup> Admittedly, the first step gives some deference to executives and trusts that they will disclose certain private, personal matters to the board in a timely manner. Given that executives under the current regulatory regime already need to make similar disclosures, such deference is not irrational.<sup>185</sup> Moreover, our model approach exists in the context of principle-based guidance articulated by the SEC, and so disclosing executives and their boards will have some direction on what types of matters they should disclose.

The second step of this process—determination by the board—like the first step, already takes place in some boardrooms in America. However, disclosure guided by an SEC-articulated principle offers greater uniformity and fairness in the marketplace and allows for the timely disclosure of material information to the investing public.<sup>186</sup> The board or a designated committee—duty-bound to the company and its shareholders<sup>187</sup>—should make the decision independent of the relevant executive,<sup>188</sup> and that executive should have no active influence over the decision.<sup>189</sup> Once the

---

an executive officer's personal matters. However, presuming good corporate governance, no panel or person is in a better position to make that determination on behalf of the company and its shareholders than the independent members of the company's board of directors. See Fedders, *supra* note 143, at 46 (discussing the difficulties and subjectivity involved in determining materiality).

184. See A.A. Sommer, Jr., *Internal Controls*, 61 N.C. L. REV. 505, 513-14 (1983) (describing the ease with which disclosures can be made); Steven Chasin, *Insider v. Issuer: Resolving and Preventing Insider Trading Compliance Policy Disputes*, 50 UCLA L. REV. 859, 861-64 (2003) (discussing insider trading compliance policies).

185. Requiring executives to self-report to their management certain private matters may lead to a difficult personal decision for the executive, but alternatives to self-reporting—such as mandated disclosure or independent management investigation—are not cost-effective and practical. *Contra* Hemingway, *supra* note 172, at 790-94 (proposing mandatory disclosure and independent company investigation as a means to gather material, disclosable information about executives).

186. See Sommer, *supra* note 184, at 513-17 (noting the importance of compliance policies to relations with the SEC); Chasin, *supra* note 184, at 861-64 (discussing the harms of ambiguous compliance policies).

187. *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 930 A.2d 92, 98 (Del. 2007) (“It is well established that the directors owe fiduciary obligations to the corporation and its shareholders.”).

188. This is common practice in many companies especially when the audit committee, compensation committee or a special committee is meeting on sensitive matters concerning company executives. See NYSE Rule 303A.03 (requiring independent directors to meet regularly without management to discuss affairs of the company).

189. See Hemingway, *supra* note 172, at 765-70 (highlighting various biases and problems that make it less than optimal to have the relevant executive have influence over



decision to disclose is made, it should be done via the existing regulatory framework. For example, a company, where appropriate, may disclose the terminal illness of its CEO through a Form 8-K, a Form 10K, or through its website.<sup>190</sup> Additionally, where appropriate, the company should also include meaningful, specific narrative disclosure in the risk factor section<sup>191</sup> of its annual report on Form 10K.<sup>192</sup> For example, Martha Stewart Omnimedia, Inc. includes in its publicly-filed annual report on Form 10-K the following language in its risk factors:

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.<sup>193</sup>

This second step, like the first step, codifies the “best practices” in the market and places the responsibility on the company’s management to make the appropriate judgment regarding the executive’s private information. Because each company, each executive, and each situation is unique, some deference should be given to the business judgment of the company’s management since they are often in the best position<sup>194</sup> to judge how certain private matters of an executive is going to impact the company.<sup>195</sup> Consistent with established law, companies—not regulators

---

the disclosure decision).

190. Consistent with current practice, flexibility should be given the company in terms of how it chooses to disclose within the current regulatory framework. For example, an executive’s initial diagnoses with colon cancer can be disclosed through both a Form 8-K and the company’s website. Depending on timing, if additional information becomes available, the company can include a risk factor in its annual report on Form 10-K speaking to the executive’s diagnosis of cancer and its potential impact on the company. *See* SEC, SEC Disclosures to Investors, *supra* note 29.

191. 17 C.F.R. § 229.305 (2008) (“Registrants shall provide, in their reporting currency, quantitative information about market risk . . .”).

192. Many companies include “key persons” risk factors that alert investors about the company’s dependence on certain key personnel. Under our model approach, risks related to certain private matters involving executives would similarly be disclosed in the annual report. *See, e.g.*, Berkshire Hathaway, Inc., Annual Report (Form 10-K), at 19 (Feb. 29, 2008) (“Berkshire is dependent for its investment and capital allocation decisions on a few key people.”).

193. Martha Stewart Living Omnimedia, Inc., Annual Report (Form 10-K), at 12 (Mar. 17, 2008).

194. *See* Del. Gen. Corp. L. Sec. 141(a) (stating the responsibility of directors under Delaware law to manage the operations and affairs of a company).

195. *See* Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1621–24 (2001) (positing that deference to business judgment allows for flexible and meaningful corporate

or judges—should initially decide with regulatory guidance what may be material.<sup>196</sup>

It is worth noting that under the proposed model approach no new rules may need to be proposed; instead, existing rules and practices may only need clarification. The absence of additional rules should minimize compliance costs and make for swifter compliance to the new practice.<sup>197</sup>

## V. CRITIQUES & CONCERNS

Rule proposals and guidance from administrative agencies usually generate some critique and concern from implicated parties. Rule proposals and guidance from the SEC that implicate the interests of industry titans and personal privacy will likely generate much critique, concern, and consternation.<sup>198</sup> Broadly, three chief categories of concerns and critiques about requiring additional disclosures from public company executives are the “status quo” critique, corporate concerns, and privacy concerns.

### A. *The Status Quo Critique*

The “status quo” critique is in many ways a default and reflexive response to new guidance or regulations from the SEC (or any regulatory body). The critique often operates on two main strains, the sufficiency strain and the extra-regulatory strain. The sufficiency strain argues that the status quo of the existing framework is sufficient to deal with whatever issues the new proposed regulations are meant to address. Polemically and practically, the sufficiency strain goes along the lines of: “We don’t need more rules. We need to properly enforce the rules that we have on the

---

governance by individual companies).

196. Under the “business judgment rule,” courts have often deferred to management on business matters regardless of how problematic they may turn out to be in hindsight. *See, e.g., Gearhart Indus. Inc. v. Smith Int’l Inc.*, 741 F.2d 707, 721 (5th Cir. 1984) (outlining the business judgment rule); *Berwald v. Mission Dev. Co.*, 185 A.2d 480, 482–83 (Del. 1962) (detailing the ramifications of business judgment rule); *Kamin v. Am. Express Co.*, 383 N.Y.S.2d 807, 810 (Sup. Ct. 1976), *aff’d* 387 N.Y.S.2d 993 (App. Div. 1976) (stating the business judgment rule).

197. *See, e.g., Alstine, supra* note 41, at 793 (“[A] legal system will incur costs simply in adjusting to the existence of a new legal norm.”); *Matwyshyn, supra* note 41, at 199-202 (noting that making changes within the existing federal securities law regime can minimize costs).

198. *See SEC, SEC Changes to Executive Compensation Disclosure, supra* note 39 (“With more than 20,000 comments, and counting, it is now official that no issue in the 72 years of the Commission’s history has generated such interest.”).

books.”<sup>199</sup> The extra-regulatory strain argues that the status quo of the existing framework is adequate because the issues to be dealt with by the proposed rules are fundamentally extra-regulatory issues that cannot be properly addressed by more rules. Polemically and practically, the extra-regulatory strain goes along the lines of: “We don’t need more rules. Let the markets work.”<sup>200</sup> These are issues that can be better dealt with by the market (or some extra-regulatory force).<sup>201</sup> These two strains frequently serve as the basis for interrelated corporate arguments that implicate regulatory cost burdens on businesses and comparative advantage in the presence of overregulation (which will be discussed in greater detail in the next part).<sup>202</sup>

While the duel-strained status quo critique may be perceived as reflexive and shallow, it is not without merit. The sufficiency strain is correct in postulating that existing securities regulations need more vigorous enforcement and faithful compliance.<sup>203</sup> Some scholars and industry experts have argued that the corporate debacles of Enron, WorldCom, and their ilk came not only from rule-breaking, but from a lack of enforcement, oversight,<sup>204</sup> and honest compliance.<sup>205</sup> Likewise, the extra-regulatory strain is correct in postulating that there are certain problems that may be better addressed with market or other extra-

---

199. See, e.g., Michelle Singletary, *Another Lending Commission? Forget It—We Need to Enforce Existing Laws*, BOSTON GLOBE, April 27, 2008.

200. See Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 683 (1984) (contending that absent mandatory disclosure in securities laws, the market will reward or punish companies that disclose).

201. See, e.g., Chang & Evans, *supra* note 60, at 51 (“[T]here are a number of reasons to believe that market solutions are pretty good at limiting corporate misbehavior—the recent spate of corporate shenanigans notwithstanding—and that heavy-handed regulation and zealous prosecution are a bit like using an elephant gun to shoot a tarantula.”).

202. See Alstine, *supra* note 41, at 793 (examining the legal costs in light of regulatory change).

203. See Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 IOWA L.J. OF CORP. L. 1, 21-37 (2003) (explaining that the frauds that gave rise to Sarbanes Oxley may have been prevented through better enforcement and proper adherence to the then-existing regulations).

204. Some scholars have suggested that the failures of Enron and other corporate scandals of that period highlighted the shortcoming in the financial institution’s gatekeepers, namely, auditors and attorneys. See, e.g., John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 301-10, 349-52 (2004) (examining the failure of the gatekeepers and the stricter liability standards imposed as a result).

205. See Ribstein, *supra* note 203 (reviewing the issues with Enron and other corporate frauds). See generally Pandit, *supra* note 36 (“An uneven application of regulations and accounting standards in an environment where capital and talent are mobile and where traditional classifications are being redefined has the potential to increase systemic risk. Applying rules partially is not the second best option to applying them consistently.”).

regulatory mechanisms. For example, while the SEC may require additional disclosures on executive compensation,<sup>206</sup> meaningful and understandable disclosure may not necessarily follow and will more likely come through discussions within the industry and feedback from the marketplace at large after the first cycle of disclosures.<sup>207</sup>

While the status quo critique has much merit in its opposition to more rules governing disclosure relating to executive officers, its arguments come up short. While existing federal securities rules need more vigorous enforcement and faithful compliance, from time to time, they also need to be updated, amended, and supplemented to account for new developments and practices in the marketplace.<sup>208</sup> “[T]he American economy does not stand still, and neither should the rules that govern it. The evolution of industries often warrants regulatory reform—to foster competition, lower prices, or replace outdated oversight structures.”<sup>209</sup> Securities regulations, being reactionary in nature, often play tortoise to the market hare, especially in a globalized financial market—falling behind and needing a market stumble to catch up. The global financial marketplace and exotic financial products<sup>210</sup> have also diminished the strength and reach of federal regulators who have limited resources and limited jurisdiction.<sup>211</sup> Federal

---

206. See SEC Final Rule, Executive Compensation and Related Person Disclosure, 17 C.F.R. § 228, 229 (2006); see also SEC, Changes to Executive Compensation Disclosure, *supra* note 39 (outlining the SEC’s adoption of principle-based disclosures for executive compensation).

207. See Dash, *supra* note 1, at A1 (“But while all the new disclosure rules have resulted in far more information, analysts say they still do not necessarily offer greater insight . . . . Many shareholders say the new proxies require more work, not less, to decipher. Pay consultants say some of the new data is so dizzying that they are not sure how to sift through it; some charts even require another set of charts to interpret them.”).

208. See, e.g., Julia Werdigier, *Paulson Calls for Strong Regulators*, N.Y. TIMES, July 31, 2008, available at <http://www.nytimes.com/2008/07/03/business/worldbusiness/03treasury.html> (reporting U.S. Treasury Secretary Henry Paulson’s call for a new regulatory system, finding that the current system is outdated and does not address the new innovations in the financial market).

209. Senator Barack Obama, Remarks of Senator Barack Obama: Renewing the American Economy (March 27, 2008), available at [http://www.barackobama.com/2008/03/27/remarks\\_of\\_senator\\_barack\\_obam\\_54.php](http://www.barackobama.com/2008/03/27/remarks_of_senator_barack_obam_54.php).

210. See, e.g., Counterparty Risk Management Policy Group, *Containing Systemic Risk: The Road to Reform The Report of the CRMPG III*, 70-75 (Aug. 6, 2008) (calling attention to the lack of risk monitoring and risk management regulations in an increasing complex financial system).

211. See David Rothkopf, *What Power Looks Like*, NEWSWEEK (Int’l Ed.) Apr. 14, 2008, at 38, available at <http://news.uk.msn.com/newsweek.aspx?cp-documentid=7992352> (“[N]ational institutions are ineffective beyond their borders and international institutions have not evolved as quickly as global markets, many retaining ownership and management structures dating to the late 1940s with resources inadequate to many global challenges [.]”).

regulators at the SEC and the Federal Reserve during the credit crisis of 2007 and 2008 were ill-equipped under outdated regulatory framework to prevent and address the crisis.<sup>212</sup> As result, various new proposals were made by the US Treasury Department to address regulatory insufficiencies in light of modern market conditions.<sup>213</sup>

Generally, free markets work, albeit sometimes in a blunt and violent manner. Yet, free markets can also work better and smoother with proper incentives and refinements. While there are many market-based and extra-regulatory cures to the securities market's ills and defects,<sup>214</sup> those cures are often imperfect and untimely, and need some motivation from the government. Sometimes markets are self-reinforcing instead of self-correcting. Absent external pressures and incentives from regulators, it is unlikely that private industry will impose meaningful higher standards and checks on themselves or come together in a timely fashion to solve its own shortcomings.<sup>215</sup> The threat of regulation or actual intervention from government has in the past served as the impetus for industry self-reform or corrective, systemic action. For example, in 2008, Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke urged J.P. Morgan and other banks to act swiftly to purchase Bear Stearns in order to stem a global financial catastrophe.<sup>216</sup> Such public-private collaboration in the financial sector in such a context is more likely to happen at the urging of government than profit-driven private enterprise.<sup>217</sup>

---

212. See Werdigier, *supra* note 208 and accompanying text.

213. See DEPARTMENT OF THE TREASURY, THE DEPARTMENT OF THE TREASURY BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE 1 (Mar. 1, 2008) ("In this report, Treasury presents a series of 'short-term' and 'intermediate-term' recommendations that could immediately improve and reform the U.S. regulatory structure.").

214. See, e.g., Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2359-65, 2395-2400 (1998) (proposing market-based alternatives rooted in state law and self-regulatory organization to the existing federal securities law regime); Paul Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453, 1453-58 (1997) (positing that the stock exchange can serve as a primarily regulator of the securities industry).

215. Because of greater public scrutiny—both regulated and not—some companies have taken stricter position concerning the private behavior of their executives. Cf. Carol Hymowitz, *Personal Boundaries Shrink as Companies Punish Bad Behavior*, WALL ST. J., June 18, 2007, at B1 ("As with politicians, today's ambitious business managers need to be aware that their personal behavior will be as closely scrutinized and judged as their work performance. Corporate directors are far less willing than they were a few years ago to look the other way if an executive does something that threatens to embarrass a company.").

216. See Bryan Burrough, *Bring Down Bear Stearns*, VANITY FAIR, Aug. 2008, at 106 (chronicling the fall of Bear Stearns and the collaboration between federal regulators and J.P. Morgan to purchase Bear Stearns to prevent a global financial crises).

217. See, e.g., *id.* (detailing how J.P. Morgan, absent the intervention and assistance of federal regulators, was unwilling to assist in the bailout of Bear Stearns given the significant

In the case of additional rules requiring more disclosure from executive officers, the existing regulatory framework is lacking and extra-regulatory solutions to potential problems are unlikely to bear fruit in the near term. As previously discussed, existing rules and practices concerning disclosure relating to executive officers leaves shareholders and the marketplace vulnerable.<sup>218</sup> Moreover, there appears to be little incentive and motivation in the near term for executive officers to make additional personal disclosures. Executive accountability to a growing investor base has not grown at the same rate as executive compensation.<sup>219</sup> Greater rewards should arguably come with greater accountability and transparency.<sup>220</sup> Absent governmental regulators, who is going to cause CEOs and other industry titans to disclose what can be perceived as personal foibles and conflicts material to the company and its shareholders?<sup>221</sup> Therefore, in the area of executive officers' disclosures, new rules or reinterpretations of existing rules may be warranted given the status quo.

### B. *Corporate Concerns*

Requiring additional disclosure from public company executives will undoubtedly raise some corporate resistance.<sup>222</sup> Chiefly, companies, executives, and their supporters will likely argue that the additional regulations will impose unnecessary costs on the company<sup>223</sup> and could

---

risk involved in a solely private bailout).

218. *Supra* Part III.D.

219. Many critics point out that executive compensation has increased to an unreasonable level at the expense of shareholders without asking for much in return from the executives. *See* Yermack, *supra* note 58 (discussing CEO perks, particularly the use of corporate planes); Nick Bunkley, *Ford Pays Chief \$28 Million for 4 Months' Work*, N.Y. TIMES, April 6, 2008 (“[In 2007,] the Ford Motor Company paid its new chief executive, Alan R. Mulally, \$28.18 million in his first four months on the job . . .”); Eric Dash, *Has the Exit Sign Ever Looked So Good?*, N.Y. TIMES, April 8, 2007, available at <http://www.nytimes.com/2007/04/08/business/yourmoney/08axe.html> (“At America’s biggest companies, it was possible for chief executives to fumble, fudge or fail to deliver results—and yet still walk away with more money than most people earn in a lifetime.”).

220. *See* Dash, *Has the Exit Sign Ever Looked So Good?*, *supra* note 219 (discussing the exit packages of the chief executives of America’s biggest companies).

221. *Contra* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2399-2403 (1998) (proposing a securities regulation regime based self-regulatory organizations such as stock exchanges).

222. In 2006, when the SEC proposed new rules concerning executive compensation disclosure, it generated the most comments in the history of SEC rule proposals. *See* SEC, *Changes to Executive Compensation Disclosure*, *supra* note 39 (“With more than 20,000 comments, and counting, it is now official that no issue in the 72 years of the Commission’s history has generated such interest.” (quoting SEC chairman Christopher Cox)).

223. *See, e.g.*, Alstine, *supra* note 41, at 789-94 (examining the compliance costs of new

have a chilling effect on potential executives, and the U.S. capital markets for initial public offerings.<sup>224</sup> These concerns are legitimate because regulators have acted in reactionary and blunt manners in the past.<sup>225</sup> However, when taken into consideration and balanced against creating better corporate governance and more public trust in the securities market, regulations requiring more meaningful and material private disclosure about executive officers that respect the privacy of executives and the business judgment of companies is desirable.<sup>226</sup>

From a financial costs perspective, the costs for requiring and producing additional disclosure by executive officers, as proposed, are minimal because it works within the current regulatory apparatus. Arguably, no new rules need to be imposed, no new monitoring mechanism is needed, and no new board committees are required. The greatest cost is likely not a financial one, but an emotional and psychological one; it is the toll that is exacted from the disclosing executive and their family.<sup>227</sup> That cost, while unquantifiable in financial terms, may be significant enough to have a chilling effect on qualified, but very private, people who are considering becoming public company executives<sup>228</sup> either through ascension in a public company or through an initial public offering of a private company.<sup>229</sup>

---

laws and regulations for companies).

224. Regulatory costs imposed on public companies can have an effect on existing public companies as well as companies that are considering taking themselves public. Absent clear, sensible regulations and implementation, new rules can have adverse impact on capital markets in this country. See Bloomberg & Schumer, *supra* note 39, at ii (“[O]ur regulatory framework is a thicket of complicated rules, rather than a streamlined set of commonly understood principles, as is the case in the United Kingdom and elsewhere. The flawed implementation of the 2002 Sarbanes-Oxley Act (SOX), which produced far heavier costs than expected, has only aggravated the situation . . . .”); Nathan Wilda, *David Pays For Goliath’s Mistakes: The Costly Effect Sarbanes-Oxley Has On Small Companies*, 38 J. MARSHALL L. REV. 671, 671-80 (2004) (discussing how Sarbanes-Oxley did not properly take into account its impact on smaller companies, which resulted in serious costs burdens on small public companies and small private companies contemplating a public offering).

225. Whereas obtuse, rigid regulations can stunt and stifle economic growth, smart, principled regulation can coexist with and spur economic expansion. The history of the American stock markets serve as anecdotal proof that market growth can run on parallel tracks with regulatory expansion.

226. See *supra* Part IV (outlining a model approach).

227. See Hemingway, *supra* note 172, at 767-68 (“[E]xecutives must make these decisions in what may be highly stressful or emotionally charged situations (e.g., under threat of criminal prosecution or civil enforcement, in the wake of a medical diagnosis of a serious or terminal illness, at a time of financial strife, or during the course of a divorce or nonpublic extramarital affair).”).

228. See generally Kenji Yoshino, *Covering*, 111 YALE L.J. 769 (2002) (discussing covering in the context of discrimination and civil rights).

229. See generally William J. Carney, *The Costs of Being Public After Sarbanes-Oxley*:

The chilling effect of additional private disclosures is mitigated by the two-part disclosure process, the presumably enticing compensation of being a public company executive,<sup>230</sup> and the allure of public funds. The proposed two-part disclosure process only publicizes the private information after confidential deliberation about whether such private information is material to a reasonable investor. Absent extenuating circumstances, it is unlikely that frivolous, irrelevant, and perhaps embarrassing information would be disclosed by a company. Absent a uniform standard, as under the proposed model, companies will continue to disclose diversely or not at all because of privacy and other concerns.<sup>231</sup>

While the chilling effect of additional disclosure requirements may give momentary pause to private entrepreneurs thinking about making an initial public offering in the United States, the warmth emanating from the draw, integrity, and strength of the US capital markets will likely prove too tempting to resist.<sup>232</sup> During the implementation of Sarbanes Oxley in 2002, some argued that the additional regulations would lead to a serious decline in initial public offerings in the US markets and a mass exodus to foreign markets.<sup>233</sup> Nearly a decade after Sarbanes Oxley, that fear has not materialized.<sup>234</sup> Maintaining high standards of integrity in the U.S. capital markets<sup>235</sup> may add costs to companies and their executives in the near

---

*The Irony of "Going Private,"* 55 EMORY L.J. 141, 141-48 (2006) (criticizing the heavy compliance costs of Sarbanes-Oxley on small companies and its chilling effect on public offerings in the U.S. capital markets).

230. See Dash, *supra* note 1, at A1 (discussing compensation packages and perks of public company executives); Yermack, *supra* note 58 (discussing the role of perquisites in managerial compensation); Rajan & Wulf, *supra* note 58 (examining how treating perks as merely managerial excess is incorrect).

231. See Nocera, *supra* note 7, at C1 (discussing the reluctance of companies to talk about private matters concerning their executives because of privacy concerns).

232. See Richard D. Truesdell, Jr. & Margaret E. Tahyar, *Increasing the Attractiveness of U.S. Capital Markets to Foreign Private Issuers*, THE REVIEW OF SECURITIES & COMMODITIES REGULATION, April, 2008, at 37 (discussing the attractiveness of U.S. capital markets in light of recent SEC regulations).

233. See, e.g., Chang & Evans, *supra* note 60, at 51 ("The available evidence suggests that companies have had a greater likelihood of staying or going private, and of choosing a non-U.S. stock exchange for an IPO, following Sarbanes-Oxley.").

234. See Annette L. Nazareth, SEC Commissioner, Remarks Before the ALI-ABA Sarbanes-Oxley Institute, (Oct. 12, 2006) ("[T]he percentage of American companies which conduct their IPOs in the U.S. has remained steady."); *contra* Bloomberg & Schumer, *supra* note 39, at 43 (citing evidence that suggest a migration of initial public offerings from U.S. exchanges).

235. See Marcel Kahan, *Securities Law and the Social Costs of "Inaccurate" Stock Prices*, 41 DUKE L.J. 977, 978-82 (1992) (discussing how securities regulations maintain high integrity in capital markets and reduce the social costs associated with inefficient prices); Bloomberg & Schumer, *supra* note 39, at ii ("The time has come not only to re-examine implementation of SOX, but also to undertake broader reforms, using a principles



term, but will ultimately pay greater dividends through more investment motivated by greater trust in the markets.<sup>236</sup>

### C. *Privacy Concerns*

Requiring additional disclosure from public company executives that include certain material private matters will undoubtedly raise concerns about the individual's privacy rights. These privacy concerns are legitimate, but must be examined in the context of contemporary capital markets, the enhanced role of the executive, and modern media.

While there is no consensus on a definition of privacy,<sup>237</sup> there is greater consensus that all persons have a right to privacy. That right to privacy, like its varied meanings, is neither uniform nor absolute—lines are drawn, exceptions are made, rules are discriminately applied.<sup>238</sup> When it comes to public company executives, their privacy rights are not like those of an ordinary, private citizen because there is a meaningful “public

---

based approach to eliminate duplication and inefficiencies in our regulatory system. And we must do both while ensuring that we maintain our strong protections for investors and consumers.”).

236. See Nazareth, *supra* note 234 and accompanying text (“The United States historically has been a leader in the area of corporate governance. . . . We cannot let our rules stagnate lest they become impediments to progress and to investment in America's capital markets.”); *contra* Barbara Ann Banoff, *Regulatory Subsidies, Efficient Markets, and Shelf Registration: An Analysis of Rule 415*, 70 VA. L. REV. 135, 175-81 (1984) (suggesting that certain new regulations which improve market confidence and pricing are not justified by the costs imposed on issuers and underwriters in public offerings).

237. See *e.g.*, 41 Am. Jur. *Privacy* § 2 (1942) (defining privacy, in part, as the right of a person to be free from unwarranted publicity); see also ANITA L. ALLEN, *UNEASY ACCESS: PRIVACY FOR WOMEN IN A FREE SOCIETY* 34 (1988) (“[P]rivacy denotes a degree of inaccessibility of persons, their mental states, and information about them to the senses and surveillance devices of others.”); SISSELA BOK, *SECRETS: ON THE ETHICS OF CONCEALMENT & REVELATION*, 10-11 (1983) (“[P]rivacy [i]s the condition of being protected from unwanted access by others—either physical access, personal information or attention.”); ALAN WESTIN, *PRIVACY AND FREEDOM* 7 (The Association of the Bar of the city of New York 1967) (“Privacy is the claim of individuals, groups or institutions to determine for themselves when, how, and to what extent information about them is communicated to others.”); Ruth Gavison, *Privacy and the Limits of Law*, 89 YALE L.J. 421, 428 (1980) (“[P]rivacy is a limitation of others' access to an individual. . . . [A]n individual enjoys *perfect* privacy when he is completely inaccessible to others.”); Tom Gerety, *Redefining Privacy*, 12 HARV. C.R.-C.L. L. REV. 233, 236 (1977) (defining privacy as autonomy or control over the intimacies of personal identity); Hyman Gross, *The Concept of Privacy*, 42 N.Y.U. L. REV. 34, 35-36 (1967) (“[P]rivacy is the condition of human life in which acquaintance with a person or with affairs of his life which are personal to him is limited.”).

238. See DAVID KORN, *MEDICAL INFORMATION PRIVACY AND THE CONDUCT OF BIOMEDICAL RESEARCH, PRIVACY AND HEALTHCARE* (Biomedical Ethics Reviews) 107 (James M. Humber & Robert F. Almeder eds., 2001) (“[I]n contemporary society there is and can be no absolute right to privacy.”).

interest” in their private matters.<sup>239</sup> The privacy rights of public company executives are more akin to those of celebrities<sup>240</sup> and public officials in that they arguably have a lower expectation of privacy and cannot be expected to be “let alone.”<sup>241</sup> Our elected federal politicians are required by law to make certain financial disclosures about their personal finances,<sup>242</sup> and they expect that their private lives will be fair game to the media. Likewise, celebrities understand that their privacy rights are not like those of the ordinary citizen because they are “public figures” under the law.<sup>243</sup> Akin to celebrities,<sup>244</sup> executives who run public companies should reasonably expect to abdicate a certain level of privacy.<sup>245</sup>

The proliferation of modern media has increased the public’s appetite for information about public figures.<sup>246</sup> The proliferation of new media coupled with the growth in securities investing by ordinary citizens has further intensified coverage of public company executives.<sup>247</sup> Perpetual business news channels, websites, chat rooms, and blogs all exist to satisfy the public’s insatiable appetite for more information.<sup>248</sup> As a result, actions of public company officials are closely monitored, and their “zone of privacy”<sup>249</sup> and “expectation of privacy”<sup>250</sup> have diminished in the 21<sup>st</sup>

---

239. See Maremont, *supra* note 26, at A1 (discussing scholarship that studied the impact of CEO’s private lives on their companies); Bennedson et al., *supra* note 177 (examining the impact of certain events in the private lives of the CEO on firm performance).

240. See, e.g., John R. Engen, *Hiring a Celebrity CEO*, BOARD MEMBER MAGAZINE, Winter 2000 (discussing the celebrity status of a CEO and the potential gains and perils of a hiring a celebrity CEO).

241. Melvin v. Reid, 297 P.2d 91, 92 (Cal. Ct. App. 1931)

242. See <http://www.opensecrets.org/pfds/index.php> (cataloguing financial disclosure forms of federal elected officials).

243. See *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 324 (1974) (holding that when the media defames a private individual, it cannot claim a constitutional privilege against liability).

244. See HAIGH, *supra* note 62, at 96-103 (describing the ascent to cult status of the CEO in contemporary society).

245. See *In re Franchard Corp.*, 42 S.E.C. 163, 174 (1964) (noting how the solicitation of public funds for a company can result in diminished levels of privacy for that company’s executives).

246. See Edwin Lawrence Godkin, *The Rights Of The Citizen, IV. —To His Own Reputation*, 8 SCRIBNER’S MAG. 58, 66 (July 1890) (“The chief enemy of privacy in modern life is that interest in other people and their affairs known as curiosity, which in the days before newspapers created personal gossip.”); see also SEC, Disclosure to Investors (exploring how public companies can effectively disclose information to investors).

247. See HAIGH, *supra* note 62, at 97-99.

248. See Clifford & Anderson, *supra* note 38 (discussing the growth of new sources of information for business news and gossip).

249. See *Whalen v. Roe*, 429 U.S. 589, 598-99 (discussing how the appellees contend that the statute invades a constitutionally protected “zone of privacy.”). The cases sometimes characterized as protecting “privacy” have in fact involved at least two different kinds of interests. One is the individual interest in avoiding disclosure of personal matters,

Century. Additional regulated disclosure, as proposed, should reasonably be expected to fit into this shrunken zone of privacy.

Being a public company executive comes with the occupational hazard of less privacy, which is compensated for in terms of prestige, perks, and money.<sup>251</sup> Nonetheless, due consideration must be given to the disclosure of private, material matters of executives. Matters such as serious illness, pending divorce, and potential crime can be legally complex and deeply personal,<sup>252</sup> and deciding to disclose such matters must be done with due consideration for the executive. Under this Article's proposed two-step model approach, reasonable deference is given to the disclosing executive and the judgment of the company's management.<sup>253</sup> Only private matters determined to be material and proper for timely disclosure will be made public, while private matters that are immaterial and irrelevant to the investing public will remain undisclosed.

## VI. CONCLUSION

Disclosing material private matters of public company executives is a difficult and complex but sometimes necessary act. Advocates that favor more disclosure and advocates that favor more privacy both have many legitimate arguments and concerns. In this Article, I have argued that when viewed in the context of contemporary capital markets, the enhanced role of the executive, and the modern media additional disclosure from executives about material, private matters is desirable. In support of this argument, I have proposed a principle-based model approach that affords companies and executives reasonable deference on what to disclose and how to disclose it, while simultaneously strengthening regulatory safeguards for the investing public with minimal compliance burdens.

This model approach for addressing the issue of material, private matters of executives, while sensible, will not be quickly implemented. No

---

and another is the interest in independence in making certain kinds of important decisions.

250. See *Katz v. United States*, 389 U.S. 347, 362 (1967) (Harlan, J., concurring).

251. See Rajan & Wulf, *supra* note 58 (explaining how perks are not simply managerial excess); see also Yermack, *supra* note 58 (examining the perks involved for executive officers).

252. See Glenn, *supra* note 25, at 542-43 (discussing potential conflicts between SEC requirements and the Americans with Disabilities Act of 1990 in the context of disclosing executive illness); see also Hemingway, *supra* note 172, at 764-770 (raising potential privacy, First Amendment, and Fifth Amendment issues in the context of executive disclosure). See generally Antony Page & Katy Yang, *Controlling Corporate Speech: Is Regulation Fair Disclosure Unconstitutional?*, 39 U.C. DAVIS L. REV. 1 (2005) (discussing the constitutionality of Regulation Fair Disclosure).

253. See *supra* Part IV.C (discussing the disclosure process under our proposed model approach).

regulatory approach that implicates billions of dollars, personal facts of powerful executives, privacy rights, and investments of ordinary Americans will have a smooth and easy implementation; nor should it. Asking someone to disclose to the world a personal ailment, a private tragedy, or an intimate fact for the sake of better corporate governance and market integrity is not easy, for these are not easy simple issues with straight-forward resolutions. In the end, my hope is that by thinking and talking about these issues, we can begin to raise the level of corporate awareness and debate and thereby engender increased disclosure of material, private matters prior to the passage of any rule or law.