Sovereign Prerogatives

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BOOK REVIEW

Sovereign Prerogatives


Reviewed by Jayne W. Barnard*

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I. INTRODUCTION

In his recent book describing the 1990 merger of Time, Inc. with Warner Communications, Inc., reporter Richard Clurman chronicled, with palpable disdain, both the spangled lifestyle and sordid business practices of Steven Ross, then Chairman of Warner Communications. Clurman's intent was to illustrate the perfidy of Time's board of directors in selling out that historic white-shoe company to a band of Hollywood sharpies. He focused in passing on Ross's academic deficiencies. He also emphasized Ross's charm and guile.

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2. Steve Ross, Clurman sniffed, "calls the author of Madame Bovary 'Flow Bert.'" Id. at 26.
Reporter Connie Bruck has now gone Clurman one better with a comprehensive biography focusing solely on Steve Ross. An armchair epic in its detailed coverage of dozens of transactions and the personalities who animated them, the book is illuminating, especially in its treatment of the public obligations of a chief executive officer (CEO) and the parallel obligations of that CEO's corporate board.

Ross, who died in 1992 of prostate cancer, represented the kind of corporate leader around whom legends swirled—his vacation junkets with Barbara Streisand and Clint Eastwood; his fatherly relationship with Steven Spielberg; and his early recognition of the power of cable television and the prospects for an interactive "information superhighway." Steve Ross embodied the visionary corporate figurehead of the 1980s—handsome, dynamic, quick with numbers, slightly sinister, and hugely successful.

Connie Bruck's biography traces Ross's rise in business from his early days working as a "soother" in his father-in-law's funeral home, through his orchestration of the merger of the funeral home with the Kinney System parking lot empire, through a well-timed acquisition of the Warner Brothers-Seven Arts movie studio. Ross ultimately constructed an international media conglomerate that at times included MTV; Warner, Atlantic, Asylum, and Elektra records; Atari computer games; Warner Cable; Showtime; The Movie Channel; Nickelodeon; Home Box Office (HBO); and Time and People magazines. Over time, Ross did business with many of the greats of the 1980's: Michael Milken of Drexel Burnham Lambert, who twice sought unsuccessfully to engineer a management buyout of the company; James Robinson of American Express, who authorized a $175 million investment in one of the earliest cable franchising companies, Warner-Amex; and New York power-lawyer Arthur Liman, who brokered the Time-Warner merger and became one of Ross's closest associates. At the peak of his career, Ross was equally at home in Democratic national politics, New York society drawing rooms, and Hollywood studio screening rooms.

Bruck focuses mostly on the dark side of Ross's rise, devoting over half of the book to the early years of his career, during which Ross developed his people-pleasing skills and used, then discarded, wives and close friends. She recounts in exacting detail an alleged kickback scheme in 1973 in which Ross was said to have been paid $100,000 in cash in exchange for arranging a $1.5 million corporate investment in the Westchester Premier Theater. The theater later failed amidst allegations of skimming and mob infiltration. Several Warner employees were prosecuted for their role in this scheme, and one served time in prison.

4. Id. at 215-16, 225.
5. Id. at 218-19. American Express later sold out after years of losses at Warner-Amex. "It was very emotional and bitter—American Express felt totally misled," said one of its advisors. "No set of numbers Warner had given them turned out to be even vaguely true. . . . [T]hey'd finally figured out they were the pigeon." Id. at 221.
6. Id. at 10-11.
7. Id. at 131.
Ross escaped indictment, however, by offering what Bruck suggests was less than candid testimony in a crucial SEC deposition. Bruck obviously is fascinated by this episode and other alleged brushes with the underworld which she document throughout Ross’s career. In highlighting Ross’s supposed mob ties, however, Bruck nearly misses what is, to an observer of corporate governance, at least as good a story. Indeed, there are two good stories interwoven throughout Bruck’s biography, both of which raise provocative questions of corporate governance and corporate law. Rather than forcing the reader to consider abstract principles supported by fictional depictions of how business leaders should behave, Bruck shows us how one very prominent leader actually did behave. In so doing, she vividly demonstrates that corporate executives, including the most successful ones, often are oblivious to their fiduciary obligations and that corporate directors, including prestigious outsiders, are often remarkably supine in performing their monitoring role.

The first thread of Steve Ross’s story involves the use of shareholders’ money to create a lavish corporate image, to support Ross’s ever-widening social calendar, to furnish idyllic getaways for his Hollywood cronies, and to build upon the legend of Steve Ross’s generosity. Repeatedly in Bruck’s book, Ross directs that corporate funds be set aside to make large charitable contributions to his friends’ causes, both worthy and not so worthy; to acquire airplanes and helicopters with which to ferry those friends—and their pets and lovers—back and forth across the country; and to acquire furniture and museum-quality artwork with which to adorn his offices and homes.

Ross’s largesse often cemented his relationships with temperamental stars, so at one level it cannot be faulted as an abuse of managerial discretion. At another level, however, one may fairly question whether a corporation’s board of directors has some obligation to its investors to curb this kind of spending, even in a Hollywood environment. In other words, what is and what should be the operative law governing executives’ corporate expenditures? What kind of notice should be given, and what response is appropriate, when a highly-placed executive engages in chronic grandiose behavior, even in years when his corporation is performing abysmally and lower level workers are being laid off in large numbers? Is this an issue for the board at all? Steve Ross’s story provides a troubling illustration of the difficulties facing boards of directors when their CEO is a big spender, the directors themselves are often the beneficiaries of his generosity, and traditions of deference and civility in dealing with the CEO inhibit the directors from taking corrective action.

The second thread of Steve Ross’s story as portrayed in Bruck’s book concerns the events surrounding Ross’s heart attack in 1980 and his later, ultimately fatal, bout with prostate cancer beginning in the mid-1980s. In both instances, Ross withheld disclosure about his condition from his employees and from the public, and, when reporters pressed for an update on the progress of his cancer treatments, he intentionally released

8. BRUCK, supra note 3, at 123-27.
10. See infra notes 39-41, 73-74 and accompanying text.
11. See infra note 78 and accompanying text.
12. See infra note 58 and accompanying text.
13. See infra notes 95-98 and accompanying text.
misleading information. 14 Virtually until the day he died, the official corporate line was that Ross would soon be returning to work.

Bruck explains this behavior by suggesting that upbeat, though false, reports of his progress bolstered Ross's resolve to beat his disease. His family, Bruck states, insisted on releasing only positive reports in order to keep Ross hopeful. 15 However laudatory the family's intentions may have been, however, they call into serious question whether Time Warner nevertheless had an obligation under the federal securities laws or stock exchange rules to be more forthcoming with its investors concerning the prospects for Ross's future leadership of the company.

This question has arisen frequently in recent years, as companies have disclosed, sometimes belatedly, that their CEOs have contracted serious illnesses. 16 Inevitably, such announcements have short-term consequences for the company's share price. 17 What is less clear is what the consequences of withholding this information may be. There is no bright line governing when and to what extent information about executive health matters must be disclosed to the public. 18 Steve Ross's story permits an exploration of the problems facing a public company when its CEO, who may wish to deny painful evidence of his mortality, becomes seriously ill.

II. THE BOARD OF DIRECTORS AND THE BIG-SPENDING CHIEF EXECUTIVE

Lavish and public spending is common behavior among many chief executives—both successful and unsuccessful ones. Consider, for example, Ross Johnson's creation of a corporate "Air Force" at RJR Nabisco—a fleet of ten planes including two $21 million jets—and his wholesale dispensation of endowed academic chairs in honor of his company's directors; 19 John Gutfreund's $6.5 million penthouse, his Paris-based "trophy wife," and his "big swinging dick" style of bonding with employees at Salomon Brothers; 20 or Charles Keating's six-figure bonuses to employees and high profile charitable contributions in the years leading up to the collapse of Lincoln Savings. 21 Grand

14. See infra notes 95, 100 and accompanying text.
15. BRUCK, supra note 3, at 320.
17. For example, when Michael Walsh, CEO of Tenneco, announced that he had been diagnosed with brain cancer, the company's stock fell quickly $2.00 per share. Hayes, Tenneco's Chief, supra note 16, at D1.
18. See infra note 114 and accompanying text.
20. MARTIN MAYER, NIGHTMARE ON WALL STREET: SALOMON BROTHERS AND THE CORRUPTION OF THE MARKETPLACE 13 (1993) and BURROUGH & HELYAR, supra note 19, at 216 (describing Gutfreund's apartment and wife); MICHAEL LEWIS, LIAR'S POKER: RISING THROUGH THE WRECKAGE ON WALL STREET 14 (1989) (describing Gutfreund's legendary offer to play a hand of "liar's poker" for "one million dollars, no tears"). "Big swinging dick" was the designation given to the most successful bond traders at Salomon Brothers. Id. at 46.
21. MICHAEL BINSTEIN & CHARLES BOWDEN, TRUST ME: CHARLES KEATING AND THE MISSING BIL-
gestures and big spending often punctuated the management styles of these larger-than-life CEOs.

For some chief executives, lavish and public spending may be no more than an occasional tactic for impressing clients or competitors. Displayed repeatedly, it may signify a serious mental condition, as in the case of Ted Turner, whose business and other decisions often have been driven by manic depressive disorder, a condition he now acknowledges. Most often, however, lavish and public spending is associated with skewed priorities and bad business judgment. Examples abound of the scenario in which big, visible corporate spending has been followed by a big, visible corporate debacle.

• When Robert J. Buckley, Chairman of Allegheny International, Inc., spent millions of Allegheny's dollars to fund a lavish lifestyle for his executives and board, it proved to be a symptom of wider loose management practices that ultimately led the company into Chapter 11.23

• James E. Stewart, Chairman and CEO of Lone Star Industries, Inc., made headlines for his $2.9 million expense account in 1990, just weeks before Lone Star, too, entered Chapter 11.24 Among other indulgences, Stewart had run up $148,329 in hotel bills while staying at New York's Plaza Hotel; the tab for four nights at San Francisco’s Fairmont was $20,000.25

• After Robert F. Fomon, CEO of E. F. Hutton Co., squandered hundreds of thousands of corporate dollars on an international sporting life and later became obsessed with the interior decoration of the company’s lavish headquarters, few were surprised when Hutton ultimately had to be rescued in a buyout by Smith Barney.26

LIONS 59 (1993). One observer has described Keating’s largesse this way:

[Keating] will be having lunch with Father Bruce [Ritter] in New York, scribble “$100,000 donation” on a matchbook, and flip it to the priest just to witness the expression on his face. He will be visiting a village in Ireland, meet some people, and fly the whole village back to Phoenix for a two-week vacation at his hotel. A girl in the mailroom will do something right, and he will give her a new Corvette.

Id.


23. Clare Ausberry, Allegheny International Seeks Protection Under Bankruptcy Law in Surprise Move, WALL ST. J., Feb. 22, 1988, at 3. Allegheny’s purchases included a fleet of jets, executive retreats costing hundreds of thousands of dollars each year, and an elegant Tudor mansion costing nearly $1 million for use in giving private parties because there was “[no] decent hotel in Pittsburgh for entertaining directors and important clients.” William C. Symonds, Big Trouble at Allegheny, BUS. WK., Aug. 11, 1986, at 56. Buckley also initiated “an elaborate new corporate headquarters to crown a renewal of Pittsburgh’s culture district.” Id.

24. Lisa Driscoll, As His Company Struggles, a CEO Digs In—At the Plaza, The Ritz, BUS. WK., Nov. 5, 1990, at 134.

25. Id.

Armand Hammer, CEO of Occidental Petroleum from 1957 until his death in 1990, persuaded Occidental's board to make millions of dollars in charitable contributions to Hammer's pet charities. Occidental ultimately created the Armand Hammer Museum and Cultural Center of Art, an $86 million project paid for entirely with corporate funds.27 One month after Hammer's death, Occidental's new CEO announced a complete reorganization of the company, including a $2 billion write-off.28

In these cases, at least with the benefit of hindsight, the CEOs' behavior clearly signaled their loss of perspective and their management teams' loss of control over excessive and imprudent corporate spending. In other cases, however, similar behavior may reflect not failure, but success.

Consider William Paley of CBS, whose accumulation of exquisite French furniture and items of world-class art cemented his reputation for connoisseurship and enhanced CBS's image as the "Tiffany Network."29 Using $11 million of CBS's cash reserves, Paley bought eighty percent of the New York Yankees because "[a]ll my life I wanted to own a baseball team."30 Throughout the period of Paley's acquisitions, the CBS network rose in value from $1 million when he acquired control in 1928 to over $1 billion in 1965.31 Or consider Malcolm Forbes, whose fabled dinner cruises on the corporate yacht Highlander, million-dollar celebrity-filled parties, and imaginative junkets to such far-flung ports as Tangier helped to make the Forbes publishing empire one of the country's most profitable.32 In each case, the CEO's grandiosity and very public corporate spending—in many ways indistinguishable from the behavior of CEOs who have driven their companies to ruin—had direct and favorable consequences for their companies and shareholders.

In short, the mere fact of lavish and public spending may or may not be a sign of corporate financial mismanagement. Then, too, it may be. What, then, is a board of directors to do when confronted with the grandiose spending habits of a corporate CEO? Steve Ross's story provides a useful illustration.


28. CARL BLUMAY, THE DARKER SIDE OF POWER: THE REAL ARMAND HAMMER 464-65 (1992). "On a normal day a little over 600,000 shares of Occidental stock were traded. The day after Hammer's death, 8.1 million shares changed hands and the stock price closed at $22.62, up $1.875." Id. at 463. See also Susan Antilla, When a C.E.O.'s Pain is a Gain, N.Y. TIMES, Nov. 1, 1992, §3, at 15 (reporting the substantial stock spike upon Hammer's death). Other examples of companies led to grief by high-spending executives include Ferrofluidics Corp. and Reliance Group Holdings, Inc. See Mark Maremont, Public Company, Private Fiefdom?, BUS. WK., Oct. 25, 1993, at 108 (reporting that the CEO and his family had "milked" Ferrofluidics of $16 million in "pay, bonuses, perks and profits" while the company was losing $17.7 million); Larry Light, Saul Steinberg's Honey Pot Named Reliance, BUS. WK., July 12, 1993, at 129 (reporting that the CEO was paid a record salary, while family members were also on the payroll and receiving low interest loans, at a time when the company's stock price was plummeting).


30. Id. at 440.

31. Id. at 63, 424.

A. Steve Ross's Use of Corporate Funds and the Warner Board's Response

From the beginning of his business life, Steve Ross was a big spender. After being hired by his in-laws to work in their funeral home, Ross immediately took to buying expensive Christmas presents for them, and borrowing money from a bank to finance his purchases.\(^{33}\) This preference for expensive gift-giving continued throughout his life, but soon he was not borrowing from banks to buy his gifts. Instead, he used corporate funds and the gifts he gave were remarkable, even to their hard-to-impress recipients. Every Christmas, said Barbra Streisand, her most lavish present would come not from her lover, but from Steve Ross.\(^{34}\)

Ross loved to buy gifts for his friends and colleagues. Once, he took three women friends to Giorgio in Beverly Hills and bought them $30,000 worth of clothing in a single two-hour outing.\(^{35}\) On a business trip to Asia, he bought his girlfriend and two executives’ wives pearl necklaces, reportedly valued at $20,000 apiece.\(^{36}\) Business gifts valued at $50,000 or $100,000 were not uncommon.\(^{37}\) According to Steven Spielberg, Ross was “the single most generous person I’ve ever met in my life.”\(^{38}\)

Ross also loved to give to charity. In 1983, “even as the company was losing over a half-billion dollars,” Warner Communications donated $1 million to the Dallas Museum, where Ross’s latest wife had ties.\(^{39}\) “In the fall of that year, Richard Kasholek, head of the Los Angeles Museum of Contemporary Art, [went] to see Ross at the Beverly Hills Hotel to ask for a donation. As Kasholek recalled, Ross had unhesitatingly whipped out a company check and written it out for $250,000.”\(^{40}\)

Ross insisted on paying his subordinates well above the going rate. “From the beginning at Warner, Ross grasped the importance of finding the best creative people and paying them so much that money could not lure them away.”\(^{41}\) This meant that Warner’s executives often were making more money than those in comparable positions elsewhere and, in the early years, more money than Ross.\(^{42}\) Later, Ross negotiated a 10-year employment contract with Warner Communications, reputedly making him the highest paid CEO in the country.\(^{43}\)

Ross demanded the utmost comfort in his personal and business surroundings. When in the early years of his first marriage his father-in-law offered to build him a forty-foot swimming pool, Ross insisted on an eighty-foot pool.\(^{44}\) And, as Ross progressed through two later marriages, moving into increasingly grand homes, his insistence on luxury became a defining characteristic of his life. He almost never flew on

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33. See BRUCK, supra note 3, at 24.
34. Id. at 82.
35. Id. at 96.
36. Id. at 103.
37. Id. at 204.
38. See BRUCK, supra note 3, at 194.
39. Id. at 211-12.
40. Id. at 212.
41. Id.
42. Id. at 66.
43. See BRUCK, supra note 3, at 67.
44. Id. at 226.
45. Id. at 39.
commercial flights, unless it was on the Concorde. At one point, he bought a castle in Italy—"actually an entire peasant village, plus an additional 240 surrounding acres." He routinely handed $200 tips to astonished hotel bellhops and waiters.

Ross’s insistence on the finest accommodations extended to the office as well as to his personal life. He conferred limousines on dozens of his executives. He had Warner Communications acquire a beautiful executive retreat outside of Acapulco and outfitted it with tennis courts, a pool, and a screening room. "[Villa Eden] was considered an idyllic, almost magical retreat, even by some who took the world’s most luxurious resorts in stride. Once arrived, guests rarely sallied forth to neighboring Acapulco; the chef was superb, all imaginable needs were attended to, and everything was provided, gratis."

The company’s operating divisions picked up on these signals. At Atari, CEO Ray Kassar "installed a dining room attended by waiters in formal attire, that was the culinary rival of the most exclusive restaurants in Silicon Valley." The company bought Kassar a "grand apartment in Trump Tower, with panoramic views." The annual meeting was held in Monte Carlo. "As one former executive would later emphasize, it was not so much a matter of extravagant perks as, rather, a storybook lifestyle that was almost wholly subsidized."

Executives followed Ross’s example at the corporate level, also. During one corporate crisis, Manny Gerard, an executive in the “office of the president,” flew his family back from a Hawaiian vacation on a Warner Communications jet, at a cost to Warner of $80,000-$90,000. At Warner’s “world headquarters,” another executive, David Horowitz, redecorated his office at a cost of $750,000. Soon after Ross’s marriage to art consultant Courtney Sales, the company, with Sales’s assistance, purchased $8 million worth of paintings for the headquarters and spent millions more on Art Deco furniture.

Ross’s enthusiasms included more than just paintings and furniture. Several years after investing personal funds in the New York Cosmos soccer team, Ross arranged in 1975 for Warner to buy the money-losing team for a dollar. Warner then signed Brazilian soccer star Pele to a three-year, $4.5 million contract and hired two other interna-

References:
46. Id. at 75.
47. Id. at 99.
48. BRUCK, supra note 3, at 324.
49. Id. at 86.
50. Id. at 72. “Most of [the executives] travelled almost exclusively by limousine, helicopter, and private jet . . . During the gas shortage in New York, those who did not have limousines had their cars filled so that they would never have to wait in line.” Id. at 75-76.
51. Id. at 74.
52. Id. at 168.
53. BRUCK, supra note 3, at 168.
54. Id.
55. Id.
56. Id. at 212.
57. Id. at 211.
58. BRUCK, supra note 3, at 168.
tional soccer stars at similarly elevated salaries. The Cosmos suddenly took off; by 1977, the team was attracting 75,000 spectators at every game and they were the North American Soccer League champions.

Ross attended every Cosmos home game and traveled on a company jet to most of the team's away games. He became deeply immersed in coaching strategies, lodging arrangements for the team, and public relations. The Cosmo's manager said of Ross years later:

He would always go the extra length; supposing we wanted a certain player, and I would tell Steve, 'we can't get him. We have a budget of $50,000.' He would say 'What does he want?' And it might have been $200,000. He would say 'Do it!' We had the best players in the world. But every year, he wanted to get more players, make it more exciting. He always wanted to go the extra yard, and never stop.59

Unfortunately, the Cosmos, for all their glamour and success on the playing field, were a losing business proposition. Warner was losing as much as $5 million a year on the team, but, as one executive said, it was never disclosed because Ross and his associates took the view that "anything under $10 million was not 'material.'"60

Ross's enthusiasms led to other problems within the company. In 1982, he committed Atari, without Atari's permission, to purchasing the rights to produce an E.T. video game for $23 million. Of the four million E.T. games shipped, 3.5 million were returned unsold.61 Atari, already mortally wounded by intense competition in the computer games market and a sluggish, nearly paralyzed management, ultimately was sold "at a fire-sale price."62

Ross's spending habits eventually caught the attention of Warner Communications shareholders. In 1970, shortly after the Warner Brothers-Seven Arts purchase, a derivative suit was filed challenging a $1.5 million "finder's fee" paid as part of the purchase to Ross's Hollywood friend Mickey Rudin.63 Another suit alleged "misappropriation and waste of assets" in connection with Ross's assembly of a series of limited partnerships in which he and other Warner executives were the limited partners with nominal investments and high profit potential, and in which Warner Communications was the general partner with a large investment and high loss potential.64

In 1976, another suit was filed, challenging as excessive salaries paid to Ross and other members of the "office of the president."65 In the early 1980s, a fourth suit was filed, alleging that Ross was defrauding shareholders by causing Warner Communica-

59. Id. at 94.
60. Id. at 95.
61. Id. at 179-80. At the time, Atari's executives were infuriated. Years later, one of them commented, "I think it was a brilliant move .... He succeeded in breaking MCA's hold on Spielberg .... Steve's viewpoint was, so what if I overpay by $22 million? How can you compare that to the value of a relationship with Spielberg? And I think he was dead right." Id. at 199.
62. Id. at 214.
63. BRUCK, supra note 3, at 51.
64. Id. at 76. After several years of litigation, Warner Communications ultimately settled these suits and disbanded the partnerships. Id.
65. Id. at 100-01.
tions to pay his personal expenses. All of these suits, although hardly unique to Warner in an era of widespread shareholder litigation, provided repeated notice to Warner’s directors that Ross’s extravagances properly might be a subject of their attention.

In 1983, the volatile year in which Warner Communications lost nearly half a billion dollars, media mogul Rupert Murdoch contemplated taking over the company. Ross refused to meet with Murdoch at his office, but sent a helicopter to bring him to Ross’s weekend home in East Hampton. After the meeting, “Murdoch was horrified. He said, ‘this guy is living like Midas out on the Island, while his company is falling apart.’”

Ross ultimately agreed to let Chris-Craft Industries, Inc. buy thirty percent of Warner Communications stock, both to prop up Warner’s share price and to fend off Murdoch’s advances. Thus, Herbert Siegel, Chris-Craft’s chairman, joined Warner’s board where he quickly became Ross’s chief nemesis, acting as the champion of cost control. The battle lines soon became clear:

Ross, a mercurial free-spender, charismatic suitor of Hollywood talent [faced] Siegel, a hardheaded businessman with a sharp pencil at the ready;
Ross, someone who demanded the most luxurious perks the corporate till could provide, [faced] Siegel, inhabitant of a spartan corporate suite, fastidious in his cost accounting for shareholders’ money.

At Siegel’s insistence, Ross shut down the endlessly unprofitable Warner Leisure division, which was run by a crony from Ross’s old parking lot days, laid off hundreds of employees, and sold off a dozen or so money-losing units. But, when during Ross’s salary negotiations, Siegel asked how much Ross’s lifestyle was costing the company, Ross became “enraged, terming the questions ‘insulting’ and ‘degrading.’”
Not surprisingly, Siegel’s inquiries about Ross’s lifestyle discomfited Warner’s board, as they would any board which had enjoyed a longstanding personal relationship with its CEO. Warner’s board acted as most boards would; they quietly quashed all discussions of “lifestyle” issues.

This behavior is not surprising given that, until Herb Siegel came on the scene, eleven of Warner’s sixteen board members had been corporate insiders and the others were seemingly “mesmerized” by Ross. Lawyer William Vanden Heuvel, for example, was on a sizeable retainer from Warner Communications. In addition, he received a $950,000 finder’s fee for his role in selling Warner Cosmetics to L’Oreal in 1984. Director Beverly Sills received substantial corporate donations each year for her New York City Opera Company. When Mac Schwebel, another long-time director, was

66. Id. at 99.
67. Id. at 202.
68. BRUCK, supra note 3, at 206.
69. Id. at 210.
70. Id. at 227.
71. Id. at 229.
72. Id. at 223.
73. BRUCK, supra note 3, at 223.
Thus, these directors were more than willing to overlook Ross’s failure to alert them to the fact that the Warner Leisure division had lost $70 million, or his insistence on maintaining the Cosmos long after it was apparent that the team would never break even. Over the years, Steve Ross had put together a very loyal, compliant board of directors. Their failure to take Ross in hand and challenge some of his more exorbitant outlays is therefore understandable. Their behavior may now be seen as an artifact of an era in which corporate boards were more submissive to their CEOs than boards are thought to be today.

But what if Warner, and later Time Warner, had had a truly independent board? How should such a board have responded when they learned of such practices as the use of corporate planes for the ferrying of pets or bedtime snacks, or the expenditure of nearly $30,000 on tennis balls and sneakers to outfit the executive retreat? What action might have been appropriate when they learned of Ross’s lavish Christmas gifts or his impulsive decision to have Warner purchase Barbra Streisand’s New York townhouse when she could not find a buyer and claimed that she was “desperate” to be rid of it? What guidelines, if any, might properly be crafted to address these kinds of situations?

B. Seeing and Reacting to What May (or May Not) be a CEO’s Excessive Personal Spending

Until they read Master of the Game, it is unlikely that Warner’s directors knew about most—or any—of the big ticket purchases that Ross had made. As directors, they were not engaged in line-by-line scrutiny of executive suite expenses. More importantly, even if the board had known of these expenditures, the directors may have had good reason not to challenge them. This is because Ross was delivering where it mattered. For example, entertainment industry employees are notoriously unfaithful and Ross’s more-than-competitive compensation practices and generous dispensation of company resources “protect[ed] his company from the rapid turnover that was so endemic, and

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74. Id. at 232.
75. See supra note 68 and accompanying text.
76. See supra note 60 and accompanying text.
77. After former Senator Abraham Ribicoff, having been placed on Warner’s board by Herb Siegel, resigned in 1987, he described his experience on the board as “an exercise in futility.” “What you have,” said Ribicoff, “[is] a person who has exceeded his power with the greatest of arrogance and you have a bunch of myrmidons on that board completely manipulated by Steve Ross . . . . I have never in all my life been with a board so subservient to the chairman or the chief executive officer of any company.” BRUCK, supra note 3, at 234.
78. Id. at 213. Ross allegedly sent a company plane across the country once to bring Steven Spielberg’s dogs to East Hampton. On another occasion, he sent a plane back to New York from the Caribbean, where he was vacationing with Quincy Jones, to pick up some hot dogs. Id.
79. Id. at 212.
80. Id. at 81-82. Ross’s agreement to purchase Streisand’s house occurred at his first meeting with her, at a dinner party in Los Angeles. Id.
destructive, in other entertainment companies. Moreover, even taking into account 1983, a dreadful year in which Atari collapsed and Warner Communications laid off thousands of employees, the total compounded average annual return to shareholders between 1976 and 1986 was twenty-two percent per year. When a corporate CEO can point to a long-term record with this kind of growth and profitability, why would the directors want to quibble about his expense account?

At a more practical level, reviewing discrete expenditures is the job of internal auditors, not the board. Unless those auditors can come forward with concerns of sufficient magnitude to warrant the audit committee’s attention, the audit committee—let alone the board—has no reason to consider such items. The company must comply, of course, with the SEC’s requirements that executive compensation, including some perquisites, be disclosed, but this is a housekeeping function that is unsuitable for the board’s agenda. In short, absent gross abuses or public embarrassment, questions concerning a CEO’s lifestyle and the use of corporate funds to subsidize it are topics that corporate directors are seldom likely to consider.

This reluctance to examine excessive spending is in part a function of structural bias. Most directors are themselves CEOs who would not like the boards of the companies they head scrutinizing their perks or second-guessing their acts of corporate charity. Consequently, legitimate questions about a CEO’s use of corporate funds for personal purposes have often gone unasked, even though gross excess or even fraud has been apparent.

81. Id. at 79.
82. BRUCK, supra note 3, at 231.
83. Id. at 230-31.
84. An interesting response to this question might be suggested by decisions in cases in which investors have charged their brokers with “churning” their accounts. Success in increasing the value of an investor’s account is not a defense to a churning claim, say those judges who have considered the question. See Davis v. Merrill Lynch, Pierce, Fenner & Smith, 906 F.2d 1206, 1218 (8th Cir. 1990) (“If we were to adopt Merrill Lynch’s view, securities brokers would be free to churn their customers’ accounts with impunity so long as the net value of the account did not fall below the amount originally invested.”); Nesbit v. McNeil, 896 F.2d 380, 385 (9th Cir. 1990) (holding that trading gains cannot be offset against excessive commissions attributable to churning). These decisions correctly rely on the proposition that broker misconduct is still misconduct even though the broker has been successful in generating an overall profit.
85. In the case of Warner Communications, even the internal auditors may not have been on the job. According to one person who worked for years in the accounting department of Warner Communications, “No items were checked on expense accounts. There were no controls.” BRUCK, supra note 3, at 76.
86. 17 C.F.R. § 240.14a-101 (1995) (Form 14, item 8).
87. KORN/FERRY INTERNATIONAL, BOARD OF DIRECTORS TWENTIETH ANNUAL STUDY 7 (June 1993) (noting that directors continue to be drawn largely from the ranks of current and former chief executive officers and chief operating officers of other companies).
88. See, e.g., Diana B. Henriques, A Celebrity Boss Faces Exile from 2d Corporate Kingdom, N.Y. TIMES, Feb. 10, 1995, at A1, D4 (recounting the failure of the board at Morrison Knudson Corporation to curb CEO William Agee’s excessive personal use of corporate resources, even after the Internal Revenue Service challenged many of the corporation’s expenditures made on Agee’s behalf); Kenneth N. Gilpin, For W.R. Grace, A Question of Disclosure, N.Y. TIMES, Mar. 10, 1955, at D3 (describing the failure of the company’s board to comply with SEC disclosure requirements regarding payments made to the company’s
More importantly, this tradition of turning a blind eye to a CEO’s use of corporate funds for personal purposes often has left critical, related issues unexamined. A board that is reluctant to ask embarrassing questions about a CEO’s excessive use of private jets or penthouse suites, or her usurpation of decisions relating to corporate charitable contributions, may be equally unwilling to ask embarrassing questions about more important company issues. As a consequence, investors end up with a plummeting portfolio or worse, with the business press and critics fairly asking “what was the board thinking?”

Consider some of the companies whose executives are discussed above: Allegheny International, Lone Star Industries, E.F. Hutton, Occidental Petroleum, and Lincoln Savings. In each of these cases—some more notorious than others—the board of directors, consistent with well-established tradition, avoided unseemly confrontations concerning the CEO’s use of corporate funds for lifestyle or self-promoting purposes. In each of these cases the board also failed to pursue more critical issues of fundamental corporate policy such as redundant personnel, excessive compensation for favored executives, and misallocation of corporate assets generally.

The parallels in these cases are not coincidental. In retrospect, it seems apparent that the pattern of self-aggrandizement and excessive spending by these CEOs was a marker of their deeper failure of financial control over the business of the company as a whole. The failure of the directors to recognize or challenge these arguably inconsequential but clearly excessive expenditures mirrored their unwillingness to take on more significant issues. Because they ignored these CEOs’ personal excesses, these directors did not consider or examine whether their CEOs’ big spending was a symptom of deeper, more fundamental corporate problems.

**C. A Proposal**

Based on the records of the companies described above, it would seem that the traditional “hands off” approach to executive spending for personal use may be ripe for revision. The following guidelines, or organizing principles, may provide an important addition to the current, more general, recipes for directorial action:

1. Everything the CEO receives from the company in support of his lifestyle—whether by reimbursement of personal outlays or through direct charge to the company—is the legitimate business of the board of directors. Reviewing such items

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89. See Jay W. Lorsch, Pawn Or Potentates: The Reality of America’s Corporate Boards 91-95 (1989) (describing the “unspoken norms” of board behavior, including the understanding that directors will not embarrass the CEO in a board meeting but will express their concerns privately and that directors will not meet with each other “behind the chairman’s back”).


91. Steve Ross benefitted from both kinds of expenditures. “When Ross chartered a yacht, at least part of the expense was borne by Time Warner, one former Ross associate said; if stars, or studio or record executives, visited, some of the cost was said to be charged to the appropriate division’s overhead.” BRUCK, supra
does not necessarily show a lack of confidence in the CEO, nor should it signal dissatisfaction with the overall course of the company’s management.

2. The board has no obligation to seek out details of a CEO’s expense account or other uses of corporate funds for lifestyle enhancement in the absence of visible cues suggesting excessive personal aggrandizement.

3. Where there are visible cues suggesting excessive personal aggrandizement, the board, through its audit committee, compensation committee, or a special committee, should request an accounting of expenditures made to support the CEO’s lifestyle, including corporate charitable contributions where applicable. The board should evaluate these expenditures in light of the CEO’s compensation arrangement, the company’s performance, known data about the lifestyle support and charitable giving practices at comparable companies, and overall customs in the industry and community. The board should review this information carefully to ensure that corporate lifestyle expenditures have been consistent with board policy and appropriate under the circumstances and that the procedures for monitoring such expenditures have been effective.

4. Even in the absence of specific provocation, a corporate board periodically should review general questions relating to lifestyle support for the CEO and other top-level executives, corporate charitable contributions, and similar high-profile expenditures, to ensure that the corporation’s practices are consistent with the board’s intentions. This periodic review, which could occur every three to four years, would serve two important functions within the company: (1) it would inhibit gross abuses by the CEO and other top-level executives; and (2) it might alert the directors and executives to the potential legal and public relations risks presented by specific corporate spending practices.

5. Following any board-level review of executive lifestyle expenditures, the board should specifically determine whether further review of related expenditures, policies, or practices is needed. If the CEO is treating herself to undue luxury at company expense, the board may want to take a closer look at other cost-control issues such as staffing generally, compensation practices, continuing support of non-performing units, and other indicia of management priorities run wild.

6. Any action taken by the board at the completion of these reviews should be treated as the product of considered business judgment. Decisions relating to the appropriate level of lifestyle expenditures or corporate charitable contributions rarely should be addressed by shareholders, nor should courts entertain suits challenging such expenditures in the absence of colorable allegations of gross abuse amounting to misappropriation.\footnote{note 3, at 325-26.}

\footnote{92. Not all expenditures for personal use, even lavish expenditures, constitute misappropriation. Whether any particular expenditure constitutes misappropriation “must be evaluated in the light of the corporation’s general financial condition.” Iwasaki v. Iwasaki Brothers, Inc., 649 P.2d 598, 602 (Or. Ct. App. 1982). An}
These guidelines, if applied, would inevitably result in board intrusion into a delicate area long avoided by corporate directors, for obvious reasons. Nevertheless, such scrutiny may be warranted and, furthermore, makes good business sense. Corporate directors can no longer deny that a CEO’s grandiosity is legitimate fodder for investment analysts and the business press. Directors should therefore recognize that the decisions they make—or fail to make—concerning extra-contractual executive compensation are a proper measure of their stewardship as directors.

My objective in urging corporate boards to look periodically at the question of executive lifestyle spending is not designed to satisfy the puritanical notions of critics who think that CEOs, as a class, are simply paid too much or live too well. That claim, and the legislation which it has spawned, is unworthy of serious comment. Rather, my point is to ensure that directors adopt a process, suited to the unique characteristics of each company, by which the personal expenditures of top-level executives are reviewed, at least in gross terms, on a regular basis. The process should focus on the larger implications, if any, of a CEO’s spending habits. This is not merely voyeurism, nor public relations damage control. It is instead an early warning device designed to alert directors to the possibility of real corporate harm.

Had Warner Communications’s board taken a serious look at Steve Ross’s use of corporate funds for his personal comfort and gifts to others, particularly in light of the financial results Ross generated, it surely would have ratified his actions enthusiastically. The point of this portion of this review is that Warner’s board never took that serious look—indeed the directors studiously averted their eyes—and that responsible boards confronting behavior similar to Steve Ross’s in the future should take at least reasonable steps to consider that behavior’s implications.

III. DISCLOSURE OBLIGATIONS WHEN THE CEO BECOMES INCAPACITATED

A second legal issue in Master of the Game is raised by Steve Ross’s failure to make appropriate public disclosures at the time of his serious illnesses. In June 1980, for example, Ross suffered a heart attack that incapacitated him for the summer. Instead of disclosing this development, Ross “ordered that it be kept a secret, saying it would be ‘bad for the company’ if it became public. [His wife] reportedly was instructed to tell people who called that he had a ‘bad back.’”

Sometime in the mid-1980s, Ross was diagnosed with prostate cancer—“something that [was never] publicly disclosed, and was known only by a handful of people apart from [his] family and closest associates.” Apparently he then underwent surgery and

acquisition of a condominium, for example, for the exclusive use of corporate officers need not constitute misappropriation. Orchard v. Covelli, 590 F. Supp. 1548, 1554-55 (W.D. Pa. 1984), appeal dismissed, 791 F.2d 920, aff'd, 802 F.2d 448 (3d Cir. 1986).

93. See supra note 89 and accompanying text.


95. BRUCK, supra note 3, at 190.

96. Id. at 281.
received radiation. After that his doctors regularly monitored his blood chemistry.97 Then, in November 1991, Ross's prostate cancer recurred and he began chemotherapy.98 Although the prognosis under these circumstances was poor and his doctors at New York's Memorial Sloan-Kettering Hospital told his family that the treatment at best might give him an extra year to live,99 Time Warner put out a very positive public statement on the matter: "My physicians are optimistic, and I am maintaining my normal work schedule," Ross said in a prepared press release.100 In fact, from that day forward, Ross never returned to his office.

Throughout the spring of 1992, Ross continued the pose of being in full command of the company, and in fact, he was quite instrumental in the ouster of his co-CEO, N.J. Nicholas, in favor of Ross's preferred successor, Gerald Levin. One reason the Time Warner board members went along with this maneuver was because they thought that the issue of succession in the short run was largely academic. Participating by phone in the February 1992 board meeting, where the ouster of Nicholas took place, Ross told his directors that he expected to be back in the office before summer.101 In early June, Ross indicated his intention to be back at work in time to attend the annual shareholders' meeting in July.102 It was not until mid-June 1992 that Ross finally conceded publicly the gravity of his illness. Announcing that he was taking a "temporary leave of absence,"103 Ross nevertheless insisted that his relationship with Time Warner would not change. This spin-doctoring apparently worked. "Analysts said the departure of Ross, who began working at home late last year when he began chemotherapy treatments, would probably not have a significant short-term effect because the 64-year-old Ross had been focusing on planning rather than day-to-day management."104

Time Warner's official company line throughout this period was optimistic. In April 1992, Time Warner's newly-appointed co-CEO, Gerald Levin, told investment analysts that Ross's cancer was in remission and that he no longer had a tumor.105 At the annual shareholders' meeting in July, Levin informed those present that "Ross is continuing his treatment. . . . He is responding to his treatment and is eager to get back as soon as his doctors permit."106 Ross's wife, Courtney Sales, also appeared at the meeting and confirmed Ross's eagerness to return to work.107 In fact, by July, Ross

97. Id. at 317.
98. Id. at 301.
99. Id. at 318.
101. BRUCK, supra note 3, at 304.
102. Id. at 322.
103. Ailing Time Warner Chairman Steven Ross to Take Leave, REUTERS LIB. REP., June 14, 1992, at 1.
107. BRUCK, supra note 3, at 323.
was gravely ill, drugged for pain, unable to receive visitors outside of his immediate family, and constantly in and out of the hospital where he received transfusions.

In November 1992, Ross entered the University of Southern California Cancer Center in Los Angeles for an operation his New York doctors had characterized as futile.\(^\text{108}\) After a ten-hour operation, his new surgeon declared that Ross's tumor was gone at last.\(^\text{109}\) The doctor said that what cancer remained "could be treated with chemotherapy once Ross regained his strength."\(^\text{110}\) Time Warner issued an enthusiastic press release. The UPI reported that "Time Warner Inc. said Tuesday that chairman Steven J. Ross has undergone successful surgery for prostate cancer . . . . [The company is] pleased to confirm that Steven Ross has made satisfactory progress in the chemotherapy treatments, so much so that he has been able to receive successful surgical treatment."\(^\text{111}\)

Ross died on December 20, 1992, after additional surgery, never having left the hospital. Shortly before his death, but more than a year after Ross had stopped coming to work, Time Warner's board had finally requested an accounting of his condition from his surgeon. The doctor told them in writing that Ross would eventually be able to resume some level of participation in the company, but never his full-time duties.\(^\text{112}\) Nevertheless, "in mid-December, [Time Warner] executive vice-president Geoffrey Holmes told a group of analysts that Ross would [soon] be returning [to work]."\(^\text{113}\)

A. Deciding to Disclose the CEO's Grave Illness

The law governing a corporation's affirmative obligation to disclose an executive's medical condition is unclear.\(^\text{114}\) Federal law does not require companies to make timely disclosure of executive illness.\(^\text{115}\) While both the New York Stock Exchange and

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108. Id. at 334.
109. Id.
110. Id.
112. BRUCK, supra note 3, at 338.
113. Id.
114. See, e.g., Rob Seitz, Corporate Conundrum: Disclosing Illness in the Corner Office, N.Y. TIMES, May 2, 1993, at C9 ("Securities and Exchange Commission rules require public companies to disclose all 'material information' about the health of top executives as part of their responsibilities to shareholders. But that still leaves much to the interpretation of company lawyers."); Martin Zimmerman, Disclosure Rules Remain Hazy Area, DALLAS MORNING NEWS, Jan. 25, 1993, at D1 ("There is no hard and fast rule on how and when to disclose information regarding the health of executives."); Linda Grant, Shareholder Profit vs. CEO Privacy: Recent Cases Renew Debate Over Disclosure of an Executive's Illness, L.A. TIMES, Jan. 22, 1993, at D1 ("No regulations specifically address the sensitive topic of CEO illness, and many corporate chiefains consider their health a private matter.").
115. "Despite cogent arguments in favor of an affirmative duty to disclose, neither the courts nor the SEC has been willing to recognize such a general mandate." Marc I. Steinberg & Robin M. Goldman, Issuer Affirmative Disclosure Obligations—An Analytical Framework for Merger Negotiations, Soft Information, and Bad News, 46 Md. L. REV. 923, 923 (1987); see also Dennis J. Block, Affirmative Duty to Disclose Material Information Concerning Issuer's Financial Condition and Business Plans, 40 BUS. LAW. 1243 (1985) (reviewing applicable law).

Some specific disclosures are required by regulation to be included in periodic corporate reports, in-
the National Association of Securities Dealers require companies to disclose "material" information to their shareholders,²¹⁶ what constitutes materiality and the timing of public announcements is left to each company. This latitude has resulted in a number of corporate decisions to withhold information concerning important executive medical conditions. One recent incident involved Buffets Inc., a newly public restaurant chain, which withheld from a meeting of securities analysts the fact that a forty-nine year old vice president and "key player" in the company's growth strategy had died unexpectedly of a heart attack the night before.²¹⁷ Following the presentation, and "buoyed by the management team's rosy outlook," the company's stock rose 6.8%.²¹⁸ Only after this significant bounce did news of the executive's death come out.

There are several reasons why an accurate portrayal of the health prospects of top-level executives should be of material interest to investors. Sometimes managers, and especially the CEO, are singularly involved in a particular facet of the company's business at a level where their inability to continue could significantly impair the company's prospects for success. This phenomenon, most often but not exclusively found in immature or thinly-staffed companies, forms the basis for the "key man" life insurance industry.

In the Buffets case, the vice president whose death was not disclosed to investment analysts had been responsible for site selection, a critical responsibility in a young company expecting to build fifty new restaurants in the next year. In Steve Ross's case, his personal charisma had played an important role not only in maintaining the loyalty of Time Warner's stars, but also in securing international co-venture partners.²¹⁹ Following the announcement of his "temporary" leave of absence in June 1991, one publication reported:

Steven Ross' leave from Time Warner Inc.'s top office for cancer treatment will not affect its imminent $1 billion tie-up with two Japanese groups but clouds the entertainment giant's long-term outlook, analysts said.

including disclosure of "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." ¹⁷ C.F.R. § 249.310 (1995) (Form 10-K, Item 7, incorporating by reference Regulation S-K, Item 303). As a general rule, however, adverse information falling short of that required to be disclosed on Form 8-K, filing of which is triggered by such events as bankruptcy or the resignation of the outside auditing firm or a director, need not be reported in between reports except in limited circumstances as when the issuer is purchasing or selling its stock in the securities markets or when the issuer previously has made a public statement that, although accurate when made, has become false or misleading as a result of subsequent events. Steinberg & Goldman, supra, at 924. Information concerning premerger negotiations may need to be disclosed where that information has become material under the Basic, Inc. v. Levinson test. Basic Inc. v. Levinson, 485 U.S. 224, 238-40 (1988).

¹¹⁶. The NYSE rules provide that a corporation whose securities are listed on the Exchange "is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities." NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 202.05 (1993). The NASD requires that issuers listed on the NASDAQ disclose to the public "any material information which may affect the value of its securities or influence investors' decisions." NATIONAL ASSOCIATION OF SECURITIES DEALERS MANUAL sched. D, pt. II, § 16 (1995).


¹¹⁸. Id.

¹¹⁹. BRUCK, supra note 3, at 312-15 (describing Ross's personal diplomacy).
'It's sort of like (late founder William) Paley at CBS,' said media analyst Ed Atorino at Salomon Brothers. 'There are a handful of guys like that around. And, when those guys leave, it takes time for it to be felt but it is felt.'

Even if the CEO is not directly involved with critical negotiations or personally tied to key customers, serious illness in the executive suite can have other implications of interest to investors. Preoccupation with serious illness and pain, or the results of medication, may cloud an executive's judgment, impair her concentration, distract her from previously established priorities, limit her ability to interact with subordinates, inhibit travel, interrupt ongoing negotiations, or, in cross-cultural settings, interrupt the establishment of business relationships. It may cause subordinates to hold back on new initiatives and move pending decisions to the back burner. It may incline the executive toward short-term projects at the expense of long-term objectives or toward "safe" activities at the expense of higher risk ventures. On the other hand, for some executives, serious illness may generate exactly the opposite response. All of these possibilities would be of interest to prudent investors making decisions to buy or sell a company's stock.

Serious illness for most people is a transformative experience. Pain can alter a patient's personality, perceptions, and judgment. Therefore, one might reasonably posit that when a CEO has a serious illness, particularly one involving pain, the illness should be treated as presumptively material and the company should disclose the illness as soon as reasonably possible following diagnosis.

B. The Arguments Against and For Mandatory Disclosure

There are many arguments against the proposed bright line disclosure rule. One objection is that such a rule would be both overinclusive and underinclusive. Requiring early medical disclosure without evidence of some adverse impact on an executive's performance would only confuse investors, needlessly invade the executive's privacy, and run the risk of affecting the company's share price without good reason. At the same time, requiring medical disclosure while not requiring disclosure of similarly disruptive personal traumas, such as divorce, death of a parent, problems with children, or alcohol or drug abuse, would falsely suggest a level of investor protection that simply cannot be attained.

Principal investors may desire to have at their disposal full disclosure concerning the experiences that influence their corporate leaders. This is the purpose behind the comprehensive biographical section required in registration statements and other

123. 17 C.F.R. § 239.11 (1995) (Form S-1, Item 11(j), incorporating by reference Regulation S-K, Item
corporate documents. But many significant influences on corporate decisionmakers—including religious, romantic, economic, and peer influences—are not routinely disclosed to investors, nor should they be. Why single out a CEO’s medical circumstances and exclude the rest if one’s true objective is effective investment disclosure?

Another objection to a bright line rule mandating timely medical disclosure is the frequent unreliability of early diagnosis. Many companies have understandably delayed releasing medical information when the CEO’s circumstances have been unstable or evolving.124 Even known diseases, such as cancer, AIDS, and heart disease, can present very different prognoses depending on the stage of the disease when detected, the physical condition, mental state and family support structure of the patient, the expertise of the treating physician, and the availability of experimental treatments and an insurance company willing to pay for them. Requiring medical disclosure before all these circumstances have been fully evaluated could lead to significant misunderstandings, both overestimating and underestimating the true risk to investors. As Professor Alan Bromberg has said, “wrong information can be as bad as none at all. It’s just as dangerous to make the stock market overreact as it is to deprive it of information to which it should react.”125

A particularly persuasive objection to mandatory medical disclosure is the problem of ongoing disclosure. What will be a company’s obligation to update its initial medical disclosure? As an executive’s medical condition changes, either improving or declining, how often, and how graphically, will the company have to keep its shareholders apprised? It is better, according to this position, to keep all this information under wraps until it is clear that the CEO’s death is imminent, and that she knows it and has accepted it. At this point, considerations of an orderly succession may outweigh any remaining considerations of privacy.

All of these arguments can be used to support the position that the current rule regarding medical disclosure should remain flexible, entrusting to corporate executives and their legal staffs the determination as to when a CEO’s medical condition has progressed to the point that it has become “material” to the investment community. Maintaining this laissez faire policy, however, will only lead to a continuation of the kinds of abuses illustrated in Master of the Game. Indeed, it will often result in truthful disclosure to shareholders only when the CEO is on his deathbed, if then.126 This delay is a result both of the human tendency to cling to hope and a less savory desire to cling to power.127

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124. For example, when Brinker International’s CEO Norman Brinker was seriously brain damaged in a polo accident, the company waited a full day before revealing that an accident had even occurred. Martin Zimmerman, Disclosure Rules Remain Hazy Area, DALLAS MORNING NEWS, Jan. 25, 1993, at D1. “The two-paragraph statement contained few details of his injuries, said his vital signs were stable, the prognosis appeared ‘favorable’ and didn’t reveal that he remained unconscious.” Id. “The statement put out by the company indicated exactly what was known by the company at that time,” said Debra Smithart-Weitzman, Brinker executive vice president and financial officer.” Id.

125. Id.

126. See Jonathan P. Hicks, Reginald Lewis, 50, is Dead, Financier Led Beatrice Takeover, N.Y. TIMES, Jan. 20, 1993, at A21 (announcing that Reginald Lewis, CEO of TLC Beatrice International, whose diagnosis and hospitalization had been disclosed just the day before, had died of brain cancer).

127. A recent study of political leaders who became ill in office confirms the strategic value of withhold-
When executives like Steve Ross conclude that it is better to mislead investors than to sully their personal myths of invincibility, or when their colleagues like the executives at Time Warner seize the occasion of the CEO's "temporary" absence to advance their personal agendas and reconfigure the executive succession plan, the market may not be served. If corporations are not specifically required to make timely medical disclosure, the public's mistrust of the corporate fiduciary relationship, now represented by the retreat of individual investors from the equity markets and complaints about executive compensation, will continue.

Entrepreneurial start-up companies, in particular, will suffer if investors believe that they are unlikely to be adequately informed in the event the CEO develops a debilitating medical condition. How many people would invest in such a company if they believed that the CEO (as with Steve Ross in 1980) could suffer a coronary and be sidelined for several critical weeks without making some public disclosure? How many people would invest in such a company if they believed that a key executive (as with Ross in 1991) could be incapacitated by a disease without the board making meaningful inquiry into his prospects for recovery?

C. A Proposal

The current at-will protocol for disclosure of a CEO's medical problems, which acts as a license for extended corporate silence, should be revised. NASDAQ and the stock exchanges should replace their existing guidelines for disclosure and adopt instead a bright line rule mandating timely disclosure of a CEO's medical problems. The following organizing principles would aid in forming the rule:

1. Investors have a right to know of any medical condition that might substantially interfere with the ability of a public company's CEO (or other executive officer) to perform the duties of his or her position over an extended period of time. Disclosure should be made as soon as that condition is definitively diagnosed.

2. The board of directors has a right to request and receive on a confidential basis information from a CEO's (or other executive officer's) physician concerning her condition, prognosis, prescribed course of treatment, and prospects for resuming her previous

With the active support of the inner circle, the leader may decide to conceal the illness, for a host of reasons. Concealment may be a function of the leader's own denial of his failing health. The leader and the inner circle may rationalize that the country is in a crisis and that the public would be thrown into a panic if it became known that its leader was ill. But, in fact, the inner circle may well recognize that to acknowledge the leader's illness would be to lose power. The insidiously with which the illness presents itself may aid this endeavor to conceal it. Subtle signs of early illness are easily overlooked so that those outside the inner circle who are in a position to evaluate the leader's health and decision-making may tend to ignore early warning signs, especially if the inner circle assists in the deception.

level of performance with the company. Access to this information should be made an 
express term of the executive’s employment contract.

3. The board may determine at any time that material information concerning the 
officer’s condition, prognosis, prescribed course of treatment, and prospects for resuming 
his previous level of performance with the company should be disclosed to the 
public forthwith, notwithstanding the objection of the CEO, other executives, or his 
family. This determination may take into account the certainty of the medical informa-
tion sought to be disclosed, the temporary volatility of the share price (though this may 
not be grounds for deferring disclosure indefinitely), and any special circumstances, 
including the pendency of contractual negotiations, that might be adversely influenced 
by the timing of the disclosure.

4. Even considering any special circumstances or perceived justifications for continu-
ing to withhold this information, material medical information about a CEO (or other 
executive officer) should be disclosed to the public within forty-five days of definitive 
diagnosis. Without this principle the others are meaningless.

These guidelines would result in increased dissemination of information that histori-
ically has been thought too intimate to be made public. However, these guidelines also 
might facilitate three desirable goals: (1) CEOs would be encouraged to build depth into 
their management structures so their companies (and their shareholders) would have less 
to fear in the event an adverse medical disclosure became necessary; (2) boards would 
be encouraged to consider the need for a well-developed succession plan, lack of which 
now imperils many companies each year; 128 and (3) consultants and scholars would be 
encouraged to explore workable alternatives to the domineering “one-man-show” style 
of CEOs like Steve Ross. The challenge is to find a structure that maintains the CEO’s 
high level of personal involvement and sense of mission (both defining characteristics 
of Ross’s reign), while also distributing real power and leadership opportunities to oth-
ers.

Had Time Warner followed these guidelines and made timely and honest disclosure 
of Ross’s condition, rather than trafficking in disinformation, various outcomes might 
have resulted. Time Warner’s stock price might have dropped with disclosure. Gerald 
Levin probably would have unseated the heir apparent, N.J. Nicholas, and become 
CEO, although the process inevitably would have been more public and disruptive to 
the company than it was when the misled Time Warner board thought Ross was going 
to recover. Time Warner’s shareholders probably would not have been worse off in the 
long run. However, the integrity of the marketplace, which depends on candid informa-
tion, would have been reinforced had truthful and timely disclosure occurred.

128. See Joann S. Lublin, Eisner’s Surgery Underscores the Lack of Succession Planning at Many Firms, 
WALL ST. J., July 19, 1994, at A2 (discussing the lack of succession planning at many major companies, 
citing the case of Walt Disney Co., whose chairman Michael D. Eisner recently underwent quadruple-bypass 
surgery).
IV. THE GENERAL PROBLEM OF THE GRANDIOSE CEO

Some observers of top corporate leaders have noted a phenomenon in recent years known colloquially as "CEO disease."\(^{129}\) This disease is characterized by the following symptoms:

[S]pending too much time away from the job, playing the role of statesman for the sake of personal recognition, . . . [competing] with industry counterparts over how much money he makes, how big the headquarters building is, or how many corporate jets are parked on the landing strip. "Too many people treat CEOs as some kind of exalted, omnipotent leader," says John Sculley, former CEO of Apple Computer Inc. "The real danger is that you start believing that stuff."\(^{130}\)

The behavior revealed in *Master of the Game* is entirely consistent with a diagnosis of "CEO disease." During his rule of Warner Communications, Steve Ross refused to meaningfully share power with his subordinates, withheld important information from his directors and the investment community, treated corporate property as if it were his own, and lustily measured his power by its trappings. When Ross at last had ousted the pestiferous Herb Siegel from the Warner board of directors, for example, his first act was to go out and buy $50 million worth of new aircraft.\(^{131}\)

Boards of directors inevitably play the role of enabler when a top executive manifests CEO disease. When directors fail to challenge the CEO, or, when necessary, to assume the role of loyal opposition—when they fail to curb the CEO's own self-inflating instincts—the results are predictable and often disastrous. Allegheny International, Lone Star Industries, E.F. Hutton, Occidental Petroleum, and Lincoln Savings are just a few examples of the sad scenario.

The cost of grandiosity is not always so high, of course. The phenomenon nevertheless may have an impact, even in high-performing companies.

Many chief executives come to believe that they are [invincible]. The perquisites and deferences create a protective cocoon—if not a full-fledged fantasy world—for the chieftains of some of the nation's largest companies. "Many CEOs take on a level of self-importance that goes way beyond reality," says Douglas D. Danforth, former CEO of Westinghouse Electric Corp. and now a director at several large corporations. "They view the company as their own . . . . Some people's personalities change completely."\(^{132}\)

This passage captures the essence of Steve Ross's relationship with his business. Over the years, "Ross had made the company—and its treasury—so much of an extension of himself that it was hard to say where one ended and the other began."\(^{133}\)

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130. *Id.*
133. BRUCK, *supra* note 3, at 213.
The lesson in Steve Ross's biography is that this kind of intense identification between a CEO and his company may bring about mixed blessings. Steve Ross was often a masterful and farsighted CEO. He also had precisely those characteristics—grandiosity, deceit, and a sense of consummate entitlement—of which directors and investors should be wary.