CORPORATE CODES OF ETHICS, MANDATORY DISCLOSURE, AND THE MARKET FOR ETHICAL CONDUCT

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This is an article about the intersection of law, corporate self-regulation, and ethics. The legal development that occasions this discussion is a change in the federal securities law governing the reporting requirements for public companies. As part of the Sarbanes–Oxley Act of 2002 (the Act),[1] Congress directed the U.S. Securities and Exchange Commission (SEC) to issue rules requiring publicly traded companies to disclose whether they have adopted a code of ethics for senior financial officers.[2] A little over a year after Sarbanes–Oxley became law, the Chairman of the SEC, in testimony before a Senate oversight committee, outlined the steps the Commission had taken to implement the statutory mandate as follows:

> *To further focus attention on honest and ethical conduct*, the Commission adopted rules on January 15, 2003 pursuant to Section 406 of the [Sarbanes–Oxley] Act. These *rules require a reporting company to disclose* annually whether the company has adopted *a code of ethics* for the company's principal executive officer and senior financial officers. If a company has not adopted such a code, the company is required to explain why. The rules also require a company to disclose on a current basis amendments and waivers relating to the code of ethics for any of those officers.[3]

In the Chairman's brief and otherwise unremarkable description of the Commission's rules, one can discern an intriguing combination of elements

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1. Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

2. *Id.* § 406, 15 U.S.C. § 7264 (West Supp. 2004).

3. *Testimony Concerning Implementation of the Sarbanes–Oxley Act of 2002 Before the Senate Comm. on Banking, Hous. and Urban Affairs*, 103d Cong. at Part III.C.2 (2003) (statement of William H. Donaldson, Chairman, U.S. Sec. and Exch. Comm'n) (emphasis added) (footnote omitted), *available at* http://www.sec.gov/news/testimony/090903tswhd.htm.

in the regulatory structure implementing § 406 of the Act: (1) a common form of corporate self-regulation (the corporate code of ethics[4]); (2) a traditional type of securities law provision (a disclosure requirement); and (3) however inchoate, a normative conception of ethical corporate behavior (suggested, though not defined, in the reference to "honest and ethical conduct"). It is this combination of elements that bears scrutiny.[5]

While the reporting requirements of § 406 are new, the relationship between corporate codes of ethics (or "CCOEs") and law is one of long standing. Although CCOEs are voluntary, self-regulatory mechanisms that typically serve multiple purposes, they tend to be heavily influenced by the corporate legal environment in content and administration. The technical disclosure requirements of Sarbanes–Oxley alter, and to a limited extent, formalize, an already complex relationship between corporate codes of ethics and the law. This article considers the implications and potential consequences of this development. The discussion is organized as follows: Part I presents a detailed overview of codes of ethics as corporate self-regulatory mechanisms, focusing on code content and design. The debate concerning the efficacy of CCOEs is also addressed. Part II examines the statutory and regulatory content of the § 406 disclosure regime, placing it in the context of U.S. securities law, in general, and the Sarbanes–Oxley Act, in particular. Part III considers whether § 406 significantly changes the legal environment for public companies, focusing on its implications for civil liability under the federal securities laws. Part IV looks at how the new law is affecting the content and transparency of corporate codes. Part V explores the potential of § 406 to influence corporate behavior by

4. For definitions of the term "code of ethics," see Margaret Anne Cleek & Sherry Lynn Leonard, *Can Corporate Codes of Ethics Influence Behavior?*, 17 J. BUS. ETHICS 619, 622 (1998) ("A code of ethics is a formal document that states an organization's primary values and the ethical rules it expects its employees to follow."); Earl A. Molander, *A Paradigm for Design, Promulgation and Enforcement of Ethical Codes*, 6 J. BUS. ETHICS 619, 619–20 (1987) ("[A]n 'ethical code' is defined as 'part of that middle ground between internalized societal values on the one hand and law on the other, where *formal* social and economic sanctions of a social group—a profession, an industry, a firm, etc.—act to ensure conformity with acceptable standards of behavior and penalize deviance.'"); Mark S. Schwartz, *The Nature of the Relationship between Corporate Codes of Ethics and Behaviour*, 32 J. BUS. ETHICS 247, 248 (2001) ("[A] code of ethics is . . . a written, distinct, and formal document which consists of moral standards used to guide employee or corporate behaviour."). Corporate "codes of ethics" are also sometimes referred to as "codes of conduct." For purposes of this article, the terms are interchangeable. *See* Messod D. Beneish & Robert Chatov, *Corporate Codes of Conduct: Economic Determinants and Legal Implications for Independent Auditors*, 12 J. ACCOUNTING & PUB. POL'Y 3, 6 (1993) (defining "corporate codes of conduct" as "self-regulatory devices in which a corporation provides behavioral guidance to employees and policy commitments to stakeholders").

5. *Cf.* Thomas W. Dunfee, *On the Synergistic, Interdependent Relationship of Business Ethics and Law*, 34 AM. BUS. L.J. 317, 325 (1996) (advocating research that integrates legal and business ethics scholarship); Jeffrey Nesteruk, *Commentary: A New Role for Legal Scholarship in Business Ethics*, 36 AM. BUS. L.J. 515 (1999) (same).

facilitating competition in the market for ethical corporate conduct. Part VI concludes the article.

I. CORPORATE CODES OF ETHICS: STRUCTURE, CONTENT, AND EFFICACY

When Congress enacted the disclosure requirement for corporate codes of ethics, it was not writing on a blank slate. Voluntarily adopted corporate codes of ethics have existed for decades and most of the largest public companies doing business in the United States had them before Sarbanes–Oxley.[6] Thus, an appropriate point of departure for an evaluation of the impact and significance of the new Sarbanes–Oxley code disclosure regime is an examination of the CCOE as a distinctive and well established form of corporate self-regulation.

Historically, many corporate codes were adopted in response to highly publicized scandals and/or major legal developments.[7] Although CCOEs first appeared early in the last century,[8] a substantial number date from the 1970s,[9] when many companies adopted codes in response to a series of corporate bribery scandals that culminated in the enactment of the Foreign Corrupt Practices Act of 1977.[10] Subsequent spates of CCOE adoptions and revisions have followed the defense industry scandals of the early and mid-1980s,[11] the publication of the Treadway Commission report on

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6. *See* John C. Ruhnka & Heidi Boerstler, *Governmental Incentives for Corporate Self-Regulation*, 17 J. BUS. ETHICS 309, 324 (1998) (estimating that "more than 80% of the Fortune 1000 companies presently have formal written corporate codes of conduct in place"); Schwartz, *supra* note 4, at 248 ("In the U.S., over ninety percent of large corporations have a code of ethics . . . .").

7. *See* Leonard J. Brooks, *Corporate Codes of Ethics*, 8 J. BUS. ETHICS 117, 121 (1989) ("[I]t is evident that U.S. codes are largely designed to deal with matters that have produced scandals and subsequent regulation."); Lewis R. Tucker et al., *A Multidimensional Assessment of Ethical Codes: The Professional Business Association Perspective*, 19 J. BUS. ETHICS 287, 288 (1999) (noting that code adoptions and revisions followed "revelations of unethical behavior" in various industries); *see also* Ruhnka & Boerstler, *supra* note 6, at 323 (1998) (positing a correlation between the adoption of codes and developments in the legal environment of business since the 1970s).

8. *See, e.g.*, Mary Ellen Oliverio, *The Implementation of a Code of Ethics: The Early Efforts of One Entrepreneur*, 8 J. BUS. ETHICS 367, 368–69 (1989) (reviewing origins and content of J.C. Penney's 1913 corporate code of ethics); *see also* EDGAR L. HEERMANCE, CODES OF ETHICS: A HANDBOOK (1924) (providing a collection of codes from the early 20th century).

9. *See generally* George C.S. Benson, *Codes of Ethics*, 8 J. BUS. ETHICS 305, 306–07 (1989) (noting that many CCOEs were created in the 1970s in response to developments in domestic law that sought to prevent corporate political contributions); Donald R. Cressey & Charles A. Moore, *Managerial Values and Corporate Codes of Ethics*, 25 CALIF. MGMT. REV. 53, 54, 58 (1983) (discussing the codes of business conduct written in the 1970s in response to corporate and government scandals).

10. *See* Bernard J. White & B. Ruth Montgomery, *Corporate Codes of Conduct*, 23 CALIF. MGMT. REV. 80, 80 (1980) (noting that "[m]any companies . . . developed, expanded, or modified their codes of conduct to demonstrate compliance with the spirit and the letter of the [FCPA] law").

11. *See generally* Paul E. Fiorelli, *In Defense of Ethics: New Considerations after the Packard*

fraudulent financial reporting in 1987,[12] and the issuance of the U.S. Sentencing Guidelines for Organizations in 1991.[13]

A. Code Structure and Content

1. Types of Codes

Although corporate codes of ethics vary substantially in content and design, they are often classified into categories or types for purposes of analysis.[14] Researchers have distinguished several common CCOE formats, such as "corporate credos,"[15] "values statements,"[16] "compliance codes,"[17] and "management philosophy statements."[18] Distinctions have also been drawn between "inward-looking"[19] and "outward-looking"[20]

Commission, 34 CATH. LAW. 157, 159-62 (1991) (reviewing defense industry developments regarding CCOE adoption, revision, and administration associated with military procurement abuses examined in the Packard Commission Report of 1986). *See also* Andrew Mayer, *Military Procurement: Basic Principles and Recent Developments*, 21 GEO. WASH. J. INT'L L. & ECON. 165 (1987) (recounting defense industry misconduct that led to the appointment of the Packard Commission by President Reagan).

12. NAT'L COMM'N ON FRAUDULENT FINANCIAL REPORTING, REPORT OF THE NATIONAL COMMISSION ON FRAUDULENT FINANCIAL REPORTING (Oct. 1987), *available at* http://www.coso.org/publications/NCFFR_Part_1.htm.

13. The U.S. Sentencing Guidelines for Organizations went into effect on November 1, 1991. *See* UNITED STATES SENTENCING COMM'N, GUIDELINES MANUAL CH 8 (2004), *available at* http://www.ussc.gov/2004guid/gl2004.pdf.

14. *See generally* Gary R. Weaver, *Corporate Codes of Ethics: Purpose, Process and Content Issues*, 32 BUS. & SOC'Y 44, 53–54 (1993) (reviewing common corporate code formats).

15. *See* William S. Laufer & Diana C. Robertson, *Corporate Ethics Initiatives as Social Control*, 16 J. BUS. ETHICS 1029, 1030 (1997) (defining "corporate credos" as "statements of commitment to constituencies, as well as statements of corporate values"); Patrick E. Murphy, *Corporate Ethics Statements: Current Status and Future Prospects*, 14 J. BUS. ETHICS 727 (1995) ("A corporate credo delineates a company's ethical responsibility to stakeholders . . ."). Some firms—perhaps most notably Johnson & Johnson—have both a corporate credo and a code of ethics. The JOHNSON & JOHNSON CREDO is reprinted in Patrick E. Murphy, *Creating Ethical Corporate Structures*, 30 SLOAN MGMT. REV. 81, 83 tbl.2 (1989); *see also* JOHNSON & JOHNSON, INC., JOHNSON & JOHNSON POLICY ON BUSINESS CONDUCT (2003) (presenting a corporate credo that calls for compliance with the laws of the countries in which the company does business), *at* http://www.jnj.com/community/policies/usiness_conduct.htm.

16. *See* Murphy, *Corporate Ethics Statements*, *supra* note 15, at 728 (explaining that "[v]alues statements are intended to set out the guiding principles of the firm").

17. *See* Laufer & Robertson, *supra* note 15, at 1030 (defining "compliance codes" as "codes with provisions that contain guidelines and prohibitions regarding unethical and illegal conduct").

18. *See id.* (defining "management philosophy statements" as "formal edicts of corporate philosophy").

19. Inward-looking codes or code provisions focus on internal procedures and intra-corporate relationships. *See* Murphy, *Creating Ethical Corporate Structures*, *supra* note 15, at 85 (noting St. Paul Companies' code focused most heavily on the "Employee-Related Issues" section pertaining to "the

codes, "affirmative" and "negative" codes,[21] and among codes of differing levels of specificity.[22] At one end of the spectrum, a "corporate credo" or "values statement" consists of a broad, and typically quite brief, statement of the principles that are to inform and guide the conduct of the company's business.[23] At the opposite end of the spectrum, "compliance"-type codes tend to be relatively lengthy documents setting out rules and procedures principally focused on discouraging unlawful conduct and encouraging lawful conduct on the part of company employees.[24] While some CCOEs fall squarely within one of these categories, many others take the form of hybrids that combine elements of multiple types or formats.[25] A compliance-oriented code that is primarily structured as a quasi-regulatory list of requirements and prohibitions may also contain broad statements of normative values or principles.[26] Alternatively, codes that are drafted primarily as broad statements of principle may also include references to specifically prohibited conduct.[27]

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company's relationship to the individual, and vice versa").

20. Outward-looking codes or code provisions emphasize corporate "citizenship" and the company's relationships with external stakeholders. *See generally* Cressey & Moore, *supra* note 9, at 57.

21. Negative codes "are generally collections of 'thou shalt nots,'" while affirmative codes are collections of aspirations or "thou shalt[s]." Charles E. Harris, *Structuring a Workable Business Code of Ethics*, 30 U. FLA. L. REV. 310, 314–17 (1978).

22. *See* Sandra Pelfrey & Eileen Peacock, *Ethical Codes of Conduct Are Improving*, 16 BUS. FORUM 14, 15 (1991) (distinguishing among: (a) highly specific codes that address "every possible situation;" (b) "simple, general statements of company values;" and (c) codes that take "a middle of the road approach" combining statements of purpose, general rules, and procedures).

23. *See, e.g.*, HARRAH'S ENTERTAINMENT, INC., CODE OF COMMITMENT (example of one-page "values statement"-type code), *at* http://www.harrahs.com/about_us/code_of_commitment/index.html (last visited Feb. 9, 2005); LEAR CORP., VALUE STATEMENTS, *available at* http://www.lear.com/pdf/aboutlear/lear_value_statement.pdf (last visited Feb. 9, 2005) (same); *Security Pacific Corporation Statement of Corporate and Employee Commitments, reprinted in* THE CONFERENCE BOARD, CORPORATE ETHICS 20 (1988) (same).

24. *See* Donald Robin et al., *A Different Look at Codes of Ethics*, 32 BUS. HORIZONS 66, 67, 71 (1989) (concluding that among eighty-four *Business Week 1000* CCOEs reviewed, "[r]ule-based statements dominate, while broad, shared values are almost absent"). The role of the corporate code of conduct as a mechanism for discouraging unlawful behavior within an organization is explored in some detail in Venrice R. Palmer, *Initiating a Corporate Compliance Program*, 1178 PLI/CORP 67, 74–80 (2000).

25. *See* Linda Klebe Treviño et al., *Managing Ethics and Legal Compliance: What Works and What Hurts*, 41 CALIF. MGMT. REV. 131, 137 (1999) (stating that CCOEs of *Fortune 1000* firms generally combine compliance and value-based approaches).

26. For example, a compliance-based code may be circulated with an introductory message from the CEO articulating a values-based commitment to ethical conduct. *See, e.g.*, *Message from the Chairman and Chief Executive Officer*, AETNA, INC., CODE OF CONDUCT 1 (2003) ("At the forefront of our core values is 'Act with Integrity' . . . ."), *available at* http://www.aetna.com/governance/code.html.

27. *See, e.g.*, COSTCO, CODE OF ETHICS (requiring that employees "[n]ot offer, give, ask for, or receive any form of bribe or kickback to or from any person or pay to expedite government action or otherwise act in violation of the Foreign Corrupt Practices Act"), *available at* http://media.corporate-

2. What Codes Say

The typical CCOE of a large public company is a hybrid that combines some general statements of the firm's commitment to broadly expressed normative formulations of principled business conduct[28]—such as acting with "integrity"[29] or adherence to "the highest ethical standards"[30]—with a number of specific pronouncements or rules addressing discrete areas of unlawful and/or unethical conduct. Provisions of the latter type may be articulated as statements of corporate policy from which management and employee duties may be inferred.[31] Alternatively, such provisions may be expressed as admonitions to employees either to act in a certain way ("do's")[32] or to refrain from engaging in specific types of prohibited conduct ("don'ts").[33] These specific corporate policy statements/ admonitions generally fall within one or more of five overlapping categories: (a) follow the law; (b) be honest; (c) be loyal to the company (i.e., avoid conflicts of interest); (d) keep the company's secrets; and (e) treat corporate stakeholders and competitors with fairness and respect.[34]

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ir.net/media_files/NSD/cost/reports/our_mission.pdf (last visited Feb. 9, 2005); EATON CORP., CODE OF ETHICS (2004) (requiring employees not to "offer or accept gifts or entertainment of substantial value"), *available at* http://www.eaton.com/3/images/2004CodeofEthics.pdf.

28. *See, e.g.*, BANK OF NEW YORK CO., INC., CODE OF CONDUCT (2005) ("We are honest, trustworthy, and fair in all of our actions and relationships with, and on behalf of, the Company."), *at* http://www.bankofny.com/htmlpages/acg_coc_pec.htm; LOCKHEED MARTIN CORP., SETTING THE STANDARD 2 (2005) (committing the company to the principles of "Honesty, Integrity, Respect, Trust, Responsibility, and Citizenship"), *available at* http://www.lockheedmartin.com/data/assets/7856.pdf.

29. *See, e.g.*, INTEL CORP., PRINCIPLES FOR RESPONSIBLE BUSINESS ("Intel adheres to strict standards of honesty and conducts business with uncompromising integrity and professionalism."), *at* http://www.intel.com/intel/finance/prin_resp_bus.htm (last visited Feb. 9, 2005).

30. *See, e.g.*, ALLSTATE CORP., ALLSTATE CODE OF ETHICS 2 ("Allstate is committed to operating its business with honesty, integrity and the highest level of ethical conduct."), *available at* http://media.corporate-ir.net/media_files/irol/93/93125/corpgov/coe_021204.pdf (revised effective Feb. 12, 2004); JOHNSON CONTROLS, INC., ETHICS POLICY–THE CORNERSTONE OF CUSTOMER SATISFACTION (2004) ("We will conduct our business with the highest ethical standards."), *available at* http://www.jci.com/corpvalues/ethics_print.htm.

31. *See, e.g.*, ASHLAND, INC, BUSINESS RESPONSIBILITIES OF AN ASHLAND EMPLOYEE 3 (2004) ("All applicants and employees are judged by their qualifications, demonstrated skills and achievements without regard to age, disability, gender, national origin, race, color, religion, sexual orientation, veteran status or other personal characteristics that are protected by law."), *at* http://www.ashland.com/ashland/cobc/index.html.

32. *See, e.g.*, CSX CORP., CODE OF ETHICS 4 (2004) ("All CSX directors, officers and employees must comply with the Company's values and principles."), *available at* http://www.csx.com/share/csx/coe/main/docs/Final_COE_text_for_web-REF21270.pdf.

33. *See, e.g.*, AUTOMATIC DATA PROCESSING, INC., CODE OF BUSINESS CONDUCT & ETHICS ("You may not exploit your position or relationship with ADP for personal gain."), *at* http://www.adp.com/corporate/ethics.html (last visited Feb. 9, 2005).

34. These categories are intended to be representative and analytically useful, but neither exhaustive, nor definitive. Given the substantial variation among CCOEs, code provisions may be

a. *Follow the law:* Many CCOEs include both general exhortations to follow the law[35] and references to specific types of legal violations that employees are to avoid. Among the most commonly mentioned areas of law with which employees are called upon to comply are: the antitrust laws;[36] health, safety, and environmental regulations;[37] the Foreign Corrupt Practices Act;[38] intellectual property protections;[39] export controls;[40] and

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classified for analysis in any number of different ways. *See, e.g.*, Robin et al., *supra* note 24, at 68 (categorizing CCOE content into three thematic "clusters" and a fourth classification for "Unclustered Items"); Weaver, *supra* note 14, at 55–56 (offering six classifications for CCOE content).

35. *See, e.g.*, AVON PRODUCTS, INC., CODE OF BUSINESS CONDUCT AND ETHICS 11 (2003) ("Avon is strongly committed to conducting our business in full compliance with all applicable laws, rules and regulations in every country in which we do business."), *available at* http://www.avoncompany.com/investor/corporategovernance/pdf/code_of_conduct.pdf; JPMORGAN CHASE & CO., CODE OF CONDUCT 1 (2004) ("You are responsible for understanding and complying with [the applicable] laws and policies [of a given jurisdiction or business unit]."), *available at* http://www.jpmorganchase.com/cm/cs?pagename=Chase/Href&urlname=jpmc/about/governance/codeofconduct; ENTERGY CORP., CODE OF ENTEGRITY 7 (2003) ("It is part of your duty as an Entergy employee or Entergy representative to follow the letter and the spirit of the applicable laws, regulations, rules and regulatory orders of every jurisdiction in which Entergy operates."), *at* http://www.entergy.com/Corp/entegrity_2003/responsibilities.asp.

36. *See, e.g.*, BAKER HUGHES, INC., BUSINESS CODE OF CONDUCT 9 (2002) ("The Company's policy is to comply with both the letter and the spirit of the antitrust laws and the competition laws of the countries where we operate."), *available at* http://www.bakerhughes.com/investor/about/code_of_conduct.htm; EXXON MOBIL CORP., STANDARDS OF BUSINESS CONDUCT 5 (2004) ("It is the policy of Exxon Mobil Corporation that directors, officers, and employees are expected to comply with the antitrust and competition laws of the United States and with those of any other country or group of countries which are applicable to the Corporation's business."), *available at* http://www2.exxonmobil.com/corporate/files/corporate/sbc.pdf.

37. *See, e.g.*, HONEYWELL INT'L, CODE OF BUSINESS CONDUCT 21 (2003) ("Honeywell abides by all applicable health, safety and environmental laws and regulations in countries and communities in which we operate . . . ."), *available at* http://www.honeywell.com/sites/honeywell/codeofconduct.htm.

38. *See, e.g.*, BURLINGTON RESOURCES, CODE OF BUSINESS CONDUCT AND ETHICS FOR DIRECTORS, OFFICERS AND EMPLOYEES 4 (2004) (laying out the Company's "Anti-Bribery Provisions"), *available at* http://www.br-inc.com/docs/CodeofConduct.pdf; CORNING INC., OUR CODE OF CONDUCT 5 (2003) (stating that company "employees must not make illegal payments to foreign government officials"), *available at* http://www.corning.com/docs/corporate/inside_corning/corporate_governance/our_code_of_conduct.pdf; *see also* Kathryn Gordon & Maiko Miyake, *Business Approaches to Combating Bribery: A Study of Codes of Conduct*, 34 J. BUS. ETHICS 161 (2001) (discussing the international business community's reaction to bribery and corruption); Mary Jane Sheffet, *The Foreign Corrupt Practices Act and the Omnibus Trade and Competitiveness Act of 1988: Did They Change Corporate Behavior?*, 14 J. PUB. POL'Y & MARKETING 290 (1995) (discussing the 1988 amendments to the Foreign Corrupt Practices Act and their limited impact on corporate codes).

39. *See, e.g.*, BELLSOUTH CORP., OUR PERSONAL RESPONSIBILITY 17–20 (2003) (describing BellSouth's intellectual property and proprietary information policies), *available at* http://ethics.bellsouth.com/committment_booklet_21103.pdf.

40. *See, e.g.*, MEDTRONIC, INC., OUR PERSONAL RESPONSIBILITY 5 (2003) ("Medtronic must comply with export control and economic sanctions laws of the United States, as well as those of other countries in which it does business."), *available at* http://www.medtronic.com/corporate/downloads/code.pdf.

prohibitions against insider trading,[41] employment discrimination, and sexual harassment.[42]

b. *Be honest*: In addition to general admonitions to be honest,[43] codes typically include directives to keep accurate corporate records,[44] and to report company information truthfully within the organization and without.[45] Many codes specifically promise that information submitted to the Securities and Exchange Commission will be accurate, timely, and complete.[46] It is common, moreover, for codes to articulate commitments to truthful advertising[47] and the avoidance of deceit in relationships with customers, suppliers, and competitors.[48] Another recurring CCOE provision, within the rubric of "honesty," is the admonition to employees to use company assets solely for company business.[49]

c. *Be loyal to the company*: The vast majority of codes prohibit conflicts of interest.[50] However, the documents vary substantially in the

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41. *See, e.g.*, DEVON ENERGY CORP., CODE OF BUSINESS CONDUCT AND ETHICS 2 ("Any employee or associate is prohibited from buying or selling Company securities based on insider information or from transmitting such information to others in violation of applicable federal and/or state securities laws."), *available at* http://www.dvn.com/corpgov/GP-Code_of_Business_Conduct_and_Ethics.pdf (last visited Feb. 9, 2005).

42. *See, e.g.*, LEVI STRAUSS & CO., WORLDWIDE CODE OF BUSINESS CONDUCT 16 (2003) ("Our policies prohibit discrimination and harassment of any kind by any employee.").

43. *See, e.g.*, CATERPILLAR, CODE OF WORLDWIDE BUSINESS CONDUCT 2 (2000) ("*We must always tell the truth.*"), *available at* http://www.cat.com/cda/layout?M=38044&x=7.

44. *See, e.g.*, CHEVRONTEXACO CORP., BUSINESS CONDUCT AND ETHICS CODE 3 ("[A]ll entries to ChevronTexaco's books must be prepared with accuracy and honesty."), *available at* http://www.chevrontexaco.com/investor/corporate_governance/biz_conduct.asp (last visited Feb. 9, 2005).

45. *See, e.g.*, COCA-COLA CO., THE CODE OF BUSINESS CONDUCT 16 (stressing the need for integrity and accuracy in both internal company financial records and external regulatory reports), *available at* http://www2.coca-cola.com/ourcompany/pdf/business_conduct_codes.pdf (last visited Feb. 9, 2005).

46. *See, e.g.*, LOCKHEED MARTIN CORP., *supra* note 28, at 5 ("We must assure that all disclosures made in all periodic reports and documents filed with the Securities and Exchange Commission, and other public communications by the Corporation, are full, fair, accurate, timely, and understandable.").

47. *See, e.g.*, GENERAL MILLS, THE COMPANY OF CHAMPIONS 8 ("General Mills presents our products truthfully, responsibly and tastefully."), *available at* http://www.generalmills.com/corporate/commitment/coc.pdf (last visited Feb. 9, 2005).

48. *See, e.g.*, CINERGY CORP., CODE OF BUSINESS CONDUCT AND ETHICS 3 (Apr. 22, 2003) ("No director, officer or employee shall take unfair advantage of anyone through . . . concealment, . . . misrepresentation, fraudulent behavior or any other unfair dealing practice."), *available at* http://www.cinergy.com/governance/default_3384.asp.

49. *See, e.g.*, COLGATE-PALMOLIVE CO., CODE OF CONDUCT 10 (2004) ("Colgate equipment, systems, facilities, corporate credit cards and supplies must be used only for conducting Colgate's business . . . ."), *available at* http://www.colgate.com/Colgate/US/Corp/CodeOfConduct/CodeOfConduct.pdf.

50. *See* Cressey & Moore, *supra* note 9, at 57 tbl.1, 58 (finding that "policies regarding conflict of interest receive significantly more attention than other policy areas" in 119 codes analyzed by the

level of detail with which the employees' duty of loyalty to the company is articulated. Codes typically define conflicts of interest broadly[51] and then list specific types of potentially problematic conduct, such as working for another firm,[52] steering company business to a relative,[53] or maintaining a personal financial interest in a company transaction.[54]

d. *Keep the company's secrets*: Corporate ethics codes typically require employees to protect the secrecy of the company's confidential information.[55] Many also explicitly oblige employees to keep the secrets of customers, clients, and others with whom the company conducts business.[56]

e. *Treat stakeholders and competitors with fairness and respect*: This is, in a sense, a residual category that could be understood to encompass some or all of the content already discussed under the first four headings.[57] Corporate "stakeholders" include investors, employees, suppliers,

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authors); Pelfrey & Peacock, *supra* note 22, at 16 (stating that 94% of surveyed CCOEs included conflict-of-interest rules); White & Montgomery, *supra* note 10, at 84 tbl.3, 85 (noting that nearly 75% of surveyed corporate codes state that employees are obligated to avoid conflicts of interest).

51. *See, e.g.*, GANNETT CO., GANNETT ETHICS POLICY 1 ("A 'conflict of interest' exists when a person's private interest interferes in any way with the interests of the Company."), *at* http://www.gannett.com/street/Governance/ethics.htm (2004); ITT INDUSTRIES, INC., CODE OF CORPORATE CONDUCT 10 (2004) ("A conflict of interest occurs when personal interests interfere with your ability to exercise your judgment objectively in the best interests of ITT Industries."), *available at* http://www.ittfluidtechnology.com/conduct/start.

52. *See, e.g.*, CHARLES SCHWAB CORP., CODE OF BUSINESS CONDUCT AND ETHICS 4 (2004) (specifying that "employees may not engage in outside employment or other outside activity that interferes with their duties and responsibilities at the company"), *available at* http://www.aboutschwab.com/corpgov/code04.pdf.

53. *See, e.g.*, SHERWIN-WILLIAMS CO., BUSINESS ETHICS POLICY ("A conflict of interest is any activity . . . (including relationships with family members, relatives, friends and social acquaintances) which conflicts with the independent exercise of judgment in connection with your duties and/or employment with Sherwin-Williams."), *at* http://www2.sherwin-williams.com/InvestorRelations/Corporate_Governance/Business_Ethics_Policy/Business_Ethics_Policy.html (last visited Feb. 9, 2005).

54. *See, e.g.*, UNION PACIFIC CORP., STATEMENT OF POLICY CONCERNING BUSINESS CONDUCT AND ETHICS 1–2 (2004) (stating that "[e]mployees and their families must avoid knowingly acquiring any direct or indirect interest in . . . any transaction where the Corporation is or may become a party . . . ."), *available at* http://www.up.com/investors/governance/business_conduct.pdf.

55. *See, e.g.*, FORD MOTOR CO., STANDARDS OF CORPORATE CONDUCT 20 ("Every employee is obligated to maintain the confidentiality of Ford's business information."), *available at* http://www.ford.com/en/company/corporateGovernance/governancePolicies.htm (last visited Feb. 9, 2005).

56. *See, e.g.*, BLACK & DECKER CORP., CODE OF ETHICS AND STANDARDS OF CONDUCT 2 (2003) ("Employees should maintain the confidentiality of information entrusted to them by the Corporation or its customers, except when disclosure is authorized or is legally mandated."), *available at* http://www.bdk.com/governance/bdk_governance_appendix_1.pdf

57. The duty to avoid conflicts of interest, for example, may also be understood as an element of the employees' obligation to treat the interests of investors—the *owners* of the company—with fairness and respect. Similarly, directives to refrain from unlawful discrimination in promotion and compensation address issues of fairness and respect for employees as corporate "stakeholders."

customers, and the communities in which firms operate.[58] Nevertheless, the "treatment-of-stakeholders" category reflects the actual language of many CCOEs that specifically address the interests of certain stakeholder groups and the standards to be observed when dealing with them. Indeed, some codes are essentially structured as a series of promises to discrete stakeholder constituencies.[59] Other codes address stakeholder issues less systematically by means of general commitments to "fair dealing"[60] and/or "good corporate citizenship."[61]

B. Management Structures for Implementation & Enforcement

In addition to the types of content described in the previous section, many corporate codes of ethics include provisions governing code administration and enforcement. Although such provisions take different forms, the CCOEs of large public companies typically give some indication of: (1) who is responsible for administering the code; (2) basic procedures

58. On the subject of stakeholder theory and management, see generally CLARKSON CENTRE FOR BUSINESS ETHICS & BOARD EFFECTIVENESS, THE CLARKSON PRINCIPLES FOR STAKEHOLDER MANAGEMENT, *at* http://www.valuebasedmanagement.net/methods_clarkson_principles.html (last updated Dec. 26, 2004); R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH (1984); ANN SVENDSEN, THE STAKEHOLDER STRATEGY (1998); Thomas Donaldson & Lee E. Preston, *The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications*, 20 ACAD. OF MGMT. REV. 65 (1995).

59. A striking example of this is presented by the Kellogg Company. The outline of its code of ethics reads as follows:

> We act with integrity and show respect to Ourselves and Each Other
> . . . .
> We act with integrity and show respect to Our Customers and Consumers
> . . . .
> We act with integrity and show respect to Our Share Owners
> . . . .
> We act with integrity and show respect in the Marketplace
> . . . .
> We act with integrity and show respect to Our Communities
> . . . .

KELLOGG CO., GLOBAL CODE OF ETHICS 5 (2004), *available at* http://investor.kelloggs.com/downloads/KelloggsCodeOfEthics.pdf; *see also, e.g.*, MARATHON OIL CORP., COMMITMENT TO INTEGRITY: CODE OF BUSINESS CONDUCT (2003) (corporate code of ethics organized according to a stakeholder model), *available at* http://www.marathon.com/content/released/moc_brochure.pdf.

60. *See, e.g.*, BECTON, DICKINSON & CO., BUSINESS CONDUCT AND COMPLIANCE GUIDE 11 (2005) ("You should endeavor to deal fairly with customers, suppliers, competitors, the public and one another at all times and in accordance with ethical business practices."), *available at* http://www.bd.com/investors/pdfs/corporate_governance/business_conduct_compliance_guide.pdf; FLUOR CORP., HR POLICY RE: BUSINESS ETHICS AND CONDUCT Part II.J (2003) ("Employees should deal fairly with Fluor's customers, supplier, competitors and employees."), *at* http://www.fluor.com/investors/cg_conduct.asp#be.

61. *See, e.g.*, FEDERATED DEP'T STORES, INC., CORPORATE POLICIES/POSITIONS ("We will be good corporate citizens."), *at* http://www.federated-fds.com/company/pol.asp (last visited Feb. 9, 2005).

to be followed for reporting and evaluating possible code violations; and (3) sanctions that may be imposed upon those who are found to have violated the code.[62]

For the administration and enforcement of their CCOEs, large public companies are likely to rely on a combination of employees' personal responsibility, managerial oversight, and specialized in-house personnel (such as in-house counsel or designated compliance and/or ethics officers).[63] Many codes expressly state that all employees are responsible for their own compliance and for reporting suspected violations.[64] Indeed, it is not uncommon for CCOEs to set forth a "when-in-doubt" inquiry for employees to follow when deciding whether a given course of conduct is consistent with the letter and spirit of the company's code.[65] Employees are typically admonished, moreover, to raise questions regarding ethics and compliance with their supervisors, in-house counsel, or corporate ethics and/or compliance officers (who may or may not be attorneys).[66]

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62. It should be noted that companies typically do not include detailed information regarding code administration in the code text. In some cases, the management structures and/or procedures governing code administration may be described in other documents. *See, e.g.*, GLAXOSMITHKLINE, THE IMPACT OF MEDICINES: CORPORATE AND SOCIAL RESPONSIBILITY REPORT 2002 29 (referring to management structures for "[t]he Corporate Ethics and Compliance function" in the company's annual corporate social responsibility report), *available at* http://www.GSK.com/financial/reps02/CSR02/index.htm. In other cases, firms may not have detailed formal procedures for the evaluation of code violations. For purposes of this discussion, a corporate code of ethics regime should be understood to encompass the structures and procedures—both formal and informal—established for its administration, whether or not they are included within the four corners of the CCOE text. However, our primary focus is on the CCOE text because it is the CCOE text that may be subject to the disclosure requirements of § 406.

63. *See* Cressey & Moore, *supra* note 9, at 65 tbl.3 (data based on a survey of 119 CCOEs).

64. *See, e.g.*, FIFTH THIRD BANCORP., CODE OF BUSINESS CONDUCT AND ETHICS 9 (2004) (stating that employees "have a duty to adhere to this Code of Business Conduct and Ethics . . . and to report to the Fifth Third any suspected violations by yourself or any other employee, officer or director of Fifth Third"), *available at* http://www.53.com/wcm/resources/file/eb27ed01a81b721/About53_IR_codeofbusinessconductandethics.pdf.

65. For example, one Fortune 500 company's code of ethics offers the following "when-in-doubt" inquiry to its employees:

> When in doubt, ask yourself . . .
> Are my actions legal?
> Am I being fair and honest?
> Will my action stand the test of time?
> How will I feel about myself afterward?
> How will it look in the newspaper?
> Will I sleep soundly tonight?
> Can I explain my action to my child?
> If you are still not sure what to do, ask . . . and keep asking until you are doing the right thing.

INT'L PAPER, CODE OF BUSINESS ETHICS 21 ("Quick Quiz") (ellipses in original), *at* http://www.internationalpaper.com/about_us/people/ethics/cobe.asp (last visited Feb. 10, 2005).

66. *See, e.g.*, THE CHUBB CORP., CODE OF BUSINESS CONDUCT Introduction (2004) (instructing

Some CCOEs indicate that managers bear a special responsibility for implementing the company code by setting a good example, educating employees under their supervision, and/or seeing to it that the code is followed.[67] Other CCOEs refer to "ethics committees," "ethics officers," or other management structures for code implementation and enforcement.[68] However, it is relatively rare for CCOEs to describe code administration, enforcement, or the punishment of violations in any depth.[69] With regard to enforcement and punishment, CCOEs typically state that violators are subject to disciplinary sanctions up to and including dismissal, but offer little more in the way of specifics.[70]

C. Do CCOEs Work?

Although the corporate code of ethics is a well established and ubiquitous form of self-regulation, the efficacy of such codes is a matter of considerable debate. Many believe that CCOEs are effective tools for promoting ethical conduct and/or deterring unethical behavior.[71] An illustrative example that is sometimes cited in support of this position is the Johnson & Johnson corporate credo and the role that it may have played in shaping the company's exemplary response to the Tylenol poisoning scare of the 1980s.[72] Others dismiss corporate codes as empty exercises in

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employees that "[i]f you suspect non-compliance [with the company code], or have a question about the proper course of action in a particular situation, ask your supervisor or manager for advice"), *available at* http://www.chubb.com/investors/codeofconduct.pdf; FLEETBOSTON FINANCIAL CORP., CODE OF BUSINESS CONDUCT AND ETHICS 11 ("Your responsibility is to bring questionable situations to the attention of your manager or to a member of the Law Office or Human Resources Department."), *available at* http://www.fleet.com/downloads/code_ethics_internet.pdf (last visited Feb. 10, 2005).

67. *See, e.g.*, BAXTER INT'L, INC., GLOBAL BUSINESS PRACTICE STANDARDS 5 (2005) (holding managers responsible for employees' adherence to corporate code of conduct), *available at* http://www.baxter.com/about_baxter/sustainability/our_values_and_standards/global_business_practice_standards/downloads/english.pdf; FANNIE MAE, CODE OF BUSINESS CONDUCT 4 (2004), *available at* http://www.fanniemae.com/aboutfm/pdf/codeofconduct.pdf (holding managers responsible for demonstrating their commitment to corporate code of conduct by setting an example and "acting affirmatively to prevent prohibited conduct").

68. *See, e.g.*, FIRSTENERGY CORP., CODE OF BUSINESS CONDUCT 2 (2003) (stating that the company's "Ethics Officer . . . oversees compliance with this Code"), *available at* http://www.firstenergycorp.com/ir/files/CorporatePolicy101.pdf.

69. For an example of an exceptionally detailed description of administrative and enforcement procedures in a corporate code of ethics, see HALLIBURTON CO., CODE OF BUSINESS CONDUCT (2003), *at* http://halliburton.com/about/3_0001.jsp?printMe.

70. *See, e.g.*, BRUNSWICK CORP., ETHICS GUIDE ("[A] violation of the Guide may result in disciplinary action up to, and including, termination and/or legal proceedings."), *at* http://www.brunswick.com/ethics/english/reporting.html (last visited Feb. 10, 2005).

71. *See* Robin et al., *supra* note 24, at 71 (concluding that "codes are still seen by managers as the most viable approach for dealing with ethical problems").

72. *See, e.g.*, FRANCIS J. AGUILAR, MANAGING CORPORATE ETHICS 65–69 (1994) (describing

"window dressing."[73] Enron Corporation, wherein a detailed and famously earnest code of ethics[74] coexisted with a great deal of now infamously unethical conduct,[75] could be offered as "exhibit A" for the "window dressing" view of corporate codes.[76] In fact, as explained below, there is relatively little empirical evidence for either of these positions. Indeed, the traditional "effective-tool-for-promoting-ethical-conduct" versus "window-dressing" dichotomy probably misses much of the actual and potential significance of CCOEs. While it may be difficult, if not impossible, to

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the role of the Johnson & Johnson credo both before and during the Tylenol crisis); DAVID BATSTONE, SAVING THE CORPORATE SOUL 12–13 (2003) (discussing the test faced by the Johnson & Johnson corporate credo); Kenneth H. Blanchard, *Ethics in Management*, *in* TOUCHE ROSS & CO., ETHICS IN AMERICAN BUSINESS: A SPECIAL REPORT 37, 38 (1988) (arguing that "because [Johnson & Johnson's] management had a clear, written ethical credo to guide it, the decision to act in the best interests of the consumer was never in doubt"); LARUE TONE HOSMER , THE ETHICS OF MANAGEMENT 133–135 (4th ed. 2003) (describing the Johnson & Johnson response and asserting that company executives attribute the "prompt and complete response" to the company's credo).

73. *See, e.g.*, AGUILAR, *supra* note 72, at 64 (asserting that "[s]ome codes are mere window dressing"); John Christopher Anderson, *Respecting Human Rights: Multinational Corporations Strike Out*, 2 U. PA. J. LAB. & EMP. L. 463, 489 (2000) (characterizing CCOEs as "public relations gimmicks"); Christopher J. Cowton & Paul Thompson, *Do Codes Make a Difference? The Case of Bank Lending and the Environment*, 24 J. BUS. ETHICS 165, 165 (2000) (observing that "[i]t is not unusual to encounter the cynical assessment that they [CCOEs] are merely an exercise in public relations").

74. *See* ENRON CORP., CODE OF ETHICS 12 (2000) (suggesting that "[m]oral as well as legal obligations will be fulfilled openly, promptly, and in a manner which will reflect pride on the Company's name"), *available at* http://www.thesmokinggun.com/graphics/packageart/enron/enron.pdf.

75. *See generally* DIRK J. BARREVELD, THE ENRON COLLAPSE: CREATIVE ACCOUNTING, WRONG ECONOMICS OR CRIMINAL ACTS? (2002) (chronicling the fallout at Enron); BRIAN CRUVER, ANATOMY OF GREED: THE UNSHREDDED TRUTH FROM AN ENRON INSIDER (2002) (describing the irony of Enron's code of ethics and the reality that would later befall the corporation); LOREN FOX, ENRON: THE RISE AND FALL (2003); PETER C. FUSARO & ROSS M. MILLER, WHAT WENT WRONG AT ENRON: EVERYONE'S GUIDE TO THE LARGEST BANKRUPTCY IN U.S. HISTORY (2002) (detailing the series of missteps that led to Enron's collapse); William C. Powers, Jr. et al., *Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp.* 1 (Feb. 1, 2002), *available at* http://news.findlaw.com/hdocs/docs/enron/sicreport/sicreport020102.pdf [hereinafter Powers Report]; Marianne M. Jennings, *A Primer on Enron: Lessons From a Perfect Storm of Financial Reporting, Corporate Governance and Ethical Culture Failures*, 39 CAL. W. L. REV. 163 (2003); Peter Behr & April Witt, *Concerns Grow Amid Conflicts*, WASH. POST, July 30, 2002, at A1 (detailing many examples of Enron's unsavory conduct); Peter Behr & April Witt, *Hidden Debts, Deals Scuttle Last Chance*, WASH. POST, Aug. 1, 2002, at A1 (describing Enron's collapse after disclosures were made about its misleading profitability reports); Peter Behr & April Witt, *Visionary's Dream Led to Risky Business*, WASH. POST, July 28, 2002, at A1 (categorizing the Enron scandal as devastating to investor faith and as a catalyst for corporate reform); April Witt & Peter Behr, *Dream Job Turns into a Nightmare*, WASH. POST, July 29, 2002, at A1 (recognizing Enron CEO Jeffrey Skilling as a key contributor to Enron's collapse); April Witt & Peter Behr, *Losses, Conflicts Threaten Survival*, WASH. POST, July 31, 2002, at A1 (detailing the happenings at Enron as the extent of its losses became apparent).

76. *See* Ronald R. Sims & Johannes Brinkman, *Enron Ethics (Or: Culture Matters More than Codes)*, 45 J. BUS. ETHICS 243, 254 (2003) (arguing that Enron had a corporate culture of "window-dressing ethics").

establish empirically that CCOEs "work" in the narrow sense that the codes themselves measurably and directly cause employees to behave more ethically, it does not follow that they are ineffective, much less, inconsequential.[77] In practice, companies adopt CCOEs for a variety of reasons and corporate codes of ethics may actually "work" in more complex and subtle ways than the traditional dichotomy suggests.[78]

1. Research Literature Regarding the Influence of Codes on Employee Conduct

For all that is known about the history and content of corporate ethics codes, it is striking how little is known about their efficacy in regulating conduct.[79] To be sure, the empirical research offers some limited support for the proposition that CCOEs promote ethical behavior.[80] On balance, however, the literature is inconclusive,[81] as other studies show little or no

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77. *See* Emily F. Carasco & Jang B. Singh, *The Content and Focus of the Codes of Ethics of the World's Largest Transnational Corporations*, 108 BUS. & SOC'Y REV. 71, 73 (2003) ("Although the research findings on the effectiveness of codes are mixed, the potential value of these instruments in decision-making, together with other benefits . . . cannot be ignored.").

78. *See* Gary R. Weaver, *Does Ethics Code Design Matter?*, 14 J. BUS. ETHICS 367, 369 ("The fact that codes are invoked without clear evidence for their effectiveness in fostering consistently ethical behavior suggests that codes do not function *solely* as tools for encouraging organizational ethics.").

79. *See generally* Cleek & Leonard, *supra* note 4, at 619 ("[V]ery little research has been devoted towards discovering whether [codes] are effective in promoting ethical decision-making behavior."); Donald L. McCabe et al., *The Influence of Collegiate and Corporate Codes of Conduct on Ethics-Related Behavior in the Workplace*, 6 BUS. ETHICS Q. 461, 464 (1996) ("[E]mpirical data on how . . . [CCOEs] influence individual behavior is both limited and mixed."); Betsy Stevens, *An Analysis of Corporate Ethical Code Studies: "Where Do We Go From Here?"*, 13 J. BUS. ETHICS 63, 68 (1994) (reviewing the empirical literature and concluding that there is a "lack [of] solid evidence" regarding the effectiveness of CCOEs).

80. *See, e.g.*, W. Harvey Hegarty & Henry P. Sims, Jr., *Organizational Philosophy, Policies, and Objectives Related to Unethical Decision Behavior: A Laboratory Experiment*, 64 J. APPLIED PSYCHOL. 331, 337 (1979) (concluding from a laboratory experiment that the existence of "a clear organizational policy had a deterring influence on unethical behavior"); McCabe et al., *supra* note 79, at 471 ("[T]he existence of a corporate code of ethics was associated with significantly lower levels of self-reported unethical behavior in the workplace."); Mark John Somers, *Ethical Codes of Conduct and Organizational Context: A Study of the Relationship Between Codes of Conduct, Employee Behavior and Organizational Values*, 30 J. BUS. ETHICS 185 (2001) (concluding from results of a survey of management accountants that the presence of corporate codes of ethics is associated with less perceived unethical conduct).

81. *See* John C. Lere & Bruce R. Gaumnitz, *The Impact of Codes of Ethics on Decision Making: Some Insights from Information Economics*, 48 J. BUS. ETHICS 365 (2003) (concluding that "[t]he evidence from those [code efficacy] studies that have been conducted suggests that codes of ethics apparently do not have a major observable impact on decisions made"); M. Schwartz, *supra* note 4, at 249–50 & tbl.1 (summarizing the results of nineteen code efficacy studies published between 1979 and 1998, the author found that eight showed a significant relationship between CCOEs and ethical behavior, two showed a weak relationship, and nine showed no significant relationship); Weaver, *supra* note 78, at 367 ("[E]vidence on the actual impact of codes is at best mixed."); William A. Weeks &

correlation between corporate codes and ethical conduct.[82] Indeed, there are substantial methodological obstacles to testing the effectiveness of CCOEs with any meaningful precision.[83] Empirical research on the efficacy of corporate codes consists primarily of two types of studies: (1) experimental simulations in which students are asked to respond to ethics questions under various assumptions involving codes; and (2) surveys in which actual corporate employees are asked questions regarding the ethical climates of their firms. The first type of study suffers from the obvious limitation that it is, at best, a simulation of what *might* occur in companies. The second type, although perhaps more reliable in theory, is also methodologically problematic because it is inherently difficult to: (a) determine whether reported answers reflect actual practices or beliefs;[84] and (b) filter out the effects of all of the other factors–in addition to CCOEs–that may influence conduct and perceptions within an organization.[85]

2. Why Companies Have Codes

If it is so difficult to measure the effectiveness of CCOEs in promoting ethical conduct, why do so many firms go to the trouble to draft and

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Jacques Nantel, *Corporate Codes of Ethics and Sales Force Behavior: A Case Study*, 11 J. BUS. ETHICS 753, 753 (1992) ("[R]esearch is inconclusive regarding the effectiveness of . . . formal codes [of ethics] in changing attitudes and behavior.").

82. *See, e.g.*, Lawrence B. Chonko & Shelby D. Hunt, *Ethics and Marketing Management: An Empirical Examination*, 13 J. BUS. RES. 339, 356 (1985) (survey of marketing managers found "no relationship between corporate and industry codes of ethics and the extent of ethical problems" in firms); Cleek & Leonard, *supra* note 4, at 627 (concluding from the results of a survey of business students that "codes of ethics are not powerful enough tools to affect ethical decision-making behavior"); M. Cash Mathews, *Codes of Ethics: Organizational Behavior and Misbehavior*, 9 RES. IN CORP. SOC. PERFORMANCE & POL'Y 107, 125 (1987) (reporting as the principal finding of an empirical study of CCOEs and corporate crime "that there is . . . [no statistically significant] relationship between codes of conduct and corporate violations, contrary to the notion that the codes serve as an effective form of self-regulation").

83. *See* Cressey & Moore, *supra* note 9, at 73 (concluding, based on a content analysis of codes and interviews with auditors of large companies, "that there is no practical way of measuring any effects the codes might have had on the conduct of corporate personnel"); Harris, *supra* note 21, at 327 (arguing that "ethics are not susceptible to being measured or established by mathematical formulae or other quantifiable factors").

84. *See* Weaver, *supra* note 78, at 368 (observing that "[m]easuring ethical or unethical behavior, and in turn linking it to the character of a code, is difficult," in part, because "individuals may be reticent to make known their ethical failings"); *see also* Donna M. Randall & Maria F. Fernandes, *The Social Desirability Response Bias in Ethics Research*, 10 J. BUS. ETHICS 805, 805 (1991) (suggesting that "[d]ue to the sensitive nature of ethics research, the presence of a social desirability response bias may pose an even greater threat to the validity of findings in ethics research than in more traditional organizational behavior research topics").

85. *See generally* Brian J. Farrell et al., 17 J. MANAGERIAL PSYCHOLOGY 468, 469–71 (2002) (noting methodological obstacles to the measurement of codes efficacy); Weaver, *supra* note 14, at 51 (same).

implement them? There are a variety of reasons,[86] but a few are particularly relevant for the present discussion. First, and perhaps most importantly, many managers believe that codes can promote ethical conduct and/or deter unethical conduct, even if the code's influence cannot be precisely measured.[87] The business case for CCOEs was succinctly articulated by the New York Stock Exchange Corporate Accountability and Listing Standards Committee in a recent report as follows: "[W]e believe such a code can focus the board and management on areas of ethical risk, provide guidance to personnel to help them recognize and deal with ethical issues, provide mechanisms to report unethical conduct, and help to foster a culture of honesty and accountability."[88] Second, corporate codes may promote legal compliance by educating employees regarding legal standards and reinforcing the predispositions of those inclined to follow the law.[89] Third, CCOEs function as mechanisms for managing relationships

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86. For example, a study sponsored by the Conference Board found six principal reasons for the adoption of CCOEs: "(1) commitment of the CEO; (2) maintenance of public trust and credibility; (3) greater managerial professionalism; (4) protection against improper employee conduct; (5) need to define ethical behavior in light of new laws or social standards; and (6) change in corporate culture or structure (decentralization, acquisitions, and the like)." RONALD E. BERENBEIM, CORPORATE ETHICS 13–14 (The Conference Board 1987).

87. *See, e.g.*, *id.* at 13 (1987) (reporting, based on a Conference Board survey, that "companies believe that [codes and ethics programs] . . . can help to make employees aware that ethical considerations are factors that ought to be considered along with economic and social pressures in making business decisions"); THE BUSINESS ROUNDTABLE, CORPORATE ETHICS: A PRIME BUSINESS ASSET 5 (1988) (noting the importance of codes in communicating company expectations regarding ethical conduct); TOUCHE ROSS & CO., ETHICS IN AMERICAN BUSINESS: A SPECIAL REPORT 11 (1988) (reporting that 39% of business leaders surveyed saw "adoption of business codes as the most effective way to encourage ethical practices").

88. NEW YORK STOCK EXCH., NEW YORK STOCK EXCHANGE CORPORATE ACCOUNTABILITY & LISTING STANDARDS COMMITTEE 20 (2002), *available at* http://www.nyse.com/pdfs/corp_govreport.pdf [hereinafter NYSE COMMITTEE REPORT].

89. *See* WALTER W. MANLEY II, EXECUTIVE'S HANDBOOK OF MODEL BUSINESS CONDUCT CODES 8 (1991) (recognizing that codes "tell employees what management expects them *not* to do as well as *what* to do") (emphasis in original); Janet S. Adams et al., *Codes of Ethics as Signals for Ethical Behavior*, 29 J. BUS. ETHICS 199, 200 (2001) ("Some codes are . . . legal self-defense mechanisms."); Paul E. Fiorelli, *Winking Through the Blindfold: What Motivates the White-Collar Criminal?*, 21 AKRON L. REV. 327, 333 (1988) (arguing that CCOEs can promote lawful behavior if followed by management and consistently enforced); Schwartz, *supra* note 4, at 255–56 (noting that a CCOE can serve "as a rule-book" and/or "as a shield . . . which allows employees to better challenge and resist unethical requests"); Stevens, *supra* note 79, at 65 (observing that "[s]ome ethical codes are little more than legal barriers and self-defense mechanisms").

It should be noted that under the 1991 Federal Sentencing Guidelines for Organizations, an effective corporate compliance program, which typically includes a CCOE, is a mitigating factor in calculating federal criminal sentences for organizations. *See* UNITED STATES SENTENCING COMM'N, GUIDELINES MANUAL (2003), § 8C2.5(f), § 8A1.2, comment. (n.3(k)), *available at* http://www.ussc.gov/2003guid/tabcon03_1.htm. The Guidelines define an "effective" compliance program as one that has been designed and implemented to show, at a minimum, that the organization has taken the following seven steps: (1) "established compliance standards and procedures"; (2) given with various constituencies of the corporation.[90] Within an organization they may serve, for example, as tools of social control; as instruments for imposing and enforcing organizational conformity upon employees.[91] Alternatively, they may serve as tools of symbolic management for inspiring employee efforts in pursuit of such values as excellence, integrity, or the spirit of innovation.[92] Viewed from a broad managerial perspective, corporate codes may be understood as internal and external market signaling devices.[93] The articulation of ethical commitments in corporate codes may enhance a company's standing with customers, investors, current and prospective employees, government entities, and communities.[94] By

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responsibility for overseeing compliance to high-level personnel within the organization; (3) used due care to avoid delegating authority to those with a propensity to break the law; (4) communicated the standards and procedures effectively to all employees and agents; (5) established systems for achieving compliance through effective monitoring, detection and reporting; (6) consistently enforced the standards "though appropriate disciplinary mechanisms;" and (7) modified the compliance program after detecting offenses to prevent future violations. *Id.* comment. (n.13(k)) The U.S. Sentencing Commission proposed amendments to these Guidelines on April 30, 2004. *See* UNITED STATES SENTENCING COMM'N, AMENDMENTS TO THE SENTENCING GUIDELINES (2004), *available at* http://www.ussc.gov/2004guid/RFMay04.pdf. The amendments regarding effective corporate ethics and compliance programs, which continue and reaffirm the basic framework of the 1991 Guidelines, went into effect on November 1, 2004.

90. *See* MANLEY, *supra* note 89, at 6 (discussing the potential for codes to "*assist managers in controlling business relationships and communicating the firm's expectations to suppliers, customers, and agents*").

91. *See* Laufer & Robertson, *supra* note 15, at 1034 ("Codes of ethics are formal social controls"); Schwartz, *supra* note 4, at 255–56 (noting that a CCOE can serve as a "club" to enforce employee compliance with company rules).

92. *See* Carasco & Singh, *supra* note 77, at 72 ("[A] corporate code of ethics can help to create cohesive corporate culture and provide a mechanism for a corporation to operationalize its values."); Stevens, *supra* note 79, at 64 ("[Corporate codes of ethics] are messages through which corporations hope to shape employee behavior and effect change through explicit statements of desired behavior."); Weaver, *supra* note 14, at 48 (recognizing consideration of discrimination and social welfare in the text of codes).

93. *See* Adams et al., *supra* note 89, at 201 ("The mere presence of a code is an indication that management places some value on ethical behavior; that moral considerations have a place in the organization's functioning; and that consequences, positive and/or negative, may be attached to the ethical dimensions of organizational behavior."); Carasco & Singh, *supra* note 77, at 72 ("[A] [corporate] code of ethics serves the purpose of signaling to shareholders, activists, and the media that a company is committed to ethical behavior.").

94. *See* Don Evans, *The Responsible Care Initiative*, *in* CORPORATE ETHICS: DEVELOPING NEW STANDARDS OF ACCOUNTABILITY 53 (Theresa Brothers ed., The Conference Board 1991) (describing how codes may be of value in attracting employees and enhancing public trust); S. Prakash Sethi, *Codes of Conduct for Multinational Corporations: An Idea Whose Time Has Come*, 104 BUS. & SOC'Y REV. 225, 226 (1999) ("Corporations project these codes as a means of assuring important segments of their stakeholder constituencies, and the public at large, that they conduct their business in a highly ethical and professional manner that goes beyond the prevailing legal standards."); Randi L. Sims, *When Formal Ethics Policies Differ from Informal Expectations: A Test of Managers' Attitudes*, 19 LEADERSHIP & ORG. DEV. J. 386 (1998) (noting a correlation between employee job satisfaction and organizational commitment and codes of ethics).

addressing concerns of actual and potential stakeholders, CCOEs may confer competitive advantage or prevent the loss of competitive advantage.[95]

II. SARBANES–OXLEY & THE LEGAL REQUIREMENTS OF SECTION 406

This Part examines the statutory and regulatory structure of the § 406 code disclosure regime in detail, placing it in the context of U.S securities law, in general, and the Sarbanes–Oxley Act, in particular.

A. Securities Law Background

Disclosure is the core of U.S. securities law.[96] While many lawyers and accountants are gainfully employed navigating the intricacies of U.S.

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95. *See* MANLEY, *supra* note 89, at xiii ("A firm with a code of business conduct often enjoys a competitive advantage with customers over firms that do not have such codes."); Clarence P. Cazalot, Jr., *Creating Competitive Advantage Through Business Ethics*, 18 EXECUTIVE SPEECHES 23, 24–25 (2003) (CEO of Marathon Oil Corporation discussing use of CCOEs for competitive advantage); Sethi, *supra* note 94, at 230 ("Codes of conduct offer an invaluable opportunity for responsible corporations to create an individual and highly positive public identity for themselves, i.e., the 'reputation effect' that can have a direct result to their bottom lines in terms of increased revenues, customer loyalty, expanded markets, productive work force, and a supportive political and regulatory environment"); Curtis C. Verschoor, *A Study of the Link Between a Corporation's Financial Performance and Its Commitment to Ethics*, 17 J. BUS. ETHICS 1509, 1513 (1998) (reporting results of an empirical study showing superior financial performance by companies that emphasized compliance with a corporate code of conduct); *see also* Bryan W. Husted & David B. Allen, *Is it Ethical to Use Ethics as Strategy?*, 27 J. BUS. ETHICS 21, 26 (2000) (noting that corporate "[e]thics and social strategies are kinds of differentiation strategies"); Lynn Sharp Paine, *Does Ethics Pay?*, 10 BUS. ETHICS Q. 319 (2000) ("Increasingly, companies are launching ethics programs, values initiatives, and community involvement activities premised on management's belief that 'Ethics pays.'"); Daniel R. Turban & Daniel W. Greening, *Corporate Social Performance and Organizational Attractiveness to Prospective Employees*, 40 ACAD. MGMT. J. 658, 663 (1997) (concluding that "organizations' corporate social performance is related positively to their reputations and attractiveness as an employer"); DAVID B. MONTGOMERY & CATHERINE A. RAMUS, CORPORATE SOCIAL RESPONSIBILITY REPUTATION EFFECTS ON MBA JOB CHOICE 8 (Stanford Graduate School of Business, Research Paper No. 1805) (2003), *available at* http://gobi.stanford.edu/ResearchPapers/Library/RP1805.pdf (reporting survey results indicating that many MBA students "cared about social responsibility reputations of organizations when considering employment").

96. *See generally* 1 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 172–213 (3d ed. 1998) (discussing the federal corporate disclosure system); JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET 39–40 (3d ed. 2003) (describing disclosure as "the appropriate or inevitable method of regulating corporate finance"). For discussion of the rationale for the U.S. disclosure system, see generally John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717 (1984) (exploring theories justifying a mandatory disclosure system); Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669 (1984) (finding that disclosure helps to eliminate fraud); Joel Seligman, *The Historical Need for a Mandatory Corporate Disclosure System*, 9 J. CORP. L. 1 (1983) (noting that disclosure can be rationalized by reference to a history of fraudulent behavior that shook public confidence in the securities markets).

disclosure requirements,[97] the basic standard is that a public company must disclose on a timely basis everything that a reasonable investor would consider relevant to an investment decision;[98] no material misstatements or omissions are permitted.[99]

U.S. securities law elaborates extensively on this general axiom. Issuers must provide investors with a detailed prospectus when issuing securities.[100] Thereafter, firms whose shares are publicly traded must make additional disclosures at fixed intervals; quarterly and annual reports are required of all companies publicly traded in the U.S.[101] In addition, public companies must make ad hoc disclosures under certain circumstances.[102]

Under this disclosure-driven system, it is not illegal to sell to the public shares in a company that is losing money, has no foreseeable prospects of profits, and may quite possibly fail within a short time. U.S. law requires only that important information be disclosed. Moreover, a vigilant plaintiff's bar stands ready to assist investors harmed by violations of U.S. disclosure rules.[103]

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97. Regulation S-K, 17 C.F.R. § 229.301 (2004), provides intricate instructions for disclosure under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act"). Regulation S-X, 17 C.F.R. § 210 (2004), provides intricate instructions for financial disclosure under the Securities Act and the Exchange Act.

98. *See* TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976) (defining as material a fact about which "there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote").

99. Material misstatements and omissions made in connection with the purchase or sale of securities are prohibited by the Securities and Exchange Commission's Rule 10b-5. 17 C.F.R. § 240.10b-5 (2004); *see also* In re Mobilemedia Sec. Litig., 28 F. Supp. 2d 901, 923 (D.N.J. 1998) ("Together with the Securities Act, the Exchange Act 'embrace[s] a fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of caveat emptor.'") (omission in original) (quoting Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 151 (1972)).

100. *See* 15 U.S.C. §§ 77g, 77j(a), 77aa (2000) (providing standards for information required in registration statements and prospectus).

101. Fixed-interval disclosure requirements are created by various sections of the Exchange Act, depending on an issuer's position. *See* Exchange Act, 15 U.S.C. §§ 78l(a), 78m(a) (2000) (imposing fixed-interval disclosure requirements on companies whose stocks or bonds are traded on any national exchange); 15 U.S.C. § 78l(g)(1) (2000) (imposing fixed-interval disclosure requirements on companies with 500 or more shareholders and stocks traded over the counter, provided per 17 C.F.R. § 240.12g-1 (2004), that the company has at least $10 million in assets); and 15 U.S.C. § 78o(d) (2000) (imposing fixed-interval disclosure requirements on companies selling debt securities pursuant to a registration statement under the Securities Act of 1933 even if those securities are not listed on any exchange, unless there are fewer than 300 bondholders).

102. For example, an issuer of securities is required by SEC Rule 13a-11 to report certain material changes in the issuer's financial condition or method of operations on an ad hoc basis. 17 C.F.R. § 240.13a-11 (2004). Such developments are reported on Form 8-K. *See* THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION § 9.3 (4th ed. 2002) (describing required disclosures under SEC rules).

103. For statistics on U.S. private securities litigation, see Securities Class Action Clearinghouse, *at* http://securities.stanford.edu (last updated Feb. 2, 2005). *Most* private enforcement actions are predicated upon Rule 10b-5, promulgated pursuant to section 10b of the 1934 Exchange Act.

B. Overview of the Sarbanes–Oxley Act

The Sarbanes–Oxley Act of 2002[104] has been described as the most important change in U.S. securities regulation since the New Deal.[105] Like the 1933 Securities Act and the 1934 Exchange Act, Sarbanes–Oxley was adopted in the wake of a crisis in securities markets.[106] It contains a variety of measures aimed at reducing the risks that public companies will "implode in a wave of accounting scandals"[107] of the type that brought down Enron, threatened other large U.S. corporations, and cast doubt over the integrity of information disclosed by companies listed on U.S. securities markets.[108]

In addition to the requirements of §406 concerning CCOEs detailed below, the Sarbanes–Oxley Act mandates, among other things: disclosure in annual reports of material off-balance sheet transactions that may affect the issuer's financial condition;[109] creation of a new U.S. Public Company Accounting Oversight Board;[110] inclusion of a financial expert on an issuer's audit

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See Kardon v. Nat'l Gypsum Co., 73 F. Supp. 798, 802 (E.D. Pa. 1947) (finding an implied private right of action under Rule 10b-5 of the Securities and Exchange Act of 1934); Blue Chip Stamps v. Manor Drug Stores, 421 US 723 (1975) (affirming existence of private right of action under 10b-5).

104. Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

105. *See, e.g.*, Senator Jon S. Corzine, Address to the Consumer Federation of America Financial Services Conference (Dec. 5, 2002), *at* http://corzine.senate.gov/press_office/record.cfm?id=188861 (stating that the Sarbanes–Oxley Act is "the most important securities law[] since the '33 and '34 Acts [Securities Act of 1933 and the Securities and Exchange Act of 1934]"); ERNST & YOUNG, AN OVERVIEW OF THE SARBANES–OXLEY ACT OF 2002 (2002) (asserting that the Act "is the most sweeping securities legislation enacted in the United States in the past 70 years"), *available at* http://www.ey.com/global/download.nsf/Russia_E/EY_Sarbanes_9_12_02e/$file/EY_Sarbanes_9_12_02e.pdf.

106. For background on the Enron debacle, see FOX, *supra* note 75; Jennings, *supra* note 75, at 167; Powers Report, *supra* note 75.

107. This memorable and prophetic phrase was contained in a letter written by Enron executive Sherron Watkins on August 15, 2001 and sent to Enron founder Kenneth Lay. Watkins wrote that she was "incredibly nervous that we will implode in a wave of accounting scandals." Michael Duffy, *What Did They Know and . . . Did They Know It?*, TIME, Jan. 28, 2002, at 16. The letter was sent anonymously, but Watkins' authorship was disclosed in the Enron implosion that she had foretold. *Id.* at 19.

108. *See* Public Company Accounting Reform and Investor Protection Act of 2002, Comm. on Banking, Housing, and Urban Affairs, S. REP. NO. 107-205, at 2 ("The purpose of the bill [the Senate bill that became the Sarbanes–Oxley Act] is to address the systemic and structural weaknesses affecting our capital markets which were revealed by repeated failures of audit effectiveness and corporate financial and broker-dealer responsibility in recent months and years.") For detailed descriptions of the statutory provisions of the Sarbanes–Oxley Act, see KPMG, SARBANES–OXLEY: A CLOSER LOOK (2003).

109. 15 U.S.C. § 7261 (Supp. II 2002).

110. § 7211.

committee;[111] trading blackout periods for executives and directors when other employees are subject to blackout periods in connection with their participation in defined contribution pension plans;[112] certification by CEOs and CFOs of the accuracy of annual or periodic reports filed with the SEC;[113] and disgorgement by CEOs and CFOs of certain compensation if financial reports are restated.[114]

C. Section 406 and the SEC's Associated Regulations

Section 406 of the Sarbanes–Oxley Act[115] and the SEC's associated rules[116] comport with the basic disclosure-driven approach of U.S. securities law. In essence, they impose a few more specific disclosure obligations on public companies. For the first time, information concerning a particular type of corporate code of ethics (a "§ 406 code") must be

111. § 7265.

112. § 7244.

113. § 7241.

114. § 7243.

115. The full text of § 406 of the Act reads as follows:

> CODE OF ETHICS FOR SENIOR FINANCIAL OFFICERS
>
> (a) CODE OF ETHICS DISCLOSURE—The Commission shall issue rules to require each issuer, together with periodic reports required pursuant to sections 78m(a) or 78o(d) of this title, to disclose whether or not, and if not, the reason therefore, such issuer has adopted a code of ethics for senior financial officers, applicable to its principal financial officer and comptroller or principal accounting officer, or persons performing similar functions.
>
> (b) CHANGES IN CODES OF ETHICS—The Commission shall revise its regulations concerning matters requiring prompt disclosure on Form 8-K (or any successor thereto) to require the immediate disclosure, by means of the filing of such form, dissemination by the Internet or by other electronic means, by any issuer of any change in or waiver of the code of ethics for senior financial officers.
>
> (c) DEFINITION—In this section, the term "code of ethics" means such standards as are reasonably necessary to promote—
>
> (1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
>
> (2) full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and
>
> (3) compliance with applicable governmental rules and regulations.
>
> (d) DEADLINE FOR RULEMAKING—The Commission shall—
>
> (1) propose rules to implement this section, not later than 90 days after the date of enactment of this Act [July 30, 2002]; and
>
> (2) issue final rules to implement this section, not later than 180 days after that date of enactment [July 30, 2002].

15 U.S.C. § 7264 (2003).

116. *See* Disclosure Required by Sections 406 and 407 of the Sarbanes–Oxley Act of 2002, 68 Fed. Reg. 5110 (Jan. 31, 2003) (detailing final rules regarding disclosure), *available at* http://www.sec.gov/rules/final/33-8177.htm.

disclosed. Although the ethics code disclosure requirement was enacted by Congress without significant debate, the Senate Committee on Banking, Housing, and Urban Affairs concisely summarized the purpose and substance of the provision that later became § 406 of the Sarbanes–Oxley Act as follows:

> The problems surrounding Enron Corp. and other public companies raise concerns about the ethical standards of corporations and their senior financial managers. The Committee believes that investors have a legitimate interest in knowing whether a public company holds its financial officers to certain ethical standards in their financial dealings. The bill requires issuers to disclose whether or not they have adopted a code of ethics for senior financial officers and, if not, why not.[117]

There is no requirement that an issuer *adopt* a § 406 code. However, if an issuer does not have a code that complies with § 406, the firm must disclose that it does not have one and publicly explain why.[118] If an issuer does have a code that meets the statutory definition in § 406, it must now make that code public.[119] Also, public companies must now disclose two types of events related to § 406 codes. An issuer must disclose, within five days of such action, any: (1) material amendment to a § 406 code; or (2) grant of a waiver of the provisions of such a code.[120]

Although the relevant legislative history is too sparse to provide much in the way of guidance regarding congressional intent, it appears that the § 406 waiver reporting requirement was prompted, at least in part, by certain specific events that came to light in the investigations of the Enron implosion. Enron had a celebrated corporate code of ethics that prohibited, among many other things, conflicts of interest.[121] Although Enron's CCOE

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117. SENATE COMM. ON BANKING, HOUSING, & URBAN AFFAIRS PUBLIC COMPANY ACCOUNTING REFORM AND INVESTOR PROTECTION ACT OF 2002, S. REP. NO. 107-205, at 32. The Senate bill language regarding the code disclosure requirement was also briefly noted in the Congressional Record by one of the Sarbanes–Oxley Act's principal authors, Senator Paul Sarbanes:

> This is a small item, but it may have a good benefit. We require public companies to disclose to the investors whether they have adopted a code of ethics for senior financial officers . . . . We don't require them to have a code of ethics, although we think they should. We just require that they disclose whether they have one or not.

148 CONG. REC. S6333 (daily ed. July 8, 2002).

118. Sarbanes–Oxley Act of 2002, § 406(a), 15 U.S.C. 7264(a) (Supp. II 2002).

119. *Id.*

120. *Id.* § 406(b), 15 U.S.C. 7264(b).

121. *See* ENRON CORP., CODE OF ETHICS, *supra* note 74, at 12 ("An employee shall not conduct himself or herself in a manner which directly or indirectly would be detrimental to the best interests the

barred transactions of the type in which Enron CFO Andrew Fastow had personal interests adverse to Enron's, many such transactions nonetheless occurred.[122] The Enron board of directors granted several waivers of its CCOE so that Fastow could be on both sides of certain transactions.[123] He was simultaneously the Enron CFO and a principal in various special-purpose entities intended to keep financial information off Enron's balance sheets.[124] If § 406 and the SEC's associated regulations had been in effect at the time, Enron would have been required to disclose waivers—including "implicit" waivers—of the company's code.[125]

1. What Is a Section 406 Code?

A document qualifies as a § 406 code if: (1) it meets the SEC's definition of a "code of ethics"; and (2) it applies to certain designated persons.

Pursuant to § 406, the SEC has defined a "code of ethics" as:

> [W]ritten standards that are reasonably designed to deter wrongdoing and to promote:
> (1) Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
> (2) Full, fair, accurate, timely, and understandable disclosure in reports and documents that a registrant files with, or submits to, the Commission and in other public communications made by the registrant;
> (3) Compliance with applicable governmental laws, rules and regulations;
> (4) The prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and
> (5) Accountability for adherence to the code.[126]

Company or in a manner which would bring to the employee financial gain separately derived as a direct consequence of his or her employment with the Company.").

122. *See generally* Powers Report, *supra* note 75, at 9 (detailing Enron's unethical conduct).

123. PERMANENT SUBCOMM. ON INVESTIGATIONS, SENATE COMM. ON GOVT'L AFFAIRS, THE ROLE OF THE BOARD OF DIRECTORS IN ENRON'S COLLAPSE, S. Rep. No. 107-70, at 25–38 (2002), *available at* http://www.senate.gov/~gov_affairs/070902enronboardreport.pdf.

124. *See generally* Jennings, *supra* note 75, at 180–83 (describing Fastow's involvement in "off the books" partnerships).

125. The Commission's rules regarding the disclosure of waivers from § 406 codes of ethics are discussed in Part II(c)(3), *infra*, and accompanying notes.

126. (Item 406) Code of Ethics, 17 C.F.R. § 229.406(b) (2003).

The definition of a § 406 code adopted in the SEC's final rule is relatively minimalist by design.[127] However, the agency "strongly encourage[s] companies to adopt codes that are broader and more comprehensive than necessary to meet the new disclosure requirements."[128] It is also notable that the Commission's definition, tracking the language of the statute,[129] directs that a corporate code of ethics should promote "honest and ethical conduct" and not simply compliance with the law.[130]

Besides meeting the content requirements set forth above, a CCOE must also apply to certain persons in order to qualify as a § 406 code. The SEC's rules provide that a § 406 code is one that applies to a company's "principal executive officer, principal financial officer, principal accounting

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127. In response to public comments urging the agency to require additional, specific code content, the Commission explained its approach as follows:

> We are not adopting commenters' suggestions that we set forth additional ethical principles that the code of ethics should address. *We continue to believe that ethics codes do, and should, vary from company to company and that decisions as to the specific provisions of the code, compliance procedures and disciplinary measures for ethical breaches are best left to the company.* Such an approach is consistent with our disclosure-based regulatory scheme. Therefore, the rules do not specify every detail that the company must address in its code of ethics, or prescribe any specific language that the code of ethics must include.

Disclosure Required by Sections 406 and 407 of the Sarbanes–Oxley Act of 2002, 68 Fed. Reg. 5110, 5118 (Jan. 31, 2003), *available at* http://www.sec.gov/rules/final/33-8177.htm

128. *Id.*

129. *See* Sarbanes–Oxley Act of 2002, § 406(c), 15 U.S.C. 7264(c) (Supp. II 2002), (defining the term "code of ethics" to mean "such standards as are reasonably necessary to promote . . . honest and ethical conduct").

130. 17 C.F.R. § 229.406(b)(1). In a recently published report, the Ad Hoc Advisory Group on the Organizational Sentencing Guidelines emphasized the significance of this normative element in the SEC's definition:

> [The Commission's] description of the necessary elements of a code of ethics differs from prior regulatory standards for compliance codes in several key respects. As the name of the new code implies, *the SEC standards call for an ethics oriented code, not just one aimed at achieving law compliance*. Indeed, law compliance is treated as a subset of the broader body of ethical behavior that should be required under a code of ethics.

UNITED STATES SENTENCING COMM'N, REPORT OF THE AD HOC ADVISORY GROUP ON THE ORGANIZATIONAL SENTENCING GUIDELINES 40 (Oct. 7, 2003) (emphasis added), *available at* http://www.ussc.gov/corp/advgrprpt/AG_FINAL.pdf

The admittedly subtle difference between a compliance-oriented definition and a more "ethics oriented" approach may be illustrated by comparing the Commission's § 406 "code of ethics" definition with the "code of ethics" definition promulgated by the SEC in another regulatory context. Pursuant to the Investment Company Act of 1940, as amended, 15 U.S.C. § 80a-17(j), the SEC's rules require investment companies and their investment advisors to adopt a "written code of ethics." 17 C.F.R. § 270.17j-1(c)(1)(i) (2004). The Commission's definition of a "code of ethics" for investment companies deals exclusively with legal compliance and makes no reference to the promotion of *honest and ethical* conduct, as distinguished from *unlawful* conduct. 17 C.F.R. § 270.17j-1(b)–(c), 17 C.F.R. § 229.406(b).

officer or controller, or persons performing similar functions."[131] In other words, a § 406 code applies, at a minimum, to an issuer's CEO and CFO.

By defining a § 406 code as one applicable to CEOs, the SEC's rule-making arguably broadened the reach of the statutory provision. By its literal terms, § 406 applies only to CCOEs "for senior financial officers."[132] The statute refers to a code that is "applicable to [an issuer's] principal financial officer and comptroller or principal accounting officer, or persons performing similar functions."[133] Thus only the SEC rules, not the statute, refer to "principle executive officer[s]." The SEC reasoned that CEOs ought to be held "to at least the same standards of ethical conduct" as senior financial officers.[134]

2. The Mechanics of Disclosing a Section 406 Code

The SEC rules allow a § 406 code to be disclosed in any of three alternative ways. A firm may disclose its § 406 code as an exhibit to its annual report.[135] A company also has the option of posting its § 406 code on the investor relations section of its website, provided that in a prior annual report the company announces that its § 406 code will be posted there and provides the relevant internet address.[136] Alternatively, a firm may promise in its annual report to provide a free copy of its § 406 code to anyone making such a request.[137]

3. Disclosure of Waivers and Amendments to Section 406 Codes

Once the § 406 code has been made available, any material amendments to it or waivers of its provisions must be disclosed.[138] Under the SEC's rules, "the term 'waiver' . . . [means] the approval by the

131. 17 C.F.R. § 229.406(a).

132. Sarbanes–Oxley Act of 2002, § 406(a), 15 U.S.C. 7264(c) (Supp. II 2002).

133. *Id.*

134. Disclosure Required by Sections 406 and 407 of the Sarbanes–Oxley Act of 2002, 68 Fed. Reg. 5110, 5118 (Jan. 31, 2003), *available at* http://www.sec.gov/rules/final/33-8177.htm; *see also Testimony Concerning Implementation of the Sarbanes-Oxley Act of 2002 before the Senate Comm. on Banking, Hous. and Urban Affairs*, *supra* note 3, at Part III.C.2 (explaining that "[g]iven the role of the CEO in setting the 'tone at the top,' the Commission also included a company's principal executive officer in its final rules").

135. 17 C.F.R. § 229.406(c)(1).

136. § 229.406(c)(2).

137. § 229.406(c)(3).

138. Disclosure Required by Sections 406 and 407 of the Sarbanes–Oxley Act of 2002, 68 Fed. Reg. 5110, 5119, 5128 (Jan. 31, 2003), *available at* http://www.sec.gov/rules/final/33-8177.htm. The SEC has provided that "[t]he registrant does not need to disclose technical, administrative or other non-substantive amendments to its code of ethics." *Id*. at 5129.

company of a material departure from a provision of the code of ethics."[139] The Commission's rules also provide that an "implicit waiver" must be disclosed. An "implicit waiver" is defined "as the registrant's failure to take action within a reasonable period of time regarding a material departure from a provision of the code of ethics that has been made known to an executive officer . . . of the registrant."[140]

Again, the SEC has provided alternative means of making such disclosure. As with other ad-hoc disclosures, the issuer may use form 8-K.[141] Alternatively, the issuer could disclose amendment to or waiver of its code on the firm's website.[142] As with internet disclosure of a § 406 code, disclosure of amendments or waivers to the code require that in a prior annual report the issuer announced that information concerning its § 406 code will be disclosed via the web and that an internet address for such disclosure was provided.[143]

III. SECTION 406 AND CORPORATE LIABILITY

This Part considers whether the § 406 code disclosure regime changes the legal environment for public companies with regard to liability under the federal securities laws.

A. CCOEs and Civil Liability under Section 406

Do § 406 and the SEC's associated rules expand the scope of corporate liability? Nothing in the text of the statute, the SEC's rules, or the legislative history indicates any such change was intended by Congress or the SEC. Indeed, the official record is completely silent as to how adoption of a CCOE and its disclosure (or disclosure of waivers or amendments to it) might affect corporate liability. This may reflect a sense in Congress and the SEC that no changes in liability exposure are likely to result from the requirements of § 406. Such an inference is supported by a comparison between the SEC's rules for sections 406 and 407 of the Sarbanes–Oxley Act, both of which were addressed in the same Agency Release.[144] In contrast to the silence on liability issues related to § 406, the SEC expressly created a "safe harbor" from liability for persons designated as audit committee "financial experts" in connection with § 407 of the Sarbanes–

139. *Id.* at 5120.
140. *Id.*
141. *Id.* at 5119, 5128.
142. *Id.* at 5119, 5129.
143. *Id.*
144. *Id.* at 5110.

Oxley Act.[145] If the SEC had wished to avoid the creation of any new liability through disclosure of a CCOE pursuant to § 406, it could have created a similar safe harbor. The fact that it did not seems to suggest that the SEC did not anticipate any new fountain of liability from § 406.[146] Alternatively, the SEC might have anticipated that disclosures under § 406 could lead to liability risks, but did not wish to curtail them. However, there is nothing in the language of the statute, the regulations, or their associated legislative history to indicate that the SEC contemplated an increase in issuer liability risks arising from the § 406 code disclosure regime.

Despite the statutory and regulatory silence, it is possible, though unlikely, that significant new liability risks with respect to CCOEs could arise because of § 406 and the SEC's associated rules.[147] After all, Rule 10b-5,[148] the workhorse anti-fraud provision of U.S. securities law from which a great deal of litigation has arisen, provides no express private cause of action and was adopted by the SEC almost without comment.[149] The

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145. The safe harbor provision promulgated by the Commission pursuant to § 407 states:

> The designation or identification of a person . . . pursuant to this Item . . . does not impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the audit committee and board of directors in the absence of such designation or identification.

17 C.F.R. § 229.401(h)(4)(ii) (2004).

146. In the Release explaining its final rules implementing section 406 and section 407, the SEC specifically noted that it had adopted the safe harbor provision in response to potential liability concerns raised in public comments regarding its proposed rules for the implementation of § 407. 68 Fed. Reg. at 5116–17. The Release is devoid of any discussion of liability in connection with the rules issued to implement section 406.

147. There is general language in the Sarbanes–Oxley Act that gives the SEC the authority to enforce the Act and rules adopted pursuant to the Act. *See* Sarbanes–Oxley Act of 2002, § 3(b)(1) (2002), 15 U.S.C. 7202(b)(1) (Supp. II 2002) ("A violation by any person of this Act, any rule or regulation of the [SEC] issued under this Act . . . shall be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934 or the rules and regulations issued thereunder . . . .").

148. Rule 10b-5 provides:

> 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 national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) 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
>
> (c) 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.

17 C.F.R. § 240.10b-5 (2004).

149. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 767 (1975) (Blackmun, J., dissenting) (recounting "the apparently casual origins of the Rule"); Kardon v. Nat'l Gypsum Co., 73 F.

Supreme Court has described the rule as "a judicial oak which has grown from little more than a legislative acorn."[150] Perhaps § 406 and the SEC's associated rules will grow to similar unforeseen proportions. Indeed, one commentator suggests that because of § 406, "the legal risks associated with codes have increased dramatically" and anticipates that the effect of disclosing more information about corporate codes will be to encourage corporations to adopt very broad, general CCOEs that will generate few reportable waivers.[151]

But there are reasons to be skeptical about the potential of § 406 and the SEC's related rules to create new risks of liability. In recent years, courts have become much more reluctant to find implied private rights of action than they previously were.[152] The *Cort v. Ash* case established a test for determining when it is appropriate to find implied rights to private causes of action in a statute.[153] Congressional intent has become the controlling factor in the subsequent application of the *Cort* test,[154] and there

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Supp. 798, 802 (E.D. Pa. 1947) (finding an implied private right of action).

150. *Blue Chip Stamps*, 421 U.S. at 737.

151. Note, *The Good, the Bad, and Their Corporate Codes of Ethics: Enron, Sarbanes–Oxley, and the Problems with Legislating Good Behavior*, 116 HARV. L. REV. 2123, 2139 (2003). If an issuer is concerned that it will incur significant liability risks because of adoption of a CCOE, it could of course elect not to adopt one. Section 406 does not require a code; it requires only that an explanation be given for electing not to adopt CCOEs applicable to senior financial officers. Sarbanes–Oxley Act of 2002, § 406(a), 15 U.S.C. 7264(a) (Supp. II 2002). A corporation need only proffer as its explanation for having done so that it judged the liability risks to exceed the benefits.

152. *See* Randall W. Quinn & Paul Gonson, *The Development of the Securities Law in the Supreme Court: The Definition of a "Security" and the Implication of Private Rights of Action*, 35 HOW. L.J. 319, 333–342 (1992) ("Implying new rights in order to effectively enforce a statute, however, seems dead."); Susan J. Stabile, *The Role of Congressional Intent in Determining the Existence of Implied Private Rights of Action*, 71 NOTRE DAME L. REV. 861, 870–71 (1996) (explaining that "[r]ather than saying that if the legislature said nothing and the plaintiff was otherwise without an adequate remedy courts may imply a private right of action, recent cases suggest that a private plaintiff has no cause of action unless the statute grants one or there is clear congressional intent to grant one"); Note, *Implied Private Rights of Action under Federal Statutes: Congressional Intent, Judicial Deference, or Mutual Abdication?*, 50 FORDHAM L. REV. 611, 618 (1982) (considering a concurring opinion by Justice Rehnquist arguing that Congress should control when private parties have a cause of action).

153. The U.S. Supreme Court articulated a four-part inquiry:

> In determining whether a private remedy is implicit in a statute not expressly providing one, several factors are relevant. First, is the plaintiff 'one of the class for whose *especial* benefit the statute was enacted,'—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law . . . ?

Cort v. Ash, 422 U.S. 66, 78 (1975) (citations omitted).

154. *See* Stabile, *supra* note 152, at 868 n.39 (noting that subsequent cases applying the four-factor *Cort* test indicate that the Court "regards all of the *Cort* factors only as indicators of congressional intent").

is no indication in the text and legislative history of § 406 that Congress intended to create a private cause of action to sue based on CCOEs or their implementation.[155]

Of course, nothing precludes a plaintiff from testing the judicial waters by bringing a private lawsuit alleging securities fraud that is in some way related to a § 406 corporate code of ethics. As a general matter, if an issuer makes a material misstatement or omission, aggrieved investors can seek redress under Rule 10b-5.[156] Thus, if an issuer makes a material omission with respect to its CCOE, for example, by failing to report a waiver or substantial CCOE amendment as § 406 requires, then such an omission, if deemed material,[157] could conceivably be actionable in civil litigation. However, the specific disclosure called for by § 406 may be superfluous in terms of giving an aggrieved investor a basis for litigation. If, for example, an issuer fails to disclose a waiver of a CCOE as required by § 406, the activity occasioning the need for the waiver may itself be material and therefore subject to a disclosure obligation independent of the obligation under § 406. In the Enron case, for instance, if § 406 and the SEC's associated rules had already been in effect, the company would have been required to disclose the waivers of Enron's CCOE conflict of interest provisions allowing Andrew Fastow to have interests adverse to Enron in transactions between Enron and certain special purpose entities.

Failure to disclose such waivers in violation of § 406 could be material omissions actionable under Rule 10b-5. However, aside from failure to disclose the waivers pursuant to § 406, both the failure to disclose the *transactions themselves* and Fastow's role in them would seem to be material omissions. Thus a Rule 10b-5 claim might well exist under such circumstances even without the added disclosure obligation created by § 406. Indeed, if Enron had disclosed the waivers of its CCOE, but had not

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155. The Supreme Court's decision in *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979), may be relevant to the disposition of any future attempt to bring a claim for damages under § 406. In that case, the defendant was sued by customers of a broker dealer for improperly auditing and certifying financial statements that the broker was required to file with the SEC pursuant to § 17(a) of the Exchange Act. 15 U.S.C. § 78q(a) (2003). *Id.* at 565–66. The Court held in that case that § 17(a) did not provide an implied private cause of action because it "grants no private rights to any identifiable class and proscribes no conduct as unlawful" and there was no evidence in the legislative history of congressional intent to provide a cause of action. *Id.* at 576. The same could be said of § 406.

156. *See* Miller v. Champion Enters., Inc., 346 F.3d 660, 671 (6th Cir. 2003) ("In order to state a claim pursuant to Section 10(b) of the Exchange Act and Rule 10b-5, 'a plaintiff must allege, in connection with the purchase or sale of securities, the misstatement or omission of a material fact, made with scienter, upon which the plaintiff justifiably relied and which proximately caused the plaintiff's injury.'") (quoting Hoffman v. Comshare, Inc., 183 F.3d 542, 548 (6th Cir. 1999)).

157. *See* Basic Inc. v. Levinson, 485 U.S. 224, 238 (1988) ("[I]n order to prevail on a Rule 10b-5 claim, a plaintiff must show that the statements were *misleading* as to a *material* fact. It is not enough that a statement is false or incomplete, if the misrepresented fact is otherwise insignificant.").

adequately detailed the transactions, material omissions would still seem to exist despite any technical compliance with § 406.[158] Therefore it seems the significance of § 406 is that it will signal interested investors when an issuer grants waivers of its CCOE, not that it will provide any meaningful *additional* grounds for liability in many cases.

In sum, the changes in the legal environment wrought by § 406 could be significant, but they are unlikely to be transformative with regard to liability.

IV. The Impact of the New Disclosure Regime

This Part assesses some of the more readily observable effects of § 406, focusing specifically on how the statute and implementing regulations are affecting code content (i.e., the rhetoric and design of CCOEs), transparency, and the diffusion of corporate codes to broader groups of actual and potential stakeholders. Although the SEC's regulations have only been in effect for a short time, § 406 is already having a discernable impact on the content of some corporate codes and, more importantly, upon code transparency.

A. Changes in Code Rhetoric and Design

Looking at the press coverage and commentary on the Sarbanes–Oxley Act and implementing regulations for some indication of the initial reaction to § 406, it seems fair to say that it did not create any great seismic stir in the business or legal communities. Other elements of the Sarbanes-Oxley Act, such as the establishment of the Public Accounting Oversight Board,[159] CEO certification requirements for certain SEC filings,[160] and auditor

158. It is interesting to note in this regard that Enron did disclose in public SEC filings the existence of the now-infamous "LJM partnerships" engineered by Fastow. However, as explained in the Powers Report, "these disclosures were obtuse, did not communicate the essence of the transactions completely or clearly, and failed to convey the substance of what was going on between Enron and the partnerships. The disclosures also did not communicate the nature or extent of Fastow's financial interest in the LJM partnerships." Powers Report, *supra* note 75, at 17. In other words, the disclosures of the LJM partnerships contained untrue statements and material omissions.

159. *See generally* Neil H. Aronson, *Preventing Future Enrons: Implementing the Sarbanes-Oxley Act of 2002*, 8 STAN. J.L. BUS. & FIN. 127, 132–38 (2002) ("Some of the most extensive changes mandated by the SOA to the public market system are those affecting public accounting firms, particularly the establishment of a Public Company Accounting Oversight Board . . . ."); Stephen Labaton, *U.S. Auditing Oversight Board Begins Policing Role by Settling on Procedure*, N.Y. TIMES, Oct. 8, 2003, at C1 (focusing on the establishment of the Public Company Accounting Oversight Board).

160. *See generally* Brian Kim, *Recent Development: Sarbanes-Oxley Act*, 40 HARV. J. ON LEGIS. 235, 245 (2003) (exploring "new obligations on corporate executives in the form of certifications"); Krissah Williams, *CEOs Crafting Ways to Verify Finances*, WASH. POST, Aug. 14, 2002, at E1

independence provisions[161] have attracted far more attention. Nevertheless, it is clear that § 406 has already influenced the language and design of some corporate codes. In some cases, companies that had corporate codes of ethics before Sarbanes–Oxley have issued supplemental "§ 406 codes" for senior financial officers (adding to, but not replacing, their existing corporate codes of ethics) that closely track the language of the statute and the regulations.[162] One such supplemental § 406 code reads, in relevant part:

> The Company's Code of Conduct applies to all directors and employees of the Company, including the Chief Executive, the Chief Financial Officer, the Principal Accounting Officer and other senior financial officers. In addition to being bound by the Code of Conduct's provisions . . . we have adopted the following Code of Ethics specifically for our Chief Executive and senior financial officers.
>
> 1. You are responsible for full, fair, accurate, timely and understandable financial disclosure in reports and documents filed by the Company with the Securities and Exchange Commission and in other public communications made by the Company. . . .
>
> 2. You are responsible for the Company's system of internal financial controls. . . .
>
> 3. You may not compete with the Company . . . .
>
> 4. The Company is committed to complying with both the letter and the spirit of all applicable laws, rules and regulations. You shall promptly bring to the attention of the General Counsel and the Audit Committee any information you may have concerning evidence of a material violation of the securities or other laws, rules or regulations applicable to the Company or its employees or agents. You shall promptly bring to the attention of the General Counsel and the Audit Committee any information

(detailing the unique efforts CEOs have made to verify their financial statements in the wake of the Sarbanes–Oxley Act).

161. *See generally* Jonathan D. Glater, *Worry Over a New Conflict for Accounting Firms*, N.Y. TIMES, Sept. 23, 2003, at C1 (considering how auditors are reacting to the Sarbanes–Oxley Act); Gordon S. Kaiser & Terrence G. Perris, *Auditor Independence*, NAT'L L.J., Mar. 31, 2003, at B8 ("The [S]arbanes–[O]xley [A]ct imposes important new responsibilities on the audit committees regarding nonaudit work performed by the company's outside financial auditors.").

162. *E.g.*, ALLIED WASTE INDUS., INC., CODE OF ETHICS FOR THE EXECUTIVE AND SENIOR FINANCIAL OFFICERS (2003), *available at* http://media.corporate-ir.net/media_files/IROL/74/74587/corpgov/codeofethics.pdf; AON CORP., CODE OF ETHICS FOR SENIOR FINANCIAL OFFICERS, *at* http://www.aon.com/about/corp_governance/sfo_code.jsp (last visited Feb. 11, 2005); CITIGROUP INC., CITIGROUP CODE OF ETHICS FOR FINANCIAL PROFESSIONALS (2003), *available at* http://www.citigroup.com/citigroup/corporategovernance/data/codeofethics.pdf.

> you may have concerning any violation of this Code of Ethics. The Board of Directors may determine, or designate appropriate persons to determine, appropriate additional disciplinary or other actions to be taken in the event of violations of this Code of Ethics by the Company's Chief Executive or senior financial officers and a procedure for granting any waivers of this Code of Ethics.[163]

Other firms have revised their existing codes to comply with the requirements of § 406. Some of the revised codes now include a specific, designated part or section that functions as a code within a code. One example is a § 406 code for senior financial officers within a broader code of ethics that applies to all employees.[164] Other codes have been revised to acknowledge and/or reflect § 406 without designating a specific part of the code to apply solely to senior financial officers.[165]

On the whole, the changes in code content that have been made in response to § 406 appear to be relatively modest. Nor should this come as a surprise. It will be recalled from the discussion in Part II that the SEC's implementing regulations for § 406 include content requirements set forth in the Commission's definition of the term "code of ethics."[166] However, as explained above, when the SEC went through the process of drafting the regulations implementing § 406, the agency specifically chose to refrain from dictating more than minimum, baseline code content including: maintaining honest and ethical conduct, avoiding conflicts of interest, following the law and the company code, reporting code violations, and assuring the accuracy of the information disclosed to the Commission and

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163. AT&T CORP., CODE OF ETHICS FOR CHIEF EXECUTIVE AND SENIOR FINANCIAL OFFICERS (2003), *at* http://www.att.com/ir/cg/cecesfo.html.

164. *See, e.g.*, GOLDMAN SACHS GROUP, INC., CODE OF BUSINESS CONDUCT AND ETHICS (2005) (explaining that "[f]or purposes of Section 406 of the Sarbanes–Oxley Act of 2002 and the rules promulgated thereunder, Section I of this Code shall be our code of ethics for Senior Financial Officers"), *available at* http://www.gs.com/our_firm/investor_relations/corporate_governance/articles/corporate_governance_030224195742.html.

165. *See, e.g.*, ALLSTATE CORP., *supra* note 30, at 1 (applying generally to "every Allstate employee," but also to "the Chief Executive Officer, Chief Financial Officer, Controller, [and] other senior financial and executive officers" essentially tracking the language of the SEC's § 406 regulations); AVON PRODUCTS, INC., *supra* note 35, at 9 (stating that readers of the company code should "be aware that [pursuant to § 406] Avon is required to make a public filing with the SEC within two business days of the terms of any waiver of the Code that is granted to any Executive Officer or member of the Board of Directors") (underlining in original); HCA INC., CODE OF CONDUCT 4–5 (2003) (noting disclosure requirements of § 406 and stating that the CEO and senior financial officers are covered by the company's code of conduct), *available at* http://www.ec.hcahealthcare.com/CPM/RevisedCodeofConduct-EffectiveApril152003.pdf.

166. *See supra* notes 126–27 and accompanying text.

to the public.[167] Although the regulations offer a useful baseline—particularly for firms that are drafting a code for the first time—the SEC has left it to individual companies to fill in the details regarding code structure and content.[168]

B. Changes in Code Transparency

Although § 406 mandates some basic code content, it is more fundamentally concerned with transparency.[169] Firms are unlikely to elect the option of explaining why they have chosen *not* to adopt a code of ethics for senior financial officers.[170] Therefore, § 406 is, in effect, a legal requirement for companies subject to the statute and regulations to make public their formal ethical commitments with regard to senior financial officers, in a manner that is accessible to any interested person. The rules of express and implied waivers further enhance transparency by requiring public companies to disclose any instance in which a corporate decision does not comply with a code of ethics.[171]

To be sure, before § 406 many firms adopted and disclosed codes of ethics in the absence of any legal requirement to do so. However, many other firms did not.[172] In some cases, companies that did not have formal, written corporate codes of ethics before Sarbanes–Oxley have adopted corporate codes or are now in the process of developing such documents.[173] In other cases, firms whose codes were non-public before Sarbanes–Oxley have made, or are in the process of making, their codes public.[174] The

167. *Id.*

168. *Id.*

169. For a useful definition of "transparency" in the context of corporate conduct, see DON TAPSCOTT & DAVID TICOLL, THE NAKED CORPORATION: HOW THE AGE OF TRANSPARENCY WILL REVOLUTIONIZE BUSINESS 22 (2003) (defining "transparency" as "the *accessibility of information to stakeholders of institutions, regarding matters that affect their interests*").

170. This research has not revealed a single instance to date of a public company that has elected the option, available under § 406, of disclosing that it has no code of ethics for senior financial officers and explaining why it has chosen not to adopt one.

171. *See supra* Part II.C.3.

172. *See* Patrick E. Murphy, *Corporate Ethics Statements: Current Status and Future Prospects*, 14 J. BUS. ETHICS 727, 733 (1995) (reporting that 53% of surveyed firms with CCOEs disclosed the codes only to employees).

173. All firms have informal "codes of conduct" in the sense that all organizations have unwritten rules governing employee conduct. *See generally* Sims, *supra* note 94 (noting distinction between formal and informal codes of ethics). Sarbanes–Oxley effectively requires firms to decide which rules and/or values to commit to a formal code and to disclose that formal code to the public.

174. *See, e.g.*, ALLTEL, INC., ETHICS IN THE WORKPLACE, *available at* http://media.corporate-ir.net/media_files/irol/74/74159/pdfs/corpgov_guidelines.pdf (last visited Feb. 13, 2005) (previously non-public CCOE posted on the company's website after the SEC adopted its regulations pursuant to § 406 in 2003).

"public" that will now have access to formerly unwritten or non-public corporate codes of ethics includes: (1) corporate employees to whom non-public codes were not previously disclosed internally; (2) other corporate stakeholders, such as suppliers, agents, customers, shareholders, and community leaders; (3) potential investors; (4) interest/advocacy groups; (5) government agencies; and (6) the public at large.

V. THE DISCLOSURE REGIME & THE MARKET FOR ETHICAL CONDUCT

As the discussion in Part IV has shown, § 406 is having some effect on the content and transparency of corporate codes of ethics. Aside from marginally increasing the regulatory burden on public companies, does § 406 have any broader significance? Although the future of § 406 cannot be predicted with any precision, it is possible to suggest a basic framework for understanding how § 406 *could* function to promote ethical conduct if companies and stakeholders act to realize the law's potential. The most intriguing and important aspect of the new disclosure regime is that the reporting requirement encourages the diffusion of corporate codes to broader audiences of actual and potential stakeholders, which may, in turn, focus attention on corporate codes of ethics as instruments for seeking competitive advantage. Thus, the principal significance of § 406 lies in its potential to facilitate competition in the market for ethical corporate conduct.

A. Potential Effects of Disclosure: Articulation, Scrutiny, and Competition

How, specifically, could § 406 help to raise the ethical standards of corporate decision-making? Section 406 effectively requires publicly traded companies to articulate their ethical commitments for senior financial officers and to disclose those ethical commitments to actual and potential stakeholders. Disclosure facilitates and invites scrutiny. Scrutiny invites comparison. Comparison can enhance accountability and encourage competition.

Section 406 makes it easier for actual and potential stakeholders to access the corporate codes that articulate the ethical commitments of publicly traded companies in the United States. Thus, many more actual and potential stakeholders will have the opportunity to scrutinize those ethical commitments as a result of the new disclosure regime. Moreover, the effectively universal disclosure requirement for publicly traded firms will facilitate two types of comparative analysis. The first, which I will call *vertical ethical analysis,* is the comparison of a company's articulated ethical commitments against its actual conduct. The second, which I will call *horizontal ethical analysis*, is the comparison of Firm A's ethical commitments and conduct against Firm B's ethical commitments and conduct.

By employing the legal mechanism of (effectively) mandatory disclosure, Congress and the SEC leave it to the public (i.e., the actual and potential stakeholders listed above in Part IV.B) to evaluate a company's articulated ethical commitments and its adherence to those commitments. The costs and benefits to companies of what they declare in their codes derive from the response of the market. Thus, firms may be encouraged by the pressures and opportunities of market competition to compete in terms of the ethical commitments they make in their codes. They may be further encouraged to keep those ethical commitments by translating them into ethical performance. Of course, this model presupposes a market for ethical corporate conduct.

B. The Market for Ethical Conduct

Is there a market for ethical corporate conduct?[175] The evidence suggests that there is such a market and that it is growing. In a business environment in which corporate conduct is increasingly transparent,[176] and in which market pressures for socially responsible conduct are on the rise,[177] many firms actively compete on the basis of ethical commitments

175. The notion of a market for ethical conduct is anticipated, in part, in Thomas W. Dunfee, *The Marketplace of Morality: First Steps Toward a Theory of Moral Choice*, 8 BUS. ETHICS Q. 127 (1998) (theoretical exploration of the role of moral preferences in market transactions), and Robert J. Liubicic, *Corporate Codes of Conduct and Product Labeling Schemes: The Limits and Possibilities of Promoting International Labor Rights Through Private Initiatives*, 30 LAW & POL'Y INT'L BUS. 111, 114–19 (1998) (conceptualizing labor rights and working conditions as "private goods" which consumers choose to purchase when they select goods based on information regarding the conditions under which the goods were manufactured).

176. *See* Ariane Berthoin Antal et al., *Corporate Social Reporting Revisited*, 28 J. GEN. MGMT. 22, 26 (2002) ("The emergence of new media, particularly the Internet, has enabled more rapid and easy access to information about corporate activities as well as more interactive modes of communication between the corporation and its multiple stakeholders."); *see also* TAPSCOTT & TICOLL, *supra* note 169, at 9–21 (discussing increasing transparency and the stakeholder groups involved); Michel Ogrizek, *The Effect of Corporate Social Responsibility on the Branding of Financial Services*, 6 J. FIN. SERVICES MKTG 215, 218 (2002) (suggesting that increased demand for greater transparency in business creates pressure from "internal watchdogs" to speak out more about social causes); Frank Vogl, Corporate Integrity and Globalization: The Dawning of a New Era of Accountability & Transparency, Address Before the Smeal College of Business Administration, Penn State University (2001) (suggesting that we are at the start of a new era in corporate accountability and transparency), *available at* http://www.ethics.org/resources/speech_detail.cfm?ID=33.

177. *See* LYNN SHARP PAINE, VALUE SHIFT 108–115 (2003) (noting increasing pressure for socially responsible corporate conduct from employees, customers, investors and communities);

and performance.[178] Although there are many dimensions to this phenomenon, I focus here on three elements that are particularly relevant to this discussion: (1) socially responsible investing; (2) social marketing; and (3) corporate social reporting.

1. Socially Responsible Investing

Perhaps the clearest manifestation of the market for ethical corporate conduct is the socially responsible investment movement.[179] "Socially responsible investing" has been defined as investment "that considers the social and environmental consequences of investments, both positive and negative, within the context of rigorous financial analysis."[180] In the U.S., as of 2003, $2.18 trillion was invested according to socially responsible investment criteria.[181] There were 200 socially responsible mutual funds[182] and "more than one out of every nine dollars under professional management in the United States [was] involved in socially responsible investing."[183] This movement has been experiencing significant growth. The $2 trillion-plus aggregate figure for socially responsible investment in

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TAPSCOTT & TICOLL, *supra* note 169, at 9–21, 165–66, 190–92 (arguing that increasing transparency shifts power to stakeholders such as employees, customers, community members, and interest groups to influence corporate conduct); W. Timothy Coombs, *The Internet as Potential Equalizer: New Leverage for Confronting Social Irresponsibility*, 24 PUB. REL. REV. 289 (1998) (discussing the use of the Internet by social activist groups to influence corporate conduct); Chris Deri, *Make Alliances, Not War, with Crusading External Stakeholders*, 31 STRATEGY & LEADERSHIP 26 (2003) (discussing the growing influence of advocacy organizations on corporate conduct).

178. *See generally* PAINE, *supra* note 177, at 117 ("[C]ompanies today must meet increasingly demanding specifications to be competitive in the markets for talent, customers, public support, and, increasingly, capital itself."); TAPSCOTT & TICOLL, *supra* note 169, at 71 (noting that "[e]vidence is mounting that a company can distinguish itself in the marketplace through ethical values and behavior, building trust with all stakeholders and achieving competitive advantage as a result").

179. *See generally* PAINE, *supra* note 177, at 29–54; TAPSCOTT & TICOLL, *supra* note 169, at 233 (recognizing that the "number of socially screened funds and their assets under management soared during the mid-1990's"); Steve Schueth, *Socially Responsible Investing in the United States*, 43 J. BUS. ETHICS 189 (2003) (describing the growth and evolution of socially responsible investing in the United States).

180. SOCIAL INVESTMENT FORUM, 2003 REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES 3 (2003), *available at* http://www.citizensfunds.com/pdfs/sri_trends_report_2003.pdf. "Socially responsible" investing is also referred to as "ethical," "mission-based," or "social" investing. *See, e.g.*, Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1276 (1999) ("The term 'social investor' typically describes either investors who screen investments to exclude investments in certain products, countries, or practices, or who actively seek to invest in certain companies because of the companies' environmental, labor, or community practices.").

181. SOCIAL INVESTMENT FORUM, *supra* note 180, at 1.

182. *Id.* at ii.

183. *Id.* at 1.

the U.S. in 2003 represents a substantial increase from the $639 billion at which it stood in 1995.[184]

Although this research has revealed no empirical studies specifically examining the salience of corporate codes for social investors, it is clear that the ethical commitments and performance of public companies are of considerable importance to such investors. Thus, § 406 may facilitate and encourage the use of ethical commitments in CCOEs to attract socially screened investment and/or to respond to the preferences of social investors regarding corporate conduct. Given their predispositions, social investors may also be more likely to: monitor the extent to which a firm's conduct is consistent with its code; hold the firm accountable for living up to its ethical commitments; and compare its record to those of other firms.

2. Social Marketing

"Social marketing"—which may be defined as marketing that is related to claims regarding socially responsible corporate behavior—is another facet of the market for ethical conduct.[185] In many cases, social marketing is product-specific. That is to say, the marketing is based, in some part, upon representations that social and/or environmental concerns were taken into account in a product's sourcing, design, or manufacture.[186] A

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184. *Id.* at 2.

185. The targets of social marketing are consumers who consider corporate "social performance" in making their purchasing decisions. *See* PAINE, *supra* note 177, at 109 ("Consumers are . . . more disposed to buy from companies they perceive as ethical and socially responsible."); TAPSCOTT & TICOLL, *supra* note 169, at 165 ("Consumers across the world are increasingly punishing and rewarding companies because of their perceived corporate social performance."); Geoffrey Brewer, *Consumers Want Brands—and Social Responsibility*, 152 SALES & MKTG. MGMT. 76, 76 (2000) (according to consumer survey, "[f]ifty-four percent of Americans . . . watch a company's social performance, including its labor practices, business ethics, and environmental impacts"); Sarah Lorge, *Consumers Care About Causes*, 151 SALES & MKTG. MGMT. 74 (1999) (according to consumer survey, "[w]hile 83 percent of consumers say they have a more positive image of a company that supports a cause they care about, approximately two thirds say that if price and quality are equal, they are likely to switch to a civic-minded brand or retailer").

186. "Green marketing"—i.e., marketing related to environmental claims—is a well-established subset of social marketing. *See generally* Debbie Easterling et al., *The Greening of Advertising: A Twenty-Five Year Look at Environmental Advertising*, 4 J. MKTG. THEORY & PRACTICE 20 (1996); Tina Mainieri et al., *Green Buying: The Influence of Environmental Concern on Consumer Behavior*, 137 J. SOC. PSYCHOL. 189, 190, 202 (1997) (studying "consumers' knowledge and beliefs about environmental products, green buying habits, general environmental attitudes, and factors that influence environmentally conscious purchases" and stating that "[m]any businesses have begun to stress 'green marketing'"); Morgan P. Miles & Jeffrey G. Covin, *Environmental Marketing: A Source of Reputational, Competitive, and Financial Advantage*, 23 J. BUS. ETHICS 299, 299 (2000) (noting that the modern market encourages businesses "to seek innovative ways to utilize environmental, or green marketing"). Examples of "green" products include biodegradable paint, CFC-free hairspray, and unbleached coffee filters. Michel Laroche et al., *Targeting Consumers Who Are Willing to Pay More*

prominent example of this phenomenon is Starbucks Corporation's Fair Trade Certified Coffee.[187] This coffee is purchased by Starbucks at premium prices from democratic farmers' cooperatives that have been certified by an independent organization called Transfair USA.[188] Social marketing may also be employed to promote brands instead of, or in addition to, specific products by associating the brand with social causes.[189] Examples of companies that use social marketing to promote their brands include The Body Shop[190] and Kenneth Cole.[191]

Corporate codes of conduct have been employed, in part, as a type of brand-level social marketing; exemplified by the cases of Nike, The Gap, Levi Strauss, Reebok, and Mattel. Each of these companies markets widely-recognized consumer brands.[192] Significantly, all used well

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for Environmentally Friendly Products, 18 J. CONSUMER MKTG. 503, 503 (2001).

187. *See* STARBUCKS CORP., STARBUCKS FAIR TRADE AND COFFEE SOCIAL RESPONSIBILITY (describing Starbucks fair-trade coffee initiative), *at* http://www.starbucks.com/aboutus/fairtrade.asp (last visited Feb. 14, 2005); STARBUCKS CORP., CORPORATE SOCIAL RESPONSIBILITY ANNUAL REPORT 28–29 (2004) (same), *available at* http://www.starbucks.com/aboutus/CSR2004fullbook.pdf.

188. Frank Green, *Fair Trade Coffee Debuts, But Will it Perk Up Sales?*, SAN DIEGO UNION-TRIBUNE, Oct. 4, 2000, at C.1. The certification process for "Fair Trade" coffee is explained by Transfair USA on the organization's website at http://www.transfairusa.org/content/certification/overview.php (last visited Feb. 14, 2005); s*ee also* Rory Van Loo, *Coming to the Grocery Shelf: Fair-Trade Food*, CHRISTIAN SCI. MON., Sept. 29, 2003 (reporting on fair-trade labeling and marketing for coffee, tea, chocolate and other products), *available at* http://www.csmonitor.com/2003/0929/p13s02-wmcn.html.

189. *See* Isabelle Maignan & O.C. Ferrell, *Corporate Citizenship as a Marketing Instrument: Concepts, Evidence and Research Directions*, 35 EUR. J. MKTG. 457, 457 (2001) (suggesting that "consumers are willing to make an effort to support proactive corporate citizens"). *See generally* Scott M. Smith & David S. Alcorn, *Cause Marketing: A New Direction in the Marketing of Corporate Responsibility*, J. SERVICES MKTG. 21, 26–33 (Fall 1991) (detailing a survey in which the respondents intention to switch brands to support a manufacturer who engaged in cause marketing was higher than expected).

190. *See* THE BODY SHOP INT'L, VALUES REPORTING, *at* http://www.thebodyshopinternational.com/web/tbsgl/values_rep.jsp (last visited Feb. 14, 2005) ("The Body Shop is a strong global brand and a business with a deep commitment to social and environmental issues."); *see also* Cathy L. Hartman & Caryn L. Beck-Dudley, *Marketing Strategies and the Search for Virtue: A Case Analysis of The Body Shop, International*, 20 J. BUS. ETHICS 249 (1999) (applying the theory of "virtue ethics" to The Body Shop's marketing strategies in which social values embody the brand's identity); Jon Entine, *The Body Shop: Truth & Consequences*, DCI, Feb. 1995, at 54 (recounting recent criticisms of The Body Shop's misleading marketing practices).

191. *See* Robin Givhan, *Walking the Walk*, WASH. POST, Aug. 18, 2003, at C1 ("Cole uses politics as a way of attracting shoppers, just as Benetton uses diversity, Calvin Klein and Gucci use sex or Chanel and Hermes use snobbery."); KENNETH COLE PROD., INC., JUST CAUSES: ORGANIZATIONS WE SUPPORT (listing—under the heading "Just Causes: Organizations We Support"—social and cultural organizations supported by the company), *available at* http://www.kennethcole.com/scripts/aboutus/links.asp (last visited Feb. 14, 2005).

192. *Cf.* TAPSCOTT & TICOLL, *supra* note 169, at 170–72 (explaining that some multinational firms integrate corporate social responsibility into "brand architecture"); Deri, *supra* note 177, at 30 ("Global brands are being held accountable for global climate change, human rights abuses across their supply chains, and the degradation of the world's rain forests . . . ."); Liubicic, *supra* note 175, at 114–

publicized codes of conduct governing their relationships with suppliers[193] as part of their strategy for maintaining their corporate reputations in the face of scandals involving working conditions in some of the foreign factories from which they sourced products for sale in the United States.[194]

3. Corporate Social Reporting

The corporate social reporting movement comprises a third element of the market for ethical corporate conduct.[195] Increasingly, companies—

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19 (1998) (arguing that global codes of conduct are generally adopted by firms with prominent consumer brands).

193. *See* LEVI STRAUSS & CO., GLOBAL SOURCING AND OPERATING GUIDELINES (describing Levi Strauss's philosophy of "select[ing] business partners who follow workplace standards and business practices that are consistent with our company's values"), *at* http://www.levistrauss.com/responsibility/conduct/guidelines.htm (last visited Feb. 14, 2005); *see also* LEVI STRAUSS & CO., WORLDWIDE CODE OF BUSINESS CONDUCT 30 (2003) (declaring that "suppliers are critical to our success"); MATTEL, INC., GLOBAL MANUFACTURING PRINCIPLES (providing "guidance and minimum standards for all manufacturing plants, assembly operations, and distribution centers that manufacture, assemble or distribute Mattel products"), *available at* http://www.mattel.com/about_us/Corp_Responsibility/GMPoverview.pdf (last visited Feb. 14, 2005); MATTEL, INC., CODE OF CONDUCT (2003) (including a section on "Our Responsibility To Business Partners"), *at* http://www.mattel.com/about_us/Corp_Governance/ethics.asp; REEBOK INT'L, LTD., REEBOK HUMAN RIGHTS PRODUCTION STANDARDS (outlining Reebok's human rights standards for business partners), *at* http://www.reebok.comx/us/humanRights/text-only/business/popup/standards .html (last visited Feb. 14, 2005).

194. *See generally* Lance Compa & Tashia Hinchliffe-Darricarrère, *Enforcing International Labor Rights Through Corporate Codes of Conduct*, 33 COLUM. J. TRANSNAT'L L. 663, 677–83 (1995) (reviewing codes of conduct adopted by Levi-Strauss and Reebok); Liubicic, *supra* note 175, at 114–19, 128–29 (1998) (reviewing codes adopted by Levi-Strauss, Wal-Mart, and The Gap); Sol Picciotto, *Rights, Responsibilities and Regulation of International Business*, 42 COLUM. J. TRANSNAT'L L. 131, 141 (2003) (discussing campaigns against Nike and the Gap because of poor working conditions in their factories); S. Prakash Sethi, *Standards for Corporate Conduct in the International Arena: Challenges and Opportunities for Multinational Corporations*, 107 BUS. & SOC'Y REV. 20, 32–38 (2002) (providing an analysis of adoption and implementation of Mattel's global manufacturing principles); Elisa Westfield, *Globalization, Governance, and Multinational Enterprise Responsibility: Corporate Codes of Conduct in the 21st Century*, 42 VA. J. INT'L L. 1075, 1098–1100 (2002) (discussing codes of conduct adopted by Levi-Strauss and Reebok); Ryan P. Toftoy, Note, *Now Playing: Corporate Codes of Conduct in the Global Theater. Is Nike Just Doing It?*, 15 ARIZ. J. INT'L & COMP. L. 905, 924 (1998) (describing Nike's attempts to "improve its image in the eyes of the consuming public," including "voluntarily agreeing to an industry-wide agreement known as the Workplace Code of Conduct" and hiring former UN Ambassador Andrew Young to "review its newly rewritten Code of Conduct").

195. *See* Jamie Snider et al., *Corporate Social Responsibility in the 21st Century: A View from the World's Most Successful Firms*, 48 J. BUS. ETHICS 175, 176 (2003) ("Corporate social reporting is a method of self-presentation and impression management conducted by companies to insure various stakeholders are satisfied with their public behaviors."). Corporate social reporting may also be understood as a subset of brand-level or company-level social marketing. However, the corporate social report has emerged in recent years as a sufficiently distinctive phenomenon to merit a separate discussion. *See generally* TAPSCOTT & TICOLL, *supra* note 169, at 268 (suggesting that "[m]any social and environmental reports are selective and self-serving sales pitches"); BUILDING CORPORATE ACCOUNTABILITY: EMERGING PRACTICES IN SOCIAL AND ETHICAL ACCOUNTING, AUDITING AND

especially, large, multinational companies—are voluntarily issuing annual reports of their activities in areas of corporate social responsibility, including health and safety, charitable contributions, and environmental stewardship.[196] These reports typically articulate commitments to broad

REPORTING (Simon Zadek et al. eds., 1997) (providing background on CSR, including environmental accounting and social audits); Ariane Berthoin Antal et al., *supra* note 176 (examining social reporting of the 1960s and 1990s in light of the current interest in the subject); Pontus Cerin, *Communication in Corporate Environmental Reports*, 9 CORP. SOC. RESPONSIB. & ENVIRON. MGMT. 46 (2002) (describing the motives behind the recent trend in corporate environmental reporting and analyzing the actual validity of the reports); Julia Clarke & Monica Gibson-Sweet, *The Use of Corporate Social Disclosures in the Management of Reputation and Legitimacy: A Cross Sectoral Analysis of UK Top 100 Companies*, 8 BUS. ETHICS: A EUROPEAN REV. 5 (1999) (analyzing the use of corporate social reporting and whether it is being used as a "legitimation" tool within voluntary reporting of the top 100 UK companies); Reggy Hooghiemstra, *Corporate Communication and Impression Management—New Perspectives Why Companies Engage in Corporate Social Reporting*, 27 J. BUS. ETHICS 55 (2000) (suggesting that social and environmental disclosures are a response to public pressure from and increased media attention paid to major social incidents); Ans Kolk, *Green Reporting*, 78 HARV. BUS. REV.15, 15–16, (2000) (describing environmental reporting initiatives of Royal Dutch/Shell and Bristol-Myers Squibb); Ans Kolk, *Trends in Sustainability Reporting by the Fortune Global 250*, 12 BUS. STRATEGY & ENVIRONMENT 279 (2003) (considering the trend in non-financial reporting in Fortune Global 250 companies); Radhika Philip, *Corporate Social Reporting*, 26 HUMAN RESOURCE PLANNING 10 (2003) (discussing social reporting as it pertains to investors, customers, and employees and considering why social reports "generally tend to generate more critique than appreciation") (italics omitted).

196. *See, e.g.*, BAXTER INT'L, INC., SUSTAINABILITY AT BAXTER: A SUMMARY OF 2003 PERFORMANCE (2004) (reporting on the company's community and environmental practices, as well as internal concerns, such as diversity, risk management, and working with partners for sustainability), *available at* http://www.baxter.com/about_baxter/sustainability/sustainability_brochure_2003.pdf; EXXONMOBIL CORP., 2003 CORPORATE CITIZENSHIP REPORT SUMMARY 6–24 (including sections on environmental performance, safety, health, and community engagement), *available at* http://www.exxonmobil.com/corporate/files/corporate/CCR_2003.pdf; GENERAL MOTORS CORP., CORPORATE RESPONSIBILITY & SUSTAINABILITY REPORT 2001–2002 (2002), 31–66, *available at* http://www.gm.com/company/gmability/sustainability/reports/02/000_navigation/030_printable/fulltext_01-02.pdf (discussing the company-wide environmental progress that General Motors made in 2001–2002); HEWLETT-PACKARD DEV. CO., 2004 GLOBAL CITIZENSHIP REPORT (reporting on product environmental impacts, diversity, human rights, as well as the health, safety and wellness of employees), *available at* http://www.hp.com/hpinfo/globalcitizenship/gcreport/downloads.html; ING GROUP N.V., ING IN SOCIETY 2003 (reporting progress in corporate social responsibility and sustainability for the eighth consecutive year), *available at* http://www.ing.com/group/showdoc.jsp?docid=075241_EN&menopt=ins%7Cres; MERRILL LYNCH & CO. INC., GLOBAL PHILANTHROPY & COMMUNITY RELATIONS 2001 ANNUAL REPORT 1 (2002) ("Merrill Lynch supports a world of greater promise by bringing new opportunities to our communities, from education and the arts to civic, health and human services."), *available at* http://philanthropy.ml.com/ar2001/pdfs/files/philanthropy01report.pdf; PFIZER, INC., ENVIRONMENTAL, HEALTH & SAFETY POLICY ("We reaffirm . . . [our] commitment and pledge our continued efforts to protect our communities and the environment."), *available at* http://www.pfizer.com/ehs/mgmt/pfe_policy.pdf (last visited Feb. 16, 2005); ROYAL DUTCH SHELL PETROLEUM CO., MEETING THE ENERGY CHALLENGE: THE SHELL REPORT 2002 1 (reporting on "the progress in 2002 of the Royal Dutch/Shell Group of Companies in contributing to sustainable development"), *available at* http://www.wimm.nl/onderwijsUK/shell%20report%202002.pdf; UBS AG, HANDBOOK 2003/2004 114–16 (describing the UBS corporate responsibility and environmental programs), *available at* http://www.ubs.com/1/e/investors/annrep/annualreportingoverview/2003/

goals or principles, such as good corporate citizenship, diversity, and/or sustainability.[197] Many reports also offer quantitative measures of company social and environmental performance.[198]

It is noteworthy that the rhetoric of corporate social reports often overlaps substantially with the rhetoric of corporate codes of ethics. The broad statements of principle and ethical commitments in such reports can be very similar to those found in many CCOEs.[199] Some firms, moreover, specifically reference or quote their codes in corporate social reporting documents.[200]

C. Code Disclosure as Corporate Social Reporting

Having considered some of the elements of the market for ethical conduct, we can further refine our understanding of the new disclosure

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andbookhtml (last visited Feb. 15, 2005); VIVENDI UNIVERSAL, 2002 REPORT: OUR ECONOMIC, SOCIAL AND ENVIRONMENTAL RESPONSIBILITY 1 (2002) ("We owe a full account, in all circumstances, of how our Group intendeds to fulfill its economic, social and environmental duties."), *available at* http://www.vivendiuniversal.com/vu/en/files/environmental_report_2002.pdf.

197. *See, e.g.*, AT&T CORP., 2001–2002 CORPORATE CITIZENSHIP REPORT 4 (2002) ("AT&T is committed to diversity—in our workplace, in our community relationships, and in our suppliers."), *available at* http://www.att.com/ir/pdf/citizenship.pdf; BAXTER INT'L, INC., *supra* note 196, at 4 ("Baxter employees throughout the world strive to make a worthwhile impact on the health and well-being of our communities, and to minimize the impact that our operations have on the environment and natural resources.").

198. According to one recent study, the quantitative "social performance indicators" most frequently reported by the Fortune Global 250 are: accident/injury frequency, community spending, women in staff/management, staff diversity, and supplier diversity. Kolk, *Trends in Sustainability Reporting*, *supra* note 195, at 288. The quantitative environmental performance indicators reported by some firms include measures of emissions of air pollutants, energy consumption, and generation of hazardous waste. *See, e.g.*, DUPONT, SUSTAINABLE GROWTH 2002 PROGRESS REPORT (detailing the company's efforts to reduce emissions and purchase more renewable energy), *available at* http://www1.dupont.com/dupontglobal/corp/documents/US/en_US/news/publications/dupprogress/2002USprogrept.pdf; ELI LILLY & CO., HSE PUBLIC REPORT (2001) (disclosing quantitative measures of environmental performance including solvent emissions into the air, number of reportable releases, solid and liquid waste generation, and methylene chloride emissions), *available at* http://www.ehs.lilly.com/2000/pdfs/HSE%20Report.pdf. *But see* William S. Laufer, *Social Accountability and Corporate Greenwashing*, 43 J. BUS. ETHICS 253, 255–58 (2003) (questioning the accuracy and reliability of representations made in corporate social reporting that have not been rigorously audited and verified).

199. *See, e.g.*, AT&T CORP., *supra* note 197, at 1 (including a statement entitled "Our Common Bond" that is essentially a values statement-type corporate code of ethics); ELI LILLY & CO., *supra* note 198, at 6 (beginning corporate social report with a statement of "Vision & Strategy" that resembles a corporate credo or values statement); MCDONALD'S CORP., SOCIAL RESPONSIBILITY REPORT 6 (2002) (including a statement entitled "Our Core Values" that is essentially a values statement-type CCOE), *available at* http://www.mcdonalds.com/corp/values/socialrespons/sr_report/otherreports.html.

200. *See, e.g.*, CITIGROUP, INC., CITIZENSHIP REPORT 2002 10, 26, 46 (2003) (quoting language from the firm's code of conduct addressing community service, diversity, and the environment), *available at* http://www.citigroup.com/citigroup/citizen/community/annualreport.htm.

regime for corporate codes of ethics. In the context of the market for ethical conduct, section 406 may be understood as a modest step toward an effectively mandatory corporate social reporting of certain ethical commitments.[201] In effect, the statute and regulations say to covered firms: "If you have formal ethical commitments and/or aspirations regarding the conduct of your senior financial officers, you must disclose them and subject them to public scrutiny." Consistent with the emphasis on disclosure in U.S. securities law, the evaluation of the content and import of CCOEs disclosed pursuant to § 406 is left to the public. Viewed from this perspective, we can see a convergence between the corporate social reporting movement that has emerged independently as a result of developments in the market and the public policy embodied in § 406.[202]

CONCLUSION

Section 406 of the Sarbanes-Oxley Act is an intriguing, if decidedly incremental, addition to the federal securities laws. By itself, it is unlikely to result in a flood of litigation or a great tectonic shift in the ethics of public companies. However, it has affected and is likely to continue to affect the content, ubiquity, and transparency of corporate codes of ethics. The ultimate significance of the § 406 disclosure regime lies in its potential to facilitate competition in the market for ethical corporate conduct and in the capacity of that competition to influence corporate decision-making. In short, § 406 offers public companies and stakeholders an opportunity to

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201. Over the past three or four decades, commentators have proposed mandatory corporate social reporting of various forms. *See* Meinolf Dierkes & Ariane Berthoin Antal, *Whither Corporate Social Reporting: Is It Time to Legislate?*, 28 CAL. MGMT. REV. 106, 119 (1986) (discussing models for social reporting and proposing a mandatory reporting requirement "which determines the over-all scope of the report and outlines general guidelines to be followed"); David Hess, *Social Reporting: A Reflexive Law Approach to Corporate Social Responsiveness*, 25 IOWA J. CORP. L. 41 (1999) (advocating the use of "reflexive law," which encourages corporations to self-regulate instead of mandating that they do so); Thomas J. Schoenbaum, *The Relationship Between Corporate Disclosure and Corporate Responsibility*, 40 FORDHAM L. REV. 565, 587 (1972) (describing potential disclosure categories relating to "societal needs"); Williams, *supra* note 180, at 1299–1305 (arguing that the SEC should "implement expanded social disclosure" and presenting a "proposal to implement the expanded social disclosure regime").

202. The notion that companies are obliged to disclose their ethical commitments has also found expression in rules of the New York Stock Exchange that were adopted in response to the corporate scandals that came to light in 2001 and 2002. NEW YORK STOCK EXCH., FINAL NYSE CORPORATE GOVERNANCE RULES (2003–2004) (codified in Section 303A of the NYSE LISTED COMPANY MANUAL, *available at* http://www.nyse.com/Frameset.html?displayPage=/listed/1022221393251.html). Every company listed on the NYSE is required, as of November 2003, to "adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers." NYSE LISTED COMPANY MANUAL, *supra*, § 303A.10; *see also* NYSE COMMITTEE REPORT, *supra* note 88, at 20–22 (prior to the NYSE doing so, recommending that the NYSE require what § 303A.10 now requires)

make corporate codes more consequential as instruments of ethical competition. It is now for those companies and stakeholders to decide what they will make of that opportunity.