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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in the regulatory structure implementing § 406 of the Act: (1) a common form of corporate self-regulation (the corporate code of ethics); (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”).

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. 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. Although CCOEs first appeared early in the last century, a substantial number date from the 1970s, 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. Subsequent spates of CCOE adoptions and revisions have followed the defense industry scandals of the early and mid-1980s, the publication of the Treadway Commission report on...
fraudulent financial reporting in 1987,\textsuperscript{12} and the issuance of the U.S. Sentencing Guidelines for Organizations in 1991.\textsuperscript{13}

\textit{A. Code Structure and Content}

\textbf{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.\textsuperscript{14} Researchers have distinguished several common CCOE formats, such as “corporate credos,”\textsuperscript{15} “values statements,”\textsuperscript{16} “compliance codes,”\textsuperscript{17} and “management philosophy statements.”\textsuperscript{18} Distinctions have also been drawn between “inward-looking”\textsuperscript{19} and “outward-looking”\textsuperscript{20} code provisions.

\begin{itemize}
  \item \textsuperscript{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).
  \item \textsuperscript{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”).
  \item \textsuperscript{17} See Lauffer & Robertson, supra note 15, at 1030 (defining “compliance codes” as “codes with provisions that contain guidelines and prohibitions regarding unethical and illegal conduct”).
  \item \textsuperscript{18} See id. (defining “management philosophy statements” as “formal edicts of corporate philosophy”).
  \item \textsuperscript{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, and among codes of differing levels of specificity. 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. 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. 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. 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. Alternatively, codes that are drafted primarily as broad statements of principle may also include references to specifically prohibited conduct.

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.


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).


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).


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—such as acting with “integrity” or adherence to “the highest ethical standards”—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. Alternatively, such provisions may be expressed as admonitions to employees either to act in a certain way (“do’s”) or to refrain from engaging in specific types of prohibited conduct (“don’ts”). 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.
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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\(^{37}\) 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. .


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

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.”).
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.chervontexaco.com/investor/corporate_governance/biz_conduct.asp (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.”).
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 and then list specific types of potentially problematic conduct, such as working for another firm, steering company business to a relative, or maintaining a personal financial interest in a company transaction.

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

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. Corporate “stakeholders” include investors, employees, suppliers,


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.


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. 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. Other codes address stakeholder issues less systematically by means of general commitments to “fair dealing” and/or “good corporate citizenship.”

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


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


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

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.


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. Other CCOEs refer to “ethics committees,” “ethics officers,” or other management structures for code implementation and enforcement. However, it is relatively rare for CCOEs to describe code administration, enforcement, or the punishment of violations in any depth. 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.

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. 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. Others dismiss corporate codes as empty exercises in


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.” Enron Corporation, wherein a detailed and famously earnest code of ethics coexisted with a great deal of now infamously unethical conduct, could be offered as “exhibit A” for the “window dressing” view of corporate codes. 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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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 in the Company’s name”), available at http://www.thesmokinggun.com/graphics/packageart/enron/enron.pdf.


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. 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.

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. To be sure, the empirical research offers some limited support for the proposition that CCOEs promote ethical behavior. On balance, however, the literature is inconclusive, as other studies show little or no

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. Indeed, there are substantial methodological obstacles to testing the effectiveness of CCOEs with any meaningful precision. 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; 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.

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

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, 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. 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.” Second, corporate codes may promote legal compliance by educating employees regarding legal standards and reinforcing the predispositions of those inclined to follow the law. Third, CCOEs function as mechanisms for managing relationships

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”).


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 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.uscc.gov/2003guid/tabcon03_c1.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. Within an organization they may serve, for example, as tools of social control; as instruments for imposing and enforcing organizational conformity upon employees. 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. Viewed from a broad managerial perspective, corporate codes may be understood as internal and external market signaling devices. 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. By 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.”).

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

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.  While many lawyers and accountants are gainfully employed navigating the intricacies of U.S. securities law, in general, and the Sarbanes–Oxley Act, in particular.

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”).

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disclosure requirements, 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, no material misstatements or
omissions are permitted.

U.S. securities law elaborates extensively on this general axiom. Issuers must provide investors with a detailed prospectus when issuing
securities. 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. In addition, public
companies must make ad hoc disclosures under certain circumstances.

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.

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
disclosure under the Securities Act and the Exchange Act.

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, 77a(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,
fixed-interval disclosure requirements on companies whose stocks or bonds are traded on any national
exchange); 15 U.S.C. § 78g(1) (2004) (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

103. For statistics on U.S. private securities litigation, see Securities Class Action
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\textsuperscript{104} has been described as the most important change in U.S. securities regulation since the New Deal.\textsuperscript{105} Like the 1933 Securities Act and the 1934 Exchange Act, Sarbanes–Oxley was adopted in the wake of a crisis in securities markets.\textsuperscript{106} It contains a variety of measures aimed at reducing the risks that public companies will “implode in a wave of accounting scandals,”\textsuperscript{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.\textsuperscript{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;\textsuperscript{109} creation of a new U.S. Public Company Accounting Oversight Board;\textsuperscript{110} inclusion of a financial expert on an issuer’s audit


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

\textsuperscript{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.

\textsuperscript{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).


\textsuperscript{110} § 7211.
committee;\textsuperscript{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;\textsuperscript{112} certification by CEOs and CFOs of the accuracy of annual or periodic reports filed with the SEC;\textsuperscript{113} and disgorgement by CEOs and CFOs of certain compensation if financial reports are restated.\textsuperscript{114}

\textbf{C. Section 406 and the SEC’s Associated Regulations}

Section 406 of the Sarbanes–Oxley Act\textsuperscript{115} and the SEC’s associated rules\textsuperscript{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

\begin{footnotesize}
\begin{enumerate}
\item Section 406 of the Act reads as follows: 
\begin{quote}
CODE OF ETHICS FOR SENIOR FINANCIAL OFFICERS
\begin{enumerate}
\item \textit{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.
\item \textit{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.
\item \textit{DEFINITION—}In this section, the term “code of ethics” means such standards as are reasonably necessary to promote—
\begin{enumerate}
\item honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
\item full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and
\item compliance with applicable governmental rules and regulations.
\end{enumerate}
\item \textit{DEADLINE FOR RULEMAKING—}The Commission shall—
\begin{enumerate}
\item propose rules to implement this section, not later than 90 days after the date of enactment of this Act [July 30, 2002]; and
\item issue final rules to implement this section, not later than 180 days after that date of enactment [July 30, 2002].
\end{enumerate}
\end{enumerate}
\end{quote}
\end{enumerate}
\end{footnotesize}
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

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.


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. The Enron board of directors granted several waivers of its CCOE so that Fastow could be on both sides of certain transactions. He was simultaneously the Enron CFO and a principal in various special-purpose entities intended to keep financial information off Enron’s balance sheets. 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.

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.

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

\(^{127}\) 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.


\(^{128}\) 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.


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).
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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

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131. 17 C.F.R. § 229.406(a).
133. Id.
135. 17 C.F.R. § 229.406(c)(1).
136. § 229.406(c)(2).
137. § 229.406(c)(3).
company of a material departure from a provision of the code of ethics.\textsuperscript{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.”\textsuperscript{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.\textsuperscript{141} Alternatively, the issuer could disclose amendment to or waiver of its code on the firm's website.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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–

\textsuperscript{139} Id. at 5120.
\textsuperscript{140} Id.
\textsuperscript{141} Id. at 5119, 5128.
\textsuperscript{142} Id. at 5119, 5129.
\textsuperscript{143} Id.
\textsuperscript{144} Id. at 5110.
Oxley Act. 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. 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. After all, Rule 10b-5, 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. 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.

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.


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.

Supreme Court has described the rule as “a judicial oak which has grown from little more than a legislative acorn.”\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{153} Congressional intent has become the controlling factor in the subsequent application of the Cort test,\textsuperscript{154} and there

\textsuperscript{150.} Blue Chip Stamps, 421 U.S. at 737.

\textsuperscript{151.} Note, The Good, the Bad, and Their Corporate Codes of Ethics: Enron, Sarbanes–Oxley, and the Problems with Legislating Good Behavior, 116 H.R. 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.

\textsuperscript{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).

\textsuperscript{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 . . . ?


\textsuperscript{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.\textsuperscript{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.\textsuperscript{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,\textsuperscript{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 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

\textsuperscript{155} The Supreme Court’s decision in \textit{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). \textit{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. \textit{Id.} at 576. The same could be said of § 406.

\textsuperscript{156} See \textit{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 \textit{Hoffman v. Comshare, Inc.}, 183 F.3d 542, 548 (6th Cir. 1999)).

\textsuperscript{157} See \textit{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. 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 adequates the transactions, material omissions would still seem to exist despite any technical compliance with § 406. 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.

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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.


independence provisions\footnote{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.\footnote{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).


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.  

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. 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.

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.” 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


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. 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.

B. Changes in Code Transparency

Although § 406 mandates some basic code content, it is more fundamentally concerned with transparency. Firms are unlikely to elect the option of explaining why they have chosen not to adopt a code of ethics for senior financial officers. 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.

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. 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. In other cases, firms whose codes were non-public before Sarbanes–Oxley have made, or are in the process of making, their codes public.

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.

“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? 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, and in which market pressures for socially responsible conduct are on the rise, 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. 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. “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.” In the U.S., as of 2003, $2.18 trillion was invested according to socially responsible investment criteria. There were 200 socially responsible mutual funds and “more than one out of every nine dollars under professional management in the United States [was] involved in socially responsible investing.” This movement has been experiencing significant growth. The $2 trillion-plus aggregate figure for socially responsible investment in

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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).


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.\footnote{Id. at 2.}

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.\footnote{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”).}

A
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 Shop190 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

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).
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 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.  

3. Corporate Social Reporting

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

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


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 assure 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. 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).

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

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. Some firms, moreover, specifically reference or quote their codes in corporate social reporting documents.

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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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.”).


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.

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. 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.

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

201. Over the past three or four decades, commentators have proposed mandatory corporate social reporting of various forms. See Meinfö 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/102221393251.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.