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### Does Sarbanes-Oxley Foster the Existence of Ethical Executive Role Models in the Corporation?

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*University of Tennessee College of Law*

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Joan MacLeod Heminway, Does Sarbanes-Oxley Foster the Existence of Ethical Executive Role Models in the Corporation, 3 J. Bus. & TECH. L. 221 (2008).

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Joan MacLeod Heminway, Does Sarbanes-Oxley Foster the Existence of Ethical Executive Role Models in the Corporation, 3 J. Bus. & Tech. L. 221 (2008).

APA 7th ed.

Heminway, J. (2008). Does sarbanes-oxley foster the existence of ethical executive role models in the corporation. *Journal of Business & Technology Law*, 3(2), 221-242.

Chicago 17th ed.

Joan MacLeod Heminway, "Does Sarbanes-Oxley Foster the Existence of Ethical Executive Role Models in the Corporation," *Journal of Business & Technology Law* 3, no. 2 (2008): 221-242

McGill Guide 9th ed.

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## Does Sarbanes-Oxley Foster the Existence of Ethical Executive Role Models in the Corporation?

THE ACHIEVEMENT OF GOOD CORPORATE GOVERNANCE has been a major U.S. and international policy objective in the twenty-first century. In the past few years, both governmental and nongovernmental organizations have proposed, promoted, or adopted measures intended to achieve this objective.<sup>1</sup> Self-regulatory organizations and standard-setting bodies also have jumped on the bandwagon, as legally compelled actors and as volunteer rule makers.<sup>2</sup> The flagship example of these efforts is

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\* Associate Professor, The University of Tennessee College of Law; A.B. 1982, Brown University; J.D. 1985, New York University School of Law. I gratefully acknowledge the comments and suggestions of participants in the University of Maryland School of Law's October 2007 conference, "The Sarbanes-Oxley Act of 2002, Five Years Later: Assessing Its Impact, Charting Its Future," as well as those from colleagues and friends attending research forums sponsored by The University of Tennessee Corporate Governance Center and the Drexel University College of Law's Program in Business & Entrepreneurship Law. Thanks also are owed: to Neal Shover for digging out Robert Merton's classic book as a resource for this Article; to Tamar Frankel who offered support, encouragement, and commentary on an earlier draft; and to Jeff Churchwell, a third-year law student at The University of Tennessee College of Law, who provided valuable research assistance on this project.

1. See, e.g., Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.); Luca Enriques, *Bad Apples, Bad Oranges: A Comment from Old Europe on Post-Enron Corporate Governance Reforms*, 38 WAKE FOREST L. REV. 911, 916-26 (2003) (surveying corporate governance reforms in the European Union, France, Germany, Italy, and the United Kingdom); CAL. PUB. EMPLOYEES' RET. SYS., CORE PRINCIPLES OF ACCOUNTABLE CORPORATE GOVERNANCE (2007), available at <http://www.calpers-governance.org/principles/domestic/us/page01.asp>; SWISS BUS. FED'N, SWISS CODE OF BEST PRACTICES FOR CORPORATE GOVERNANCE (2002), available at [http://www.ecgi.org/codes/code.php?code\\_id=115](http://www.ecgi.org/codes/code.php?code_id=115).

2. See, e.g., Lawrence A. Cunningham, *A New Product for the State Corporation Law Market: Audit Committee Certifications*, 1 BERKELEY BUS. L.J. 327, 336-50 (2004) (highlighting aspects of the Public Company Accounting Oversight Board's standard-setting role in changing corporate governance); Robert B. Thompson, *Corporate Federalism in the Administrative State: The SEC's Discretion to Move the Line Between the State and Federal Realms of Corporate Governance*, 82 NOTRE DAME L. REV. 1143, 1180-86 (2007) (noting the interactive role of the U.S. Securities and Exchange Commission and stock exchanges in changing corporate governance); Robert B. Thompson, *Delaware, The Feds, and the Stock Exchange: Challenges to the First State as First in Corporate Law*, 29 DEL. J. CORP. L. 779, 792-97 (2004) (describing, among other things, the stock exchanges role as "alternative law-givers" in the area of corporate governance); ASX LTD. CORPORATE GOVERNANCE COUNCIL, PRINCIPLES OF GOOD CORPORATE GOVERNANCE AND BEST PRACTICE RECOMMENDATIONS (2003), available at <http://www.shareholder.com/visitors/dynamicdoc/document.cfm?documentid=364&companyid=asx>.

## DOES SARBANES-OXLEY FOSTER ETHICAL EXECUTIVE ROLE MODELS?

the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or the "Act"), U.S. federal legislation enhancing the corporate governance regulation of public companies.<sup>3</sup>

What does it take to achieve good corporate governance? Most agree that rules (whether in the form of principles or standards), even if necessary, are not sufficient to accomplish the task.<sup>4</sup> To that point, a few months after Sarbanes-Oxley was signed into law, Stuart C. Gilman (then the president of the Ethics Resource Center (ERC), a non-profit organization located in Washington D.C.) made the following relevant observations in testimony before the Advisory Group on Federal Sentencing Guidelines for Organizations.

*Much of the recent conversation regarding organizational leadership has centered on business scandals and the most appropriate way to avoid similar circumstances in the future. . . . this response is most evident in the Sarbanes-Oxley Act of 2002. This legislation requires executive leadership to attest to the integrity of their organizations' financial reporting and overall operations. Such an outcome presumes an effective system of monitoring and oversight of the business conduct of the organization . . . . Attesting to fiscal integrity is only possible if monitoring and oversight are integrated into the systems and practices at all levels of the organization - this includes formal systems, the informal operating norms and the culture as understood by all employees.*

*To do that requires leadership. An executive can comply with Sarbanes-Oxley and attest to the integrity of his or her organization only to the extent that he or she has set a tone for organizational integrity at the top.*

*One of the most important ways this can be accomplished by a leader is by serving as a role model. A leader's behavior has the ability to shape employees' perceptions of what constitutes acceptable ethical behavior, as well as employees' views of the leader him or herself. In other words, leadership translates from the "top-down," the conduct of the superiors influencing the actions of the subordinates.*

*If ethical behavior is to be integrated throughout an entire organization, no matter the size, those who are seen as leaders must proactively encourage ethical behavior and facilitate (legitimize) ethical dialogue. When they do, their actions help shape and maintain an ethical culture.<sup>5</sup>*

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3. Only public companies, which consist of issuers with a class of securities registered under section 12 of the Securities Exchange Act of 1934, 15 U.S.C. § 78(l) (2000 & Supp. V 2004), are governed under Sarbanes-Oxley.

4. In the words of one prominent legal scholar, "[l]aw is built on broad voluntary compliance. No matter how many laws are on the books, . . . if the majority or leadership of the population does not obey the law, law is likely to remain a dead letter." TAMAR FRANKEL, TRUST AND HONESTY: AMERICA'S BUSINESS CULTURE AT A CROSSROAD 190 (2006).

5. Dr. Stuart C. Gilman, President, Ethics Resource Center, Testimony to the Advisory Group on Federal Sentencing Guidelines for Organizations (Nov. 14, 2002), available at [http://www.ussc.gov/corp/ph11\\_02/t\\_SGilman.pdf](http://www.ussc.gov/corp/ph11_02/t_SGilman.pdf). Dr. Gilman's testimony was offered in the wake of Sarbanes-Oxley. The U.S. Sentencing Com-

Dr. Gilman's statements intuitively seem correct; to some, they may even seem obvious. In fact, consonant comments have been echoed by others before and after the enactment of Sarbanes-Oxley.<sup>6</sup> The creation and maintenance of integrity and good governance within a firm requires the active and ongoing involvement of engaged, ethical corporate leaders. In a 2005 presentation before the United Nations, one corporate leader offered his consistent views.

*Good Corporate Governance does not only mean to apply rules and to meet requirements. Good Corporate Governance is definitely more than that. Although there is no widely accepted definition or model of Corporate Governance, good Corporate Governance can only be achieved with top representatives as role models, demonstrating credibility and integrity on a daily basis. These are the determining elements that constitute sustainability in Corporate Governance.*<sup>7</sup>

Yet, this rhetoric begs for further thought and analysis. Among other things, if compliance with, or the efficacy of, Sarbanes-Oxley and other corporate governance initiatives requires that executives (or other firm leaders) be good ethical<sup>8</sup> role models, then it is important to ask whether Sarbanes-Oxley—or any other attribute

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mission in fact passed revisions to the Federal Sentencing Guidelines that relate to the promotion of ethical corporate cultures and the encouragement of ethical and legal behavior in the corporation. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1 (2004); see also Gary M. Brown, *Changing Models in Corporate Governance—Implications of the US Sarbanes-Oxley Act*, in CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES, AND MARKETS IN EUROPE, JAPAN, AND THE US 143, 159–61 (Klaus J. Hopt et al. eds., 2005); David Hess et al., *The 2004 Amendments to the Federal Sentencing Guidelines and their Implicit Call for a Symbiotic Integration of Business Ethics*, 11 FORDHAM J. CORP. & FIN. L. 725 (2006).

6. See, e.g., FRANKLIN C. ASHBY, REVITALIZE YOUR CORPORATE CULTURE 82, 88 (1999) (listing “A Focus on Building Role Models—Not Just Leaders” as one of “The Ten Identifying Features of a Great Organizational Culture”); FRANKEL, *supra* note 4, at 191 (“[W]hat most determine corporate culture are the attitude and signals of top management—sometimes only one or two people at the head of the corporate pyramid. They set the tone and direction of the organization. In corporations, the signals of top management are closely watched and followed.”); Narayana N.R. Murthy, Chairman of the Bd., Infosys Techs. Ltd., Remarks at the Robert P. Maxon Lecture at George Washington Univ.: Good Corporate Governance—A Checklist or a Mindset? (Feb. 6, 2006) (“While SOX and other initiatives have created a good framework for better governance, I do believe that such focus on rules-based regulation can only succeed if we create a mindset for decency, honesty and respectability among corporate leaders.”).

7. Felix Horber, Presentation at the United Nations: Corporate Governance—Implementation, Challenges, and Trends (Feb. 9, 2005), available at [http://www.unece.org/ie/wp8/documents/corpgov/horber\\_corp\\_gov.pdf](http://www.unece.org/ie/wp8/documents/corpgov/horber_corp_gov.pdf); see also Steven M. Mintz, *Corporate Governance in an International Context: Legal Systems, Financing Patterns and Cultural Variables*, 13 CORP. GOVERNANCE 582, 584 (2005) (“To be effective, corporate governance principles must be part of the culture of an organisation . . . . Once the board of directors and executive officers have agreed on the principles, their role as corporate leaders is to set the appropriate ethical tone for the company and communicate these principles throughout the organisation.”).

8. Although ethics often is a subject of discussion and analysis, the concept often goes undefined. For purposes of this essay, a person is ethical if that person acts in accordance with a group of moral principles— notions of right and wrong. For a brief summary of various conceptions of ethics, see Debra Moss Curtis, *Everything I Wanted To Know About Teaching Law School I Learned From Being a Kindergarten Teacher: Ethics in the Law School Classroom*, 2006 BYU EDUC. & L.J. 455, 458–60.

## DOES SARBANES-OXLEY FOSTER ETHICAL EXECUTIVE ROLE MODELS?

of existing corporate governance regulation—in fact promotes or permits the production or preservation of ethical role models in the executive ranks of public companies. An absence of support for ethical role models in public companies may signal the failure of broad-based federal corporate governance initiatives like Sarbanes-Oxley.

This Article assumes that role models—ethical roles models—may be important to the maintenance of good corporate governance (in general) and the success of Sarbanes-Oxley as a corporate governance initiative (in specific). In other words, this Article assumes that the rhetoric quoted and cited above has a basis in reality. (Although empirical work should be done to directly support this assumption, that empirical work must wait for another day.) With the noted assumptions in mind, this Article preliminarily analyzes whether Sarbanes-Oxley may encourage or discourage the existence of ethical role models in the corporation.

The preliminary analysis presented here proceeds in three further parts. First, in Part I, the Article briefly surveys social sciences literature on ethical role models. This Part focuses on both defining what an ethical role model is and identifying the conditions for creating and maintaining ethical role models in the corporation. Then, in Part II, the Article highlights certain relevant provisions from Sarbanes-Oxley that influence ethical behavior in the executive ranks and, therefore, may have an effect on role model creation and maintenance. Finally, the Article concludes in Part III by briefly summarizing and synthesizing the information included in Parts I and II.

### I. THE CREATION AND MAINTENANCE OF ETHICAL ROLE MODELS

#### A. *The Concept of an Ethical Role Model*

The term “role model” apparently was coined by Robert King Merton more than 50 years ago.<sup>9</sup> He wrote: “The concept of role model . . . [denotes] a . . . limited identification with an individual in . . . one or a selected few of his roles.”<sup>10</sup> Since that time, others have ventured forth with their own definitions. For example, a current social sciences dictionary defines role models as “persons who represent broader sets of social values and provide ideal enactments of those values.”<sup>11</sup> The study of role modeling spans the social sciences, from sociology to psychology to business management. “Role modeling in general is an aspect of social learning.”<sup>12</sup>

Despite the fact that the concept of a role model is a half-century old, we have much to learn about role models in general and ethical role models in particular.

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9. ROBERT K. MERTON, *SOCIAL THEORY AND SOCIAL STRUCTURE* 302–03 (rev. ed. 1957).

10. *Id.* at 302–03. Role models represent a narrow conception of “reference individuals;” a “person who identifies himself with a reference individual will seek to approximate the behavior and values of that individual in his several roles.” *Id.* at 302.

11. *DICTIONARY OF THE SOCIAL SCIENCES* 419 (Craig Calhoun ed., 2002).

12. Gary R. Weaver, Linda Klebe Treviño & Bradley Agle, “*Somebody I Look Up To: Ethical Role Models in Organizations*,” 34 *ORG. DYNAMICS* 313, 329 (2005).

Certain things, however, are relatively clear. In a paper published in 2005, for example, three researchers identified “four categories of attitudes and behaviors . . . along with a related foundation of contextual factors relevant to identifying someone as an ethical role model.”<sup>13</sup> These attitudes and behaviors include:

- Interpersonal Behaviors;<sup>14</sup>
- Ethical Actions and Expectations for Self;<sup>15</sup>
- Fairness with Others;<sup>16</sup> and
- Articulating Ethical Standards for Others.<sup>17</sup>

The specific findings of these researchers regarding the component attributes underlying these four principal attitudes and behaviors are rich and detailed.

- In terms of “[i]nterpersonal behaviors,” an ethical role model exhibits “care, concern and compassion,” “support[s] and take[s] responsibility for other[s],” “[v]alues and maintains relationships,” is “[h]ard working and helpful,” “[a]ccentuates the positive,” and “[a]ccepts others’ failures.”<sup>18</sup>
- An ethical role model’s “[e]thical action and expectation for self” comprise “[h]onesty,” “[t]rustworthiness,” “[i]ntegrity,” and “[h]umility,” and, along the same lines, an ethical role model holds himself or herself “to high ethical standards,” is “[c]onsistently ethical in public and private life,” is “[s]elf-sacrificial,” and “[a]ccepts responsibility for, and [is] open about, [his or her] own ethical failings.”<sup>19</sup>
- An ethical role model’s manifestations of “[f]airness with others” include equitably distributing resources, being “[o]pen to and solicitous of input,” treating people with “[e]qual respect,” and “[o]ffer[ing] explanations of decisions.”<sup>20</sup>
- As an articulator of ethical standards, an ethical role model has an “[u]ncompromising, consistent ethical vision,” “[c]ommunicates high ethical standards,” “[h]olds others ethically accountable,” “[p]uts ethics above personal/company interests,” and takes a “[l]ong-term, multiple stakeholder perspective.”<sup>21</sup>

These personal attributes exist in a context that also has certain identifiable characteristics. An ethical role model engages in “[f]requent interactions,” is “[r]espected by others,” and is not necessarily a business success.<sup>22</sup> These research observations indicate that ethical role modeling requires both personal attributes and actions consistent with those attributes.<sup>23</sup>

13. *Id.* at 315.

14. *Id.* at 315–17.

15. *Id.* at 318–20.

16. *Id.* at 320–21.

17. *Id.* at 321–23.

18. *Id.* at 316–17.

19. *Id.* at 316, 318–20.

20. *Id.* at 316, 320–21.

21. *Id.* at 316, 321–23.

22. *Id.* at 316, 323–24.

23. *Id.* at 318 (“Ethical role models act ethically, and have high ethical expectations for themselves.”).



## DOES SARBANES-OXLEY FOSTER ETHICAL EXECUTIVE ROLE MODELS?

Ethical role models may be distinguished from ethical mentors. Although both role models and mentors convey information about best practices, role modeling is comprised of relationships that (for the most part) are not entered into consciously, whereas mentoring typically is a voluntary association between or among people.<sup>24</sup> This may mean that role models are more likely to be created in an environment conducive to the establishment of the requisite actions and relationships than through institutionally mandated actions and relationships.

Ethical role models also are distinguishable from ethical leaders. “[A]lthough ethical role modeling is closely related to ethical leadership, they are not the same thing.”<sup>25</sup> Ethical role models and ethical leaders may (and undoubtedly do) share leadership-type attributes and actions, but it takes more than being an ethical leader to be an ethical role model. Ethical role modeling requires a high-level, pervasive transparency. Specifically, an ethical role model must be transparent to those around him or her in a way that honestly transmits not only his or her own high standards of behavior and the similarly high standards by which all should abide, but also his or her own faults and failures to meet these standards.<sup>26</sup>

*Recent research from the ERC Fellows Program supports the notion that being perceived as an ethical role model requires more than simply being an ethical person. Leaders must make visible the ethical challenges they face and the ethical standards they apply to any given situation. . . . ethical leaders can fail in the role of being an ethical role model—simply by failing to make the ethical issues explicit.*<sup>27</sup>

It is not surprising, then, that humility also is an identified characteristic of an ethical role model, making role models more compelling (perhaps), but hard to identify.<sup>28</sup>

We cannot say much more about ethical role models based on the existing literature. Undoubtedly, more work should be done to isolate the concept more clearly. Yet, as little as we know about ethical role models overall, we know significantly less about the part they play in creating and maintaining ethical organizational structures and activities, although we sense that ethical role models can contribute positively to those efforts.<sup>29</sup> It is important that this connection also be more closely analyzed. In any event, the current state of research on the elements and function of ethical role modeling is summarized well in the following quote.

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24. *Id.* at 314.

25. *Id.* at 324.

26. *Id.* at 324–25.

27. Gilman, *supra* note 5 (endnotes omitted).

28. See Weaver, Treviño & Agle, *supra* note 12, at 326.

29. See, e.g., *id.* at 314, 327–28.

*Modeling is a well-documented means of transmitting values, attitudes, and behaviors in all types of settings, including work. People learn much of what they know not through direct experience, but by observing the behavior of others. In the modeling process, people identify with another person, and internalize the role model's values, behaviors, or attitudes. In effect, people form a mental picture of how a role model acts in various situations, and then apply that image to the varied and novel situations they themselves encounter. In effect, people use role models to help define themselves and guide their own behavior. When it comes to ethical behavior at work, modeling is likely a powerful learning tool. Yet despite this, we know little about role modeling and how it works in the ethics arena.*<sup>30</sup>

*B. Conditions Conducive to the Establishment and Continued Existence of Ethical Role Models in the Corporation*

So, a person must (at a minimum) be ethical and humble and act ethically in a public and transparent manner in order to be an ethical role model.<sup>31</sup> Ethical nature and humility, as well as other individual attributes, are character traits inherent in or socialized into an individual over time, and they may have a role in dictating human activity.<sup>32</sup> However, the actions of individuals also are heavily influenced by environment. In fact, it has been observed that “the primary motivators of individual behavior are the situational constraints faced by the individual.”<sup>33</sup> How, then, may a rule (legal or other), organizational structure, or broader social context create an environment in which an ethical, humble person is employed and retained by a corporation and is permitted—even encouraged—to behave as an ethical role model?

There is no simple legal or other litmus test that enables a corporation to gauge the ethics or humility of a job applicant or employee.<sup>34</sup> An ethical, humble corpo-

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30. *Id.* at 314.

31. I recognize that I have measurably shortened the earlier described characteristics of a role model for the sake of simplicity and ease of presentation, although I endeavored to retain the essence of those characteristics. For the more fulsome description, see *supra* notes 18–28 and accompanying text.

32. See Richard Lavoie, *Subverting the Rule of Law: The Judiciary's Role in Fostering Unethical Behavior*, 75 U. COLO. L. REV. 115, 127 (2004) (“For a character trait to viably serve this function, it must (1) consistently come into play in a wide variety of divergent factual situations; (2) recur over time; and (3) significantly influence behavior.”).

33. *Id.* at 121. Professor Lavoie further notes that “a person’s internal character has little to do with whether she behaves ethically, but external factors, like her perception of the risk of having her unethical behavior discovered and censured, have a marked effect on her behavior.” *Id.* at 121–22; see also Lynne L. Dallas, *A Preliminary Inquiry into the Responsibility of Corporations and their Officers and Directors for Corporate Climate: The Psychology of Enron's Demise*, 35 RUTGERS L.J. 1 (2003) (describing in detail the role of social context in ethical corporate behavior and decision making and ways to evaluate and create a positive social context for the establishment of an ethical corporate climate).

34. See Jeffrey L. Seglin, *Will More Rules Yield Better Corporate Behavior?*, N.Y. TIMES, Nov. 17, 2002, § 3, at 4 (“While it might be possible to screen prospective executives for past successes in managing corporate

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rate leader, however, may be more likely to attract ethical, humble employees.<sup>35</sup> Similarly, the visible, transparent transmission of ethical values is hard to measure in an interview or periodic employee evaluation. Corporations should, of course, be alert to signs that these positive personal characteristics—and the capacity for the transmission of values to others through action—exist in their job applicants and employees.<sup>36</sup> However, because more is known about incentives to ethical conduct created by law and social context, the remainder of this Part focuses on the encouragement of ethical behavior in the corporation.

Law is inextricably intertwined with society.<sup>37</sup> Among other things, law and social context function together to represent and influence the ethical, humble, transparent behavior necessary for the creation and maintenance of role models.

*The law is created within the context of a particular society and must reflect the moral values of that society if it is to be obeyed and respected. Similarly, what is considered moral by a society is influenced by what is legally permitted. If the law consciously rejects society's cultural feedback, then unacceptable levels of unethical behavior will result.*<sup>38</sup>

Although it is often said that one cannot legislate ethics, law may have multiple roles in the encouragement of ethical behavior in a way that supports the development and sustained existence of ethical role models. Specifically, law can provide situational constraints on individuals by indicating what is unethical and ethical, punishing behavior that is unethical, or creating an environment in which ethical behavior is welcomed and rewarded.<sup>39</sup> Yet, law may not always reinforce desired behaviors; law has a social context and a social construction.<sup>40</sup> Among other things, “[f]or the law to serve as an effective constraint on behavior, the members of the

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growth or achieving favorable stock performance, how do you measure for something as apparently subjective as integrity?”).

35. See Dallas, *supra* note 33, at 42.

36. See *id.* (“When an outsider is being considered for a leadership position, those doing the considering should learn as much as possible about how that person has behaved in the past.”).

37. H.L.A. HART, *THE CONCEPT OF LAW* 197, 199 (1961) (“[T]he existence of a legal system is a social phenomenon” and “[t]he law of every modern state shows at a thousand points the influence of both the accepted social morality and wider moral ideals.”).

38. Lavoie, *supra* note 32, at 118; see also HART, *supra* note 37, at 181 (“[I]t cannot seriously be disputed that the development of law, at all times and places, has in fact been profoundly influenced . . . by the conventional morality and ideals of particular social groups . . .”).

39. See Hess et al., *supra* note 5, at 758–64; Lavoie, *supra* note 32, at 135; see also Scott Harshbarger & Goutam U. Jois, *Looking Back and Looking Forward: Sarbanes-Oxley and the Future of Corporate Governance*, 40 *AKRON L. REV.* 1, 45 (2007) (“[A] strong regulatory baseline . . . can provide business leaders with the protection they need to be ethical in a competitive market.”).

40. See, e.g., HART, *supra* note 37, at 199 (noting that even the “liability for both civil and criminal wrongs may be adjusted to prevailing views of moral responsibility”); Frederick Schauer, *The Social Construction of the Concept of Law: A Reply to Julie Dickson*, 25 *OXFORD J. LEGAL STUD.* 493, 496 (2005).

society must respect the substance of the laws and the process by which they are created and enforced.”<sup>41</sup>

Accordingly, law alone is not enough to fashion ethical role models from ethical people and encourage the long-term, consistent, open behaviors that promote and perpetuate the existence of ethical role models. Positive social context (interactions between and among stakeholders that can be, but are not always, instigated or facilitated by legal rules) also plays a key role. “[T]he relationship between regulators, corporate leaders, and professionals can and should be directed to foster an ethical, competitive corporate culture.”<sup>42</sup> Culture impacts ethical behavior and, therefore, the existence of role models.

Corporations are creatures of law; they are organized, structured, and operated within the parameters of law, principally under rules provided by state corporate law and (especially but not exclusively as to public companies) federal securities law.<sup>43</sup> Apart from establishing basic governance and operating structures and roles, these laws largely do two things relevant to ethical role modeling: identify illegal and legal behavior; and prescribe punishment (criminal and civil) for those who behave illegally.<sup>44</sup> In these ways, law influences unethical and ethical behavior in the corporation.

Society (both outside and inside the corporation) also constrains corporate activities. Social rebuke for unethical behavior is not uncommon. Moreover, a corporation’s adoption of legally permissible governance and operating structures provides social context for the behavior of the corporation’s agents in conducting the corporation’s business. These structures can impact ethical behavior in the corporation by providing operational constraints on unethical behavior or organizational impetus for ethical behavior—by helping to frame a corporate culture. Together with law, social context impacts the behavior of corporate agents.

*Unethical corporate action is not the result of “evil” executives. Unethical activities arise because the circumstances of the situation fail to constrain the behavior. Two key constraints in this regard are (1) the action’s legality; and (2) the risk of group censure. . . . However, . . . [s]ociety must also create and reinforce social constraints aimed at minimizing unethical behavior.*<sup>45</sup>

Law, then, may promote role modeling in the corporation both by defining unethical conduct as illegal and by encouraging the development of a supportive social context outside and inside the corporation—a context that channels corporate agents toward genuine, consistent, transparent ethical behavior.

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41. Lavoie, *supra* note 32, at 138.

42. Harshbarger & Jois, *supra* note 39, at 35.

43. *Santa Fe Indus. v. Green*, 430 U.S. 462, 479 (1977) (“‘Corporations are creatures of state law . . . .’”) (quoting *Cort v. Ash*, 422 U.S. 66, 84 (1975)).

44. See HART, *supra* note 37, at 27.

45. Lavoie, *supra* note 32, at 169–70 (footnotes omitted).

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However, law is not the only influence on social context. The forces that comprise and impact society are complex. Part of the complexity comes from an inability to define the concept of society as it operates in specific circumstances: society may be construed broadly or narrowly, depending on defined context.<sup>46</sup>

Corporate society is a microcosm of society as a whole. An individual employee interacts with different groups of people during different corporate activities. Each interaction provides and builds a social context for the individual employee's behavior. Combined, these interactions create a corporate culture,<sup>47</sup> a way of life in the corporation that reflects the corporation's ethical climate.<sup>48</sup> To change the overall tenor of these social interactions, a corporation must change its overall culture.<sup>49</sup> Creating or changing corporate culture is time-intensive and tricky.<sup>50</sup>

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46. Merriam Webster's definition of society includes "a community, nation, or broad grouping of people having common traditions, institutions, and collective activities and interest" as well as "a part of a community that is a unit distinguishable by particular aims or standards of living or conduct : a social circle or a group of social circles having a clearly marked identity." MERRIAM WEBSTER'S COLLEGIATE DICTIONARY 1115 (10th ed. 1996). Therefore, one society can contain numerous other societies within it. For example, there can be both a national society defined by citizenship of a particular nation, while multiple sub-societies consisting of different religious or ethnic similarities exist within the national society.

47. While corporate culture is somewhat ill-defined, it is a legally recognized concept. See Tamar Frankel, *Using the Sarbanes-Oxley Act to Reward Honest Corporations*, 62 BUS. LAW. 161, 163-65 (2006); see also LYNN L. DALLAS, *LAW AND PUBLIC POLICY: A SOCIOECONOMIC APPROACH* 565 (2005) ("Corporate culture is defined as a 'complex set of common beliefs and expectations held by members of the organization,' which are based on shared values, assumptions, attitudes and norms.") (citing Vicky Arnold & James C. Lampe, *Understanding the Factors Underlying Ethical Organizations: Enabling Continuous Ethical Improvement*, 15 J. APPLIED BUS. RES. 1, 2 (1999)); Patricia S. Abril & Ann Morales Olazábal, *The Locus of Corporate Science*, 2006 COLUM. BUS. L. REV. 81, 128 ("'Corporate culture' is defined in broad terms that include informal or implicit conduct and practices (including *sub rosa* encouragement), as well as stated policies and formal rules: 'Corporate culture' is an attitude, policy, rule, course of conduct or practice existing within the body corporate generally or within the area of the body corporate in which the relevant activities take place.") (citing MODEL CRIMINAL CODE § 501.2 (Crim. Law Officers Comm. of the Standing Comm. of the Atty's-Gen. 1992) (Austl.)); Victor Fleischer, *Options Backdating, Tax Shelters, and Corporate Culture*, 26 VA. TAX REV. 1031, 1046 (2007) ("Corporate culture may be defined as the shared beliefs and values of the members of a firm. Or, to put it more concretely, corporate culture is 'the way we do things around here.'").

48. In distinguishing between corporate culture and ethical climate, one prominent legal scholar offers the following explanation.

Corporate culture is defined as a "complex set of common beliefs and expectations held by members of the organization," which are based on shared values, assumptions, attitudes and norms. The corporation's ethical climate refers to the ethical meaning attached by employees to organizational policies, practices, and procedures. These policies, practices, and procedures influence moral awareness, the criteria used in decision-making, whether morals will have priority over other values, and moral behavior. Important to ascertaining corporate culture are the employees' perceptions of the corporation's values - as reflected by the corporation's mission statement and code of ethics, the criteria for business decisions, the words and actions of leaders, the handling of conflicts of interest, the reward system, the guidance provided to employees concerning dealing with ethical issues, and the monitoring system.

Dallas, *supra* note 33, at 3.

49. See Frankel, *supra* note 47, at 164-65.

50. *Id.* at 165 ("Changing corporate culture and the processes that comprise it takes time and great effort.").

Creating or changing the ethical components of culture in a corporation is exceedingly difficult because it typically involves a top-down change in corporate interactions with buy-in at all levels of corporate operations. Although the behavior of the chief executive, operating, financial, and accounting officers of a corporation often has a formative role in establishing an ethical corporate tone,<sup>51</sup> culture creation requires that all corporate decision making flow from a core set of common ethical principles consistently and openly observed in practice by corporate management at all levels.<sup>52</sup> “[I]n successful companies, the entire organization *lived* the core purpose every day.”<sup>53</sup> Perhaps more specifically, in terms of corporate leadership, “[e]xecutives and directors must be role models whose behavior mirrors the company’s code of ethics. And they must act on what they say. After all, ethics and values are matters of the feet and the heart, not just matters of the mouth.”<sup>54</sup>

## II. SARBANES-OXLEY AND ETHICS IN THE CORPORATION

Although Sarbanes-Oxley does not expressly provide for the creation of ethical role models in the corporation (as a statutory purpose or otherwise), the prevention of unethical corporate behavior is one of the act’s implicit purposes. Sarbanes-Oxley was enacted (in the wake of revelations of corporate fraud just after the turn of the century) “[t]o protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.”<sup>55</sup> The “other purposes” referenced in this introduction to Sarbanes-Oxley are vast. The operative coverage of the Act includes disclosure regulation, conduct regulation (including the regulation of corporate governance practices), civil procedure rules, civil and criminal penalties, and more.<sup>56</sup> The substantive breadth and depth

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51. See Jayne W. Barnard, *Reintegrative Shaming In Corporate Sentencing*, 72 S. CAL. L. REV. 959, 975–80 (1999).

52. Weaver, Treviño & Agle, *supra* note 12, at 314 (“Research studies . . . have demonstrated the importance of top management commitment in fostering ethical business practices within an organization. But employees often are influenced most by those closest to them—the people they work with every day.”); O.C. Ferrell & Linda Ferrell, *Developing a Framework for a College of Business: Business Ethics Initiative* (n.d.) (unpublished manuscript, available at <http://www.e-businessethics.com/TeachingResources/DevelopFrameWork.pdf>) (“If leaders do not actively serve as role models for the organization’s core values, then those values become nothing more than ‘lip service.’ . . . Leaders whose decisions and actions are contrary to the firm’s values, send a signal that the firm’s values are trivial or irrelevant. . . . On the other hand, when leaders model the firm’s core values at every turn, the results can be powerful.”); Joseph G. Sepesy, *Establishing an Effective Ethics Office: One Company’s Experience in the Post-Enron Era*, MITCH. B.J., Sept. 2006, at 34, 37–38 (quoting a major corporate CEO espousing this view).

53. R. Edward Freeman, *Create a New Story About Business: We Have a Unique Moment to Make a Lasting Difference in Corporate Practice. This is a Moment We Must Seize*, DIRS. & BDS., Mar. 22, 2005, at 22, 26 (emphasis added).

54. *Id.* at 26.

55. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 pmbl.

56. See *id.* § 1(b) (the Table of Contents effectively describing the breadth of the act, including titles covering “Public Accounting Oversight Board,” “Corporate Responsibility,” “Enhanced Financial Disclosures,” “Corporate and Criminal Fraud Accountability,” “White Collar Crime Penalty Enhancements,” and “Corporate Fraud and Accountability”).

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of these provisions indicate that Sarbanes-Oxley's purposes extend to, among other things, increasing oversight by, and the accountability of, management and gatekeepers and changing corporate culture in a manner that supports ethical conduct.<sup>57</sup> These purposes are potential building blocks in the creation and maintenance of ethical role models in the corporation.

In the aggregate, the prescriptions and proscriptions of Sarbanes-Oxley directly or indirectly constrain certain otherwise common conduct engaged in by executives and employees and significantly increase the number and complexity of tasks required to be completed by corporate executives and employees.<sup>58</sup> The constraints on conduct come in a variety of forms, each of which is designed to channel executives toward ethical behavior.

For example, section 406 of Sarbanes-Oxley<sup>59</sup> requires, by directing the Securities and Exchange Commission (SEC) to adopt implementing rules, that a public company disclose to the SEC whether it 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) and, if not, the reasons why it has not adopted a code of ethics.<sup>60</sup> The law also directs the SEC to mandate immediate disclosure by a public company of any change to or waiver of its code of ethics.<sup>61</sup>

It is easy to see from the way in which section 406 is drafted that events relating to the collapse of Enron Corp. in the late fall of 2001 are the genesis of this portion of the law (and a significant catalyst of Sarbanes-Oxley generally). Enron had a code of ethics, but it waived compliance with the code in key circumstances.<sup>62</sup> Enron's conduct and fate demonstrate that "a corporate code of behavior is only as good as the people charged with enforcing it and those who must demonstrate the

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57. See, e.g., George W. Bush, President of the United States, Remarks by the President at Signing of H.R. 3763, Sarbanes-Oxley Act of 2002 (July 30, 2002), available at 2002 WL 1751366 [hereinafter Bush Remarks].

58. See *id.*; see also Jonathan Peterson, *Companies Blazing a Paper Trail to Comply with New SEC Rules*, L.A. TIMES, Feb. 24, 2003, § 3, at 1 (noting that many executives now spend most of their time in Sarbanes-Oxley-related activities).

59. Sarbanes-Oxley Act § 406, 15 U.S.C. § 7264 (Supp. V 2004).

60. *Id.* § 406(a). The term "code of ethics" is defined to include:

standards . . . reasonably necessary to promote—

(1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

(2) full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and

(3) compliance with applicable governmental rules and regulations.

*Id.* § 406(c).

61. *Id.* § 406(b).

62. See Note, *The Good, the Bad, and Their Corporate Codes of Ethics: Enron, Sarbanes-Oxley, and the Problems with Legislating Good Behavior*, 116 HARV. L. REV. 2123, 2129–30 (2003) [hereinafter *The Good*].

importance of compliance by their example.<sup>63</sup> The limited legislative history indicates that Congress may have recognized this.<sup>64</sup>

Sarbanes-Oxley section 406 therefore may be viewed as promoting behavioral channeling or modification. Specifically, section 406 appears to be devised to emphasize ethical management conduct by imposing disclosure requirements that are designed to engage those outside and inside the corporation in conversations and analyses of the ethics and actions of senior management.<sup>65</sup> This approach allows for greater scrutiny of both the ethical constraints imposed by the corporation on its management and the board's oversight of those constraints.

Although section 302<sup>66</sup> of Sarbanes-Oxley does not deal directly with corporate ethics, its intent to encourage ethical conduct also is clear. Section 302 directs the SEC to establish rules requiring the principal executive officer or officers and the principal financial officer or officers to certify each periodic report and certain other items, including: their review of the report; the absence of misstatements or omissions to state material fact in that report (to their knowledge); the fair presentation of the financial statements included in the report (to their knowledge); their responsibility for, and other matters relating to, internal controls;<sup>67</sup> their disclosure of certain key negative items affecting the corporation (significant deficiencies and fraud); and changes to internal controls or matters affecting internal controls.<sup>68</sup> Certification of financial statement compliance also is required under a separate provision of Sarbanes-Oxley, section 906, under which criminal penalties may be assessed for noncompliance.<sup>69</sup>

The certification requirements in Sarbanes-Oxley section 302 and section 906 reinforce ethical behavior in the corporation by making two of the most senior corporate executives personally responsible for the accuracy and completeness of key financial and operating information included in periodic reports required to be filed by all public companies.<sup>70</sup> Sections 302 and 906 also make these corporate officers responsible for the process underlying the production of the corporation's financial statements,<sup>71</sup> and section 906 makes these same officers personally, crimi-

63. *Id.* at 2130.

64. See 148 CONG. REC. H5472 (daily ed. July 25, 2002) (statement of Rep. Jackson-Lee).

65. Sarbanes-Oxley Act § 406(b) (requiring "the immediate disclosure . . . 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.").

66. *Id.* § 302 (codified as amended at 15 U.S.C. § 7241).

67. *Id.* § 302(a)(1)–(4)(A). A related provision to section 302(a)(4)(A), Sarbanes-Oxley section 404, requires the SEC to establish rules providing for an internal control report that "state[s] the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting" as well as "contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting." *Id.* § 404(a) (codified as amended at 15 U.S.C. § 7262(a)).

68. *Id.* § 302(a)(5)–(6).

69. *Id.* § 906 (codified as amended at 18 U.S.C. § 1350).

70. See *id.* §§ 302, 906.

71. See *id.* §§ 302(a)(4), 906(b).



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nally liable for knowing noncompliance with the related financial statement certification requirements.<sup>72</sup>

Although prior law included executive signature requirements (which still exist) and related certifications as part of the reporting responsibility for every public company, after enactment of the more stringent officer certification and penalty provisions Sarbanes-Oxley, it is clear that corporate officers cannot “look the other way” when it comes to important corporate disclosures, especially those in the corporation’s financial statements.<sup>73</sup> In light of the pervasiveness of the requirements and the strict nature of the potential penalties, Chief Executive Officers (CEOs) and Chief Financial Officers (CFOs) ask the subordinate employees responsible for assembling and checking the financial information included in each periodic report to certify the same matters to them that they have to certify under section 302.<sup>74</sup> While this “passing of the buck” may seem to take away from the primary responsibility of the key responsible executives, this process may, if executed in an appropriate social context, have the unintended benefit of encouraging ethical behavior in each of these subordinates.

As final examples (although there are many more<sup>75</sup>), it seems important to consider sections 402<sup>76</sup> and 306<sup>77</sup> of Sarbanes-Oxley, which effectively prohibit, respectively, (1) loans by public companies to their executives, other than ordinary course consumer lending transactions (punishable through an SEC enforcement action against the company);<sup>78</sup> and (2) most trading of equity securities acquired in connection with service for the firm during any pension fund “blackout period” (punishable through profit disgorgement by the executive).<sup>79</sup> These statutory

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72. See *id.* § 906(c).

73. Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)*, 35 CONN. L. REV. 915, 955–56 (2003) (“These provisions look to prevent CEOs and CFOs from hiding behind the defense of ignorance.”). See generally Lisa M. Fairfax, *Form Over Substance?: Officer Certification and the Promise of Enhanced Personal Accountability Under the Sarbanes-Oxley Act*, 55 RUTGERS L. REV. 1 (2002) (acknowledging that the certification requirements may force better internal controls, but arguing that their overall importance may be merely symbolic).

74. Cunningham, *supra* note 73, at 955 (“As a practical matter, the chief effect is that those officers will now insist that subordinates certify what they send up—generating ‘sub-certifications.’”).

75. Of particular note are the lengthened statute of limitations for securities fraud actions provided for in sections 804 of Sarbanes-Oxley, Sarbanes-Oxley Act § 804(b) (codified as amended at 28 U.S.C. § 1658(b)), which may make it easier to pursue fraudulent actors, and the stiffer penalties for fraud introduced in section 807 of Sarbanes-Oxley, *id.* at § 807 (codified as amended at 18 U.S.C. § 1348), which may increase deterrence by increasing apprehension about significant jail time or monetary fines. An increased risk of legal action or significant penalties may channel behavior away from illegal activity.

76. *Id.* § 402 (codified as amended at 15 U.S.C. § 78m(k)).

77. *Id.* § 306 (codified as amended at 15 U.S.C. § 7244).

78. *Id.* § 402 (codified as amended at 15 U.S.C. § 78m(k)).

79. *Id.* § 306(a) (codified as amended at 15 U.S.C. § 7244). The term “blackout period” is defined to generally include, subject to exceptions, a

period of more than 3 consecutive business days during which the ability of not fewer than 50 percent of the participants or beneficiaries under all individual account plans maintained by the issuer to purchase, sell, or otherwise acquire or transfer an interest in any equity of such issuer held

prohibitions on conduct, like many other provisions in Sarbanes-Oxley, directly address (by proscription of related activities—personal loans and trading during blackout periods) certain unethical, even if not illegal, conduct engaged in by corporate executives in public companies involved in fraudulent behavior.<sup>80</sup> By putting a halt to activities that may be used by executives in unethical ways, sections 402 and 306 of Sarbanes-Oxley aim to promote ethical behavior.

These selected provisions from Sarbanes-Oxley evidence a pervasive scheme to encourage ethical behavior in the executive ranks of corporate America.<sup>81</sup> While they do not directly address the attraction of ethical, humble people to those ranks, the ethical behavior requirements and guidance created by these provisions may make the public company CEO or CFO job more attractive to an ethical candidate (or, at least, less attractive to an unethical applicant). However, there is no solid empirical evidence—yet—that the requisite societal environment for an ethical corporate culture, including appropriate situational constraints on behavior, has developed or is developing in such a way as to support Sarbanes-Oxley's ethical mission or that Sarbanes-Oxley encourages the kind of behavior and transparency that is exhibited by ethical role models.<sup>82</sup>

### III. SYNTHESIS AND CONCLUSION

Through its many disclosure, conduct, process, and penalty provisions, Sarbanes-Oxley attempts to create a common core of ethical behavior in public companies. This is a laudatory purpose, and there is some evidence that behaviors have changed in a positive direction as a result of the implementation of the Act. For example, public company executives necessarily are spending more time on assuring the accuracy and completeness of financial statements and other information

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in such an individual account plan is temporarily suspended by the issuer or by a fiduciary of the plan . . . .

*Id.* § 306(a)(4)(A).

80. Professor Lawrence Cunningham outlines the direct relationship between these two provisions of Sarbanes-Oxley in an early article on the act. With respect to Rule 402, he notes:

The provision is a direct response to the non-accounting corporate scandals at Adelphia and Tyco, both of which made sweetheart loans to insiders, tallying in Adelphia's case more than \$ 3.2 billion. Sweetheart loans are often used by insiders at late-stage companies, when powerholders know before others that insolvency is around the corner (those at Adelphia, a telecom player, are likely examples).

Cunningham, *supra* note 73, at 960. Similarly, in commenting on the origins of Rule 306, he observes that “[a]t the Big Four Frauds and other companies in the financial tornadoes following the tele-dot-com meltdown, insiders sold shares as stock prices plunged—even as the company's pension plan participants were forbidden under existing federal rules to sell shares or make other investment switches.” *Id.* at 958.

81. See, e.g., Stephanie Armour, *More Companies Urge Workers to Blow the Whistle*, USA TODAY, Dec. 16, 2002, at 1B (discussing companies' increasing encouragement of whistleblowers in the wake of Sarbanes-Oxley); Bush Remarks, *supra* note 57.

82. There are, however, some anecdotal examples of corporate policies and programs in the post-Sarbanes-Oxley era that positively influence ethical role modeling and culture. E.g., Sepesy, *supra* note 52, at 34–38.

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included in periodic reports.<sup>83</sup> A recent paper notes that Sarbanes-Oxley may be increasing accountability and reducing risk-taking in a way that could be construed as positive.<sup>84</sup>

However, the full benefits of Sarbanes-Oxley may not be achievable if their realization depends on the encouragement and sustained existence of ethical role models in public companies. In particular, despite creating a complex ethics system for public company executives by legal prescription, proscription, and penalty, Sarbanes-Oxley may not encourage—and in fact may discourage—the ongoing cultivation of ethical executive role models. There are two principal reasons why Sarbanes-Oxley may have this unintended negative effect, and they are interrelated. First, Sarbanes-Oxley may fail to create or support the social context necessary to maintain the ethical framework it imposes.<sup>85</sup> Second, senior executives are overwhelmed with compliance-related activities, affording them little time to engage in the kind of open, transparent interactions with each other and others in the corporation that will enable the establishment, transmission, and internalization of ethical values in the corporation.<sup>86</sup>

Sarbanes-Oxley ultimately may fail to motivate public company executives to concerted ethical behavior (stymieing role model production) because of its social construction—the way the regulation plays out in the corporate setting.<sup>87</sup> This social construction emanates from the origins of the Act and continues through its implementation over time.<sup>88</sup> Accordingly, the ideas expressed here are necessarily preliminary.<sup>89</sup>

Sarbanes-Oxley is crisis legislation—adopted in haste as a result of significant political pressure for a legislative cure-all to our nation's highly publicized corporate scandals.<sup>90</sup> The Act was enacted and is being implemented in an environment and manner that (at least arguably) disrespects executives and others in and en-

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83. Cynthia A. Glassman, Comm'r, SEC, Speech at the Federal Reserve Bank of Chicago Conference on Bank Structure and Competition: Private and Public Sector Responses to Corporate Governance Issues (May 9, 2003), available at <http://www.sec.gov/news/speech/spch050903cag.htm>.

84. See Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817, 1828–33 (2007).

85. See *infra* notes 87–98 and accompanying text; see also Hess et al., *supra* note 5, at 758 (noting, for example, that “requiring firms to force compliance programs upon their employees runs the risk of developing distrust and working against the development of compliant and ethical organizations”).

86. See *infra* notes 99–104 and accompanying text.

87. See generally Langevoort, *supra* note 84. Langevoort's paper aims “to illuminate the social nature of SOX's diffusion into practice.” *Id.* at 1819. Langevoort also suggests a possibility that the “[e]nhanced independent director responsibilities, more expansive external audits, and pervasive internal controls [included in Sarbanes-Oxley] all have the capacity to be symbolic rather than real” and ultimately lead “[m]anagers . . . to capture control of them to reduce their potency—in good faith.” *Id.* at 1854.

88. *Id.* at 1819–20, 1845 (“SOX's meaning and perceived legitimacy will be determined by an interaction among all the interpretive communities . . .”).

89. *Id.* at 1854 (“SOX's social construction will be a product of the interaction between choices now being made and events yet to come.”).

90. See *id.* at 1821.

gaged with public corporations, which may impact the Act's ability to influence executive behavior and, therefore, corporate culture and role modeling. Despite the significant burdens imposed on public company executives by Sarbanes-Oxley, because of the speed with which the Act and underlying regulations were adopted, corporate officials had little influence on or investment in the substance of the Act or the regulations adopted by the SEC and other agencies under the Act.<sup>91</sup>

If, as was earlier noted, law has a propensity to affect behavior only when society accepts the substance of the law and the process by which the law was adopted and implemented,<sup>92</sup> then Sarbanes-Oxley may have missed the mark. Former SEC Commissioner Cynthia Glassman apparently understands this connection between law and society (both outside and inside the corporation) in motivating ethical behavior, based on public comments in which she has expressed uncertainty about the ultimate efficacy of the SEC's rulemaking under Sarbanes-Oxley in creating the intended ethical environment.

*I can't walk away from any discussion of corporate governance without stressing that the most important aspect of reform comes from market participants working proactively to foster an ethical culture in business. This highlights the importance of market-based reforms because ethics is an area where the government frankly cannot legislate or regulate.*

*The Commission has put significant new rules on the books that I believe will affect behavior positively by providing incentives more consistent with fiduciary responsibilities. However, I hope we have not created unrealistic expectations that the new rules will solve all of our problems. Empty promises will not restore trust. Only if officers and directors follow the spirit as well as the letter of the new rules, will investors again place their full confidence to the markets.*<sup>93</sup>

Corporate executives (and, to a lesser extent, investors and other interested constituencies in the public at-large) question both the substance of the Act (and related agency regulations) and the process by which the law was enacted (and related regulations were adopted).<sup>94</sup> The lack of executive participation in and buy-in for

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91. This may or may not be relevant in the long run. "[S]tories about statutory origins and early histories tend to fade in importance—or be revised in collective memory—as regulation is implemented, interpreted, and enforced." *Id.* at 1833.

92. See *supra* note 41 and accompanying text (citing Lavoie, *supra* note 32, at 138).

93. Glassman, *supra* note 83.

94. See Jill E. Fisch, *Institutional Competition to Regulate Corporations: A Comment on Macey*, 55 CASE W. RES. L. REV. 617, 619 (2005) ("Many corporate executives have criticized Sarbanes-Oxley as an overreaction—imposing substantial compliance costs on the vast majority of law-abiding corporations based on the wrongdoing of a few bad apples."); Langevoort, *supra* note 84, at 1834–35 (stating an assumption, based on a hypothesis that executives "generally do not think of themselves as working directly for corporate shareholders," that "on average, managers consider SOX an intrusion and resent nearly all of it").

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Sarbanes-Oxley presents impediments to executive compliance with the letter and spirit of the Act.

To the extent that a societal context is created by Sarbanes-Oxley, it may be a culture of fear. An environment in which fear reigns may not be conducive to open ethical interactions.<sup>95</sup> Fear also may prompt executives to divert themselves from more useful ethical activities to compliance activities that may not measurably improve corporate governance or culture.<sup>96</sup> A culture of fear may, therefore, breed operating inefficiencies without necessarily increasing ethical corporate culture.

Speaking of inefficiencies, Sarbanes-Oxley is an expensive corporate proposition, and many feel that the expense is not appropriately allocated to and among those who need the behavioral corrections imposed by the Act.<sup>97</sup> Although the penalty provisions of Sarbanes-Oxley enable broad censure of executives who fail to comply (serving as a societal constraint on ethical behavior),<sup>98</sup> there is little additional evidence that Sarbanes-Oxley has created an appropriate societal context supportive of an ethical corporate culture. Without the appropriate, supportive societal context, Sarbanes-Oxley's ethical behavior system may fail to take permanent root in executives and enable them to serve as effective ethical role models.

Moreover, public company executives are so mired in the details of complying with Sarbanes-Oxley that (even if they are so inclined) they have little time to interact sincerely and openly among themselves and with others in the corporation in a manner that would enable them to serve as role models for Sarbanes-Oxley's ethical framework.<sup>99</sup> The officer certification and related internal controls provisions are particularly time-consuming, even if some of the time spent is misdirected.

*[W]e hear . . . that senior executives are spending much more time on the content of financial statements, including, by some accounts, a substantial amount of time on details that are not material to the presentation of the company's financial position. This is an unintended, but not wholly unex-*

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95. Cf. Kevin Werbach, *Sensors and Sensibilities*, 28 CARDOZO L. REV. 2321, 2367 (2007) (noting the "debate about whether . . . social shaming goes too far, and could create a culture of fear in which any behavioral lapse in public could permanently damage someone's reputation").

96. See Paul Fiorelli, *Will U.S. Sentencing Commission Amendments Encourage a New Ethical Culture Within Organizations?*, 39 WAKE FOREST L. REV. 565, 573 (2004) ("[T]hose honest executives who were using codes effectively prior to the Act will have perverse incentives to rewrite them for fear of the litigation and negative market signals that may stem from the heightened disclosure that Sarbanes-Oxley requires.").

97. See Fisch, *supra* note 94, at 619; Langevoort, *supra* note 84, at 1835 (noting that the cost of compliance is an issue that often raises criticism of SOX); Mintz, *supra* note 7, at 582 ("[I]t appears that the SOA [Sarbanes-Oxley Act] may be a costly example of the many paying for the mistakes of the few.").

98. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 807, 116 Stat. 745, 807 (codified as amended at 18 U.S.C. § 1348 (Supp. V 2006)).

99. See, e.g., Deborah Solomon & Cassell Bryan-Low, *Companies Complain About Cost of Corporate-Governance Rules*, WALL ST. J., Feb. 10, 2004, at A1 ("The real cost isn't the incremental dollars, it is having people that should be focused on the business focused instead on complying with the details of the rules." (internal quotations omitted)).

*pected, consequence as executives adjust to the idea of certifying results. . . . Hopefully, to the extent a problem exists, it will work itself out over time as companies have more experience operating under the new rules.*<sup>100</sup>

The overall danger in creating a heavy, detailed, expensive, time-consuming, legally driven system of “compliance ethics” is that the principle efforts of the firm are devoted to compliance, and a system of “enterprise ethics” therefore never develops.<sup>101</sup> The focus of management may remain on meeting the established legal requirements, merely for the sake of assuring compliance and avoiding resulting penalties for noncompliance.<sup>102</sup> The established legal and regulatory norms may come to replace, rather than supplement, market-based checks on business ethics and market-based sources of positive ethical change.<sup>103</sup>

*If there is anything that a careful review of ethics crises through the years has taught us, it is that we don't solve root causes by making more rules and laws. Hopes in this direction are misplaced. While the current perp walk, indictments, and trials are all necessary judgments on the past, they bring us no closer to a brighter future. Worse, they impart a false image of business as a process that is separate from ethics . . . .*<sup>104</sup>

Some blame the narrow focus of state law norms and fiduciary duties applicable to directors and officers for creating an environment that fails to foster ethics in the corporation.<sup>105</sup> However, as Congress enacts federal laws that extend further into corporate governance, it bears at least some of the responsibility in ensuring that law and regulation at a minimum coexist with, rather than supplant or dismantle, ethics in the corporation. Accordingly, federal corporate governance initiatives should be adopted only after a careful evaluation of their propensity to cultivate ethics in the corporation. As part of this effort, attention should be paid to fostering ethical role models in the executive ranks.

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100. Glassman, *supra* note 83.

101. Freeman, *supra* note 53, at 24 (using the quoted terms in a text box entitled “A uniting of ‘the letter and the spirit’”).

102. *Id.* (“In trying to address current ethics issues, we must be careful not to think we can legislate away every problem, issue, or variance.”); *see also* Seglin, *supra* note 34, at 4.

103. Freeman, *supra* note 53, at 24 (“[W]hen we create a false belief that all problems and issues are addressed by rules and regulations, we potentially discourage the kind of employee pushback and questioning that drove whistleblowers like Sherron Watkins at Enron and Cynthia Cooper at WorldCom to uncover two of the largest corporate frauds in history.”).

104. *Id.* at 24–25; *see also* Mintz, *supra* note 7, at 595 (“While new regulations can impose penalties for violating governance standards, they cannot create an ethical culture that fosters responsible behaviour. This can only occur if top management and the board establish an ethical environment in the organisation, one that promotes integrity, accountability and transparency.”).

105. Freeman, *supra* note 53, at 25.

## DOES SARBANES-OXLEY FOSTER ETHICAL EXECUTIVE ROLE MODELS?

As this discussion admits, the encouragement of ethical decision making in the corporation likely involves a complex interaction among state and federal laws and among a number of cognitive and behavioral factors in a societal context.<sup>106</sup> For example, as to interactions between and among legal rules, the Federal Sentencing Guidelines were amended after Sarbanes-Oxley in an attempt to strengthen ethical culture and behaviors in the corporation by creating ethics compliance programs that effectuate culture change.<sup>107</sup> These amendments work hand in hand with Sarbanes-Oxley in promoting ethical corporate environments, and (in fact) were prompted to some extent by the Act.<sup>108</sup> However, forces other than legislation and regulation may be successful, working with legal and regulatory pronouncements, in cultivating the appropriate interactions and environment for ethical role modeling and culture. For example, pressure from industry or peer groups, like The Business Roundtable, may be used to encourage the proliferation of ethical behavior and decision making in the corporation.<sup>109</sup> Lawyers and other professional gatekeepers (many of whom are subject to new or enhanced regulation under Sarbanes-Oxley), as well as their scholar counterparts, also may play an informal role in attracting the right people to management positions and encouraging them to create and maintain ethical corporate culture.<sup>110</sup> And, although the business judgment rule seems antithetical to the concept, courts may interpret and apply

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106. See generally Linda Klebe Treviño, *Ethical Decision Making in Organizations: A Person-Situation Interactionist Model*, 11 *ACAD. OF MGMT. REV.* 601 (1986) (discussing the interactionist model of decision making).

107. See *supra* note 5. The U.S. Sentencing Commission's work in this area is rooted in the same overall bodies of literature that support role modeling as important to the establishment and maintenance of a corporation's ethical culture.

The changes to the Guidelines to achieve the Commission's goal . . . are supported by research from management scholars. Although most compliance programs have characteristics of both compliance-based and integrity-based programs, the most successful programs are those where the characteristics of an integrity-based approach dominate. One of the most important factors is that of management commitment. When management demonstrates a commitment to ethics, then all members of the organization are more likely to view ethics as a key organizational value and take legal compliance initiatives more seriously. The new Guidelines expand the roles of top management by requiring them to participate in training. The Guidelines also create a duty for top management to ensure the effectiveness of the program.

Hess et al., *supra* note 5, at 744–45 (footnotes omitted).

108. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 805(a)(5), 116 Stat. 745, 805 (providing that “the United States Sentencing Commission shall review and amend, as appropriate, the Federal Sentencing Guidelines and related policy statements to ensure that . . . the guidelines that apply to organizations in United States Sentencing Guidelines, chapter 8, are sufficient to deter and punish organizational criminal misconduct”).

109. To some extent, this already has been done. Michele D. Beardslee, *If Multidisciplinary Partnerships are Introduced into the United States, What Could or Should be the Role of General Counsel?*, 9 *FORDHAM J. CORP. & FIN. L.* 1, 78–79 (2003) (“The Sarbanes-Oxley Act is calling out for companies to be vigilant with how they manage internal ethics and external relationships. Corporate-related professional associations, like The Business Roundtable, have done the same, calling out for companies, on their own, to enact best practices in corporate governance.”). But more is and will be needed.

110. See Therese H. Maynard, *Is the Moral Dimension of Fiduciary Duty Law Relevant to Teaching and Law Practice?*, *Law Matters. Lawyers Matter*, 76 *TUL. L. REV.* 1501, 1825–28 (2002); Fred C. Zacharias, *Coercing Clients: Can Lawyer Gatekeeper Rules Work?*, 47 *B.C. L. REV.* 455, 456 (2006) (“[L]awyers have legally recognized

legal rules to reinforce positive culture and ethics in the corporation.<sup>111</sup> Discrete efforts undertaken along these lines have not coalesced into concerted action that has made a cognizable difference in ethical role modeling or culture (likely, in large part, due to competing values and constituents within each interest group).<sup>112</sup> Nevertheless, these catalytic socio-legal forces—and the interaction among them and with legal rules—deserve further exploration as means of encouraging a receptive corporate context for Sarbanes-Oxley and other corporate governance reforms.

Regardless, legislation and regulatory pronouncements must and will continue to play a strong, and (hopefully) more enlightened, role. Among other things, legislatures, agencies, and self-regulatory organizations may begin to encourage ethical role models and cultures if they focus some attention on rewarding ethical best practices rather than merely penalizing noncompliant behavior.<sup>113</sup> At least one noted scholar has suggested that legislation—specifically, Sarbanes-Oxley—has the capacity “to reward truthful corporations and their management.”<sup>114</sup> Among other things, law can reward good behavior by exempting ethical actors from the application of weighty regulation under certain circumstances.<sup>115</sup> An incentive program of

authority to pressure clients into accepting their advice—particularly when that advice concerns illegal or wrongful conduct.”)

111. See 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(b)(20), & cmt. h (1994) (indicating that courts can sustain actions taken by corporate officials that “take into account emerging ethical principles, reasonably regarded as appropriate to the responsible conduct of business, that have significant support although less-than-universal acceptance.”); Hess et al., *supra* note 5, at 740 (“[I]t does appear that the [Federal Sentencing] Guidelines encourage judges and prosecutors to look for evidence of an ethical corporate culture and not simply to look for an effective compliance program. The Guidelines and Advisory Report clearly specify that an effective compliance program requires a firm to both ‘exercise due diligence to prevent and detect criminal conduct’ and develop an ethical culture.”); Therese H. Maynard, *Spinning in a Hot IPO-Breach of Fiduciary Duty or Business as Usual*, 43 WM. & MARY L. REV. 2023, 2062–63 (2002) (“By rigorously enforcing principles of fiduciary duty, the courts are reinforcing the legitimate expectations of investors (and others) who deal with corporate managers as to acceptable standards of business ethics. . . . [T]he courts should not relinquish their traditional role of enforcing fiduciary duty law to regulate ethical standards of conduct for corporate managers.”). One reading of *Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140, 1153 (Del. 1989) is that the court’s decision reinforces a valued corporate culture. See David Millon, *Frontiers of Legal Thought I: Theories of the Corporation*, 1990 DUKE L.J. 201, 257 (noting that the deciding judge “was ‘not persuaded that there may not be instances in which the law might recognize as valid a perceived threat to a ‘corporate culture’ that is shown to be palpable (for lack of a better word), distinctive and advantageous.’”). “[I]t is . . . important to emphasize that equity, and the power of courts to look to considerations of fairness, plays a large role in corporate law, especially in the important Delaware courts. Indeed, the equitable power of courts to consider basic fairness in making and applying corporate law overlays an expansive ethical quilt on the body of corporate law.” Eric W. Orts, *The Complexity and Legitimacy of Corporate Law*, 50 WASH. & LEE L. REV. 1565, 1605–06 (1993) (footnotes omitted).

112. See, e.g., Zacharias, *supra* note 110, at 501–03.

113. See Jeffrey L. Seglin, *The Right Thing: The Jail Threat Is Real. So, Will Executives Behave?*, N.Y. TIMES, July 20, 2003, §3, at 4 (“Sending chief executives to jail may indeed send a powerful message, albeit one that is decidedly short term.”).

114. Frankel, *supra* note 47, at 161 (“Honest corporations should receive a competitive advantage by receiving relief from some of the provisions of the Act so that those provisions are imposed only on rogue corporations.”).

115. *Id.* at 186–89.



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this kind should reward ethical role models in the executive suite, even if only indirectly.<sup>116</sup>

Unfortunately, despite (and, in fact, because of) its detailed efforts in creating a compliance ethics culture, Sarbanes-Oxley, as currently constituted, likely fails to foster the creation of ethical executive role models in the corporation, and ethical role modeling is significant to ethical corporate culture. Ethics regulation without necessary culture change may not achieve underlying policy objectives. Accordingly, at best, Sarbanes-Oxley may be a necessary but insufficient reaction to the corporate scandals exposed in the early years of the new millennium. Unless Sarbanes-Oxley is amended to better incentivize the development and maintenance of ethical corporate role models or other forces rise to support the establishment of ethical role models in corporate management, achievement of the overall purposes of the Act may not be possible.

Stated somewhat differently, by failing to take into account the role of social context and human interaction in promoting ethics in the corporation, legislators may have unintentionally weakened or undercut the potential impact of Sarbanes-Oxley. In ignoring these factors in corporate governance rule making, Congress (and at its direction, the SEC) may be hindering the establishment and maintenance of ethical executive role models and, if the commonly accepted rhetoric is correct, thwarting the attainment of one of Sarbanes-Oxley's key purposes—the achievement of good corporate governance. At a minimum, future corporate governance rule making should take these factors into account and better foster ethical role modeling and other attributes of a positive corporate culture in public companies.

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116. *Id.* at 171–73. Perhaps the law could incentivize corporations to reward executive role models. By rewarding corporate executives, corporations can build social capital to increase trust in and within the corporation.

[I]f an organization wants to be an ethical one, then it cannot rely on individual managers and employees to regularly risk sacrificing their own financial well-being and career potential to make it happen. Instead, the organization must take on this responsibility. The firm must develop incentives that reward people for not selling infested cookies and punish them if they do. This means that ethics is not simply about hiring people with personal integrity; it means that ethics is also about organizational structures that reward the right behavior. In other words, to foster integrity, one needs to address utilitarian considerations in which just treatment of stakeholders is rewarded so that the greatest good is achieved. Or, to put it in more conventional business terms, it is important to create win-win environments for multiple stakeholders. Through this process, social capital is established, which, in turn, builds Real Confidence and trust among stakeholders that the firm will treat them fairly.

Hess et al., *supra* note 5, at 751.