No Good Deed Goes Unpunished: Is There a Need for a Safe Harbor for Aspirational Corporate Codes of Conduct?

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No Good Deed Goes Unpunished:  
Is There a Need for a Safe Harbor for Aspirational Corporate Codes of Conduct?

Elizabeth F. Brown*

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INTRODUCTION

In the wake of Enron, Worldcom, and Tyco, there has been a renewed interest in corporate social responsibility (CSR), particularly as it is might be embodied in corporate codes of conduct or codes of ethics. Some organizations and groups have attempted to encourage U.S. corporations to adopt codes of conduct that commit the corporations to aspirational standards of conduct with regard to their stakeholders, rather than codes that merely reiterate the corporations’ existing obligations under the law.

One concern raised about adopting codes that attempt to embody CSR is that no precise definition of CSR exists. It involves different principles for different people. David Vogel in his book *The Market for Virtue* notes that CSR usually is associated with “firms’ efforts to do more to address a wide variety of social problems than they would have done in the course of their normal pursuit of profits.”2

Definitions of CSR can be placed into at least four categories: (1) minimalist, (2) philanthropic, (3) encompassing or stakeholder, and (4) social activist.3 The minimalist view is that a corporation’s only social responsibility is to increase the wealth of its shareholders.4 The most famous champion of this view is

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4. *Id.* at 40.
Milton Friedman. It still holds sway within the American business community. In a 2006 address at Aldelphi University, Thomas J. Donohue, President and CEO of the U.S. Chamber of Commerce, defined CSR as an endeavor “to earn a profit, create jobs, and make products and services that people need and that raise our standard of living.”

The philanthropic view, like the minimalist view, is that a corporation’s primary obligation is to maximize the wealth of its shareholders, but this view accepts that the corporation—in addition to its individual shareholders, managers, and employees—can engage in charitable activities. These charitable activities do not need to be tied to the corporation’s core business. They can be aimed solely at addressing moral or ethical concerns.

The encompassing or stakeholder view is that corporations should be managed to address not only the shareholders’ interests but also the interests of other groups that have a stake in the corporation, such as employees, suppliers, customers, creditors, and the community. The stakeholder definition of CSR appears to be the most common definition employed in articles in the academic and business press. The definition of CSR employed by the International Financial Corporation (IFC) fits within this category. The IFC defines corporate social responsibility as “the commitment of businesses to contribute to sustainable economic development by working with employees, their families, the local community and society at large to improve their lives in ways that are good for business and for development.”

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7. Locke, supra note 3, at 41.

8. Id.


cerned with requiring corporations to internalize their externalities also would fit within this definition. Geoffrey Heal, a Columbia Business School professor, defines CSR as "a program of actions taken to reduce externalized costs or to avoid distributional conflicts." The stakeholder definition usually identifies consumer protection, labor rights, protection of the environment, contributions to the community, and good corporate governance practices—in addition to returns for investors—as areas of concern for corporations.

Finally, the social activist view argues that corporations are responsible to society at large for the effects of their actions. Muhammad Yunus, the winner of the 2006 Nobel Peace Prize and the founder of the Grameen Bank, espouses this view. In his Nobel Lecture, he talked about "social business," which he defined as "a new kind of business introduced in the market place with the objective of making a difference in the world." Yunus claimed that "social business" would be able to address "[a]lmost all social and economic problems of the world."

The wide range of possible definitions for CSR means that a particular business may be addressing only some of the issues that a particular person or group might consider an essential part of CSR, or the business may have prioritized the CSR issues in the wrong way in the view of a particular person or group. For example, since 2000, Business Ethics Magazine has published an annual list of the "100 Best Corporate Citizens." The companies on these lists change substantially from year to year. Only thirty-four of the "100 Best Corporate Citizens" in 2000 made the list in 2003. Part of the reason for these variations is that Business Ethics Magazine has modified the criteria that it uses to determine who gets on this list every year.

13. Locke, supra note 3, at 41-42.
14. Id.
16. Id.
18. The 2000 list only considered how the corporations fared with respect to revenues, net income, return to shareholders, community relations, employee relations, and customer relations. The 2003 list considered all of those factors plus how the corporations treated women and minorities, the environment, and non-U.S. stakeholders. 100 Best Corporate Citizens 2000, BUS. ETHICS MAG., available at http://www.business-ethics.com/node/83. The 2003 list also changed in part because data provider KLD expanded its underlying database of public firms beyond

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Corporations can rather easily address the concern over the vagueness of CSR’s definition by clearly defining and disclosing what they mean when they use the term, “corporate social responsibility,” and by specifying towards whom are their CSR efforts directed. Corporations will simply have to live with the fact that some may disagree with how a corporation has defined “corporate social responsibility” or may disagree with how a corporation has prioritized the issues within its definition. No one can please everyone all of the time.

Corporations that seek to adopt codes of conduct that embody the stakeholder or social activist views of CSR face another concern: such codes will expose them to legal liabilities that they would not face if they had not adopted those aspirational standards. If a corporation adopts a code of conduct with aspirational standards—or standards higher than ones prescribed normally under existing statutes, regulations, or the common law—some courts will allow stakeholders to sue the corporation if it fails to meet those standards in its code of conduct.¹⁹ Thus, the law creates a perverse set of incentives that encourage

¹⁹. See infra notes 110 to 192 and accompanying text. Proponents of CSR have tried to convince corporations to undertake such initiatives on the grounds that the market will reward them for their efforts. Usually in order to reap the biggest rewards for CSR activities, corporations have to publicize them and convince consumers and others that they are undertaking creditable efforts to implement CSR principles. The only creditable way to do this is through formal programs with demonstrable results, which include embedding CSR principles in the corporation’s code of conduct. Consumers and others are increasingly skeptical of corporate claims regarding CSR out of concerns that corporate CSR efforts are nothing more than public relations efforts and are not making any substantive changes to the ways that corporations actually behave. Wake Up Call for Firms Doing the Right Thing, TELEGRAPH, Sept. 27, 2007, available at http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2007/09/27/cnbcorp27.xml (reporting that 44% of the British public think CSR is just spin-doctoring); Joel Makower, CSR Issue: Does Media Coverage Shape a Company’s Strategic Business Plan To Include CSR Efforts?, CNNMoney.com, Oct. 2, 2007, http://acurtar.scilset.rutgers.edu/joomla/index.php?option=com_content&task=view&id=43&Itemid=2 (stat-
corporations to do the legal minimum rather than aspire to do more for their stakeholders.

It is this problem that this Article seeks to address. This Article assumes as a normative matter that the law should not frustrate or impede the will of the shareholders or the managers of a corporation, who would like the corporation to commit itself to do more than the minimum that the law mandates in a particular area for the stakeholders of the corporation. Certainly, the normative question about the extent to which a corporation should take into account the interests of all its stakeholders, not just its shareholders, is much debated both in academic circles and in the business press. Rather than rehashing these debating that an Ipsos Reid survey found that 70% of Americans either strongly or somewhat agree that when companies label a product “green” it is just a marketing tactic).

20. This debate has raged for over sixty years. In the 1930s, Adolf Berle of Columbia Law School argued for the proposition that corporations should be managed for the shareholders while E. Merrick Dodd Jr. of Harvard Law School argued that corporations should be managed both for the shareholders and the other constituencies of the corporation. Compare A. A. Berle, Jr., Corporate Powers as Powers in Trust, 44 Harv. L. Rev. 1049, 1049 (1931) (claiming that corporate powers are “at all times exercisable only for the ratable benefit of all the shareholders as their interest appears”), with E. Merrick Dodd, Jr., For Whom Are Corporate Managers Trustees?, 45 Harv. L. Rev. 1145, 1148 (1932) (responding that the corporation is “an economic institution which has a social service as well as a profit-making function”). More recently, Kent Greenfield and D. Gordon Smith have debated these issues. See Kent Greenfield, Saving the World with Corporate Law? (Boston Coll. L. Sch. Research Paper No. 130, 2007), available at http://ssrn.com/abstract=978242; D. Gordon Smith, The Dystopian Potential of Corporate Law (Univ. of Wis. Legal Studies Research Paper No. 1040, 2007), available at http://ssrn.com/abstract=976742. John Mackey, founder and CEO of Whole Foods, Milton Friedman, and T.J. Rodgers, founder and CEO of Cypress Semiconductors, debated these issues in Reason magazine in 2005. See Rethinking the Social Responsibility of Business, 37 Reason 28, 28-29 (2005).


The opponents of CSR and stakeholder theories tend to argue that these theories undermine the property rights of shareholders to the profits of the corporation and constitute an unjustified “taking,” or that corporations are a nexus of contracts that have no duties other than those in the contracts. See FRANK H. EASTERBROOK & DANIEL R. FISCHER, THE ECONOMIC STRUCTURE OF CORPORATE LAW 23 (1991) (arguing that all parties to the corporate contract can protect themselves through negotiation); Daniel R. Fischel, The Corporate Governance Movement, 35 Vand. L. Rev. 1259, 1273 (1982) (arguing that because corporations are contracts, they are “incapable of having social or moral obligations much in the
bates here, this Article accepts the arguments that society would benefit if the
law allowed (but did not require) corporations to take the interests of their
stakeholders into account.

This Article focuses on how the law discourages corporations from adopt-
ing aspirational codes of conduct, which might address the concerns of various
stakeholder groups, and what might be done to remedy this situation. The solu-
tion that this Article will consider is for the states or the federal government or
both to adopt laws that would grant corporations who adopt aspirational codes
of conduct a safe harbor from litigation that might be brought if they fail to
meet the higher standards set forth in their codes. Corporations would only be
entitled to these safe harbors as long as they adopted and monitored the im-
plementation of such codes in good faith.

This Article will begin in Part I by providing an overview of the major exist-
ing incentives and disincentives for corporations to adopt codes of conduct.
Part I will not only examine the existing legal incentives and disincentives em-
bedded in federal and state laws but it will also look at the economic incentives
and disincentives provided by the markets. Part II will describe the factors to be
considered when creating an aspirational code of conduct and drafting legislation
to create a safe harbor from litigation for such codes. The Appendix will
provide one example of what a law creating a safe harbor for aspirational codes
of conduct might look like. This draft law is called the Promoting Aspirational
Codes Enactment Act or the PACE Act. Part II will include a discussion of this
draft act.

Part III will then examine the pros and cons of creating such a safe harbor.
Part III will analyze whether such a safe harbor would spur more corporations
to adopt aspirational goals for their conduct or whether it would simply provide
a shield against law suits for corporate behavior that otherwise would be illegal.
Finally, the Article will draw some conclusions from the analysis presented.

I. INCENTIVES AND DISINCENTIVES FOR ADOPTING CODES OF CONDUCT

A. Legal Incentives for Adopting Codes of Conduct

Both the federal and the state governments have experimented with forms
of regulation that fall between laissez faire capitalism and a "command-and-

same way that inanimate objects are incapable of having these obligations"); Jonathan R. Macey, An Economic Analysis of the Various Rationales for Making Share-
holders the Exclusive Beneficiaries of Corporate Duties, 21 STETSON L. REV. 23, 36, 42
(1991) (arguing that stakeholders can protect themselves through contract or
through the political process); Lynda J. Oswald, Shareholders v. Stakeholders: Eva-
luating Corporate Constituency Statutes Under the Takings Clause, 24 J. CORP. L. 1
(1998) (arguing that the reallocation of corporate profits to stakeholders is the
equivalent of a taking); Friedman, supra note 5, at 122 (arguing that actions that
reduce corporate profits to provide benefits to members of the community who
are not shareholders are the equivalent of an illegal tax on the shareholders' prof-

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control” regulatory system. These experiments involve various forms of cooperative regulatory regimes, including efforts by both the federal government and the state governments to provide incentives for corporations to engage in self-policing.

These experiments tend to track the business cycle, which seems to include periods of scandal that are followed by periods of concern regarding corporate social responsibility. In the wake of the latest round of corporate scandals, some corporations have tried to restore or maintain their reputations by developing CSR programs, engaging in self-regulatory regimes, or initiating cause-related marketing programs. Many companies in the Standard & Poor’s 500 Index publish corporate social responsibility reports on their websites. They have also attempted to burnish their images by being associated with various social causes. In 2005, businesses in North America spent approximately $1 billion on cause-related marketing.

This current heightened concern by corporations for CSR may be just another cycle of corporate excesses being followed by regrets. This same cycle occurred in the 1980s and early 1990s. Corporate codes of conduct became prevalent among publicly held corporations in the late 1980s. The codes at that time primarily focused on antitrust, the Foreign Corrupt Practices Act, and insider trading issues. This is not surprising since the major scandals of the 1970s and 1980s involved those issues.

While almost all Fortune 500 corporations have adopted codes of conduct and implemented compliance programs to verify that their employees are complying with the codes of conduct, most of these codes of conduct merely reflect the current requirements imposed on corporations by the existing federal and state laws. Thus, these codes simply restate the minimum legal requirements of all legitimate business organizations and do little or nothing to encourage businesses to aspire to higher standards of conduct.

22. Id.
25. Id. at 86.
26. Harvey L. Pitt & Karl A. Groskaufmanis, Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct, 78 GEO. L.J. 1559, 1601-02 (1990) (discussing the results of two Fried, Frank surveys of publicly-held corporations in 1984 and 1987 that found that over 90% of publicly held corporations had a written code of conduct).
These codes reflect the existing set of incentives and disincentives built into federal and state laws. The incentives generally only strive for codes that encourage compliance with the law. The disincentives, however, sometimes discourage the adoption of all codes of conduct and other times only discourage codes that would have a corporation exceed its legal obligations. By examining these incentives and disincentives, one can understand why it is so difficult to get corporations to adopt aspirational codes of conduct.

The major federal and state laws that encourage corporations to adopt codes of conduct and compliance programs are as follows.

1. Director’s Duty to Monitor

Directors have a duty to monitor the activities of the corporation on whose board they serve. This duty is a relatively recent development and did not exist forty years ago. In the *Graham v. Allis-Chalmers Manufacturing Co.* case in 1963, the Delaware Supreme Court held that directors would not be liable for failing to monitor the activities within the corporation unless they were put on specific notice of a problem. Commentators have suggested that compliance with the law might not always be in the shareholders’ interest in cases where it is more profitable for the business to violate the law and pay the monetary penalties than to comply with the law.

Over the next thirty years, the federal government promulgated two sets of rules that influenced the development of state law doctrines on a director’s duty to monitor. In the wake of the Watergate break-in of the Democratic Party’s headquarters, which was funded by several large corporations, the Foreign Corrupt Practices Act of 1977 (FCPA) was enacted. Section 13(b)(2) of the FCPA requires public companies to maintain accurate books and records and to implement a reasonable system of internal accounting controls. In 1991, the federal Organizational Sentencing Guidelines were implemented.

In 1996, Chancellor Allen in *In re Caremark International Derivative Litigation* concluded that times had changed since 1963 and that developments such as the Guidelines meant that it was no longer reasonable for directors to wait for something to be brought to their attention before taking action. He noted that “relevant and timely information is an essential predicate for satisfaction of..."
the board’s supervisory and monitoring role under Section 141 of the Delaware General Corporation Law.”

He went on to comment that “a director’s obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards.”

While Chancellor Allen’s comments in Caremark discussed an affirmative duty of directors to monitor a corporation’s activities, it was a duty that could only be enforced in extremely limited circumstances. Under the standard articulated by Chancellor Allen, directors must have shown a “sustained or systematic failure” to monitor the corporation’s activities in order to be found in violation of their duty.

Later cases have clarified that directors who rely with “blind faith” on documents prepared by management or company officers will not have fulfilled their monitoring and good faith obligations. The directors’ duty to monitor does not require that they know all aspects of a company or its operations in detail. Courts have held that it is sufficient for directors to provide evidence that they have implemented policies, procedures, and systems to verify compliance in order to prove that they have complied with their duty to monitor.

State laws, like section 102(b)(7) of the Delaware General Corporation Law, also make it difficult to hold directors accountable for failures to monitor, because they permit corporations to limit directors’ liability for breaches of their duty of care by including exculpation clauses in their corporate charters. The duty to monitor is part of the duty of care. For example, a shareholders’ derivative action was brought against the Board of Directors of Walt Disney Company accusing them of having breached their fiduciary duties and having wasted the corporation’s assets by hiring Michael Ovitz as president and terminating his employment fourteen months later with a $130 million severance package.

The plaintiffs alleged that the board had failed to exercise proper oversight of Michael Eisner, the then-chair and chief executive officer of Disney, who had picked Ovitz and negotiated the employment and termination agreements with him. The chancery court found that the board’s actions may have amounted to

34. Id. at 970.
35. Id.
36. Id.
39. Id. at 373.
40. In re Walt Disney Co. Derivative Litig. (Disney II), 906 A.2d 27 (Del. 2006).
a breach of their duty of care but that their actions were protected by the company’s exculpation clause.\textsuperscript{41}

Exculpation clauses, however, do not apply if the directors act in bad faith. In order to act in bad faith, directors must either intentionally seek to harm the corporation or intentionally disregard their responsibilities to the corporation.\textsuperscript{42} The obligation to act in good faith falls within the duty of loyalty.\textsuperscript{43}

Even though the likelihood of being found in violation of the duty to monitor is very low, the duty to monitor does provide directors some incentive to adopt a code of conduct and compliance program. It does not, however, provide them with any incentive to adopt a code and compliance program that does more than ensure compliance with existing laws. Nevertheless, just getting employees to comply with the law can be an uphill battle. In a KPMG survey in 2003, seventy-five percent of the officers surveyed indicated that they had uncovered fraud by employees at their business.\textsuperscript{44}

\section*{2. Foreign Corrupt Practices Act}

Section 13(b)(2) of the FCPA requires publicly traded corporations to make and keep accurate books, records, and accounts and to devise a system of internal accounting controls.\textsuperscript{45} The language in section 13(b)(2) is vague and could be broadly interpreted, although the original intent of the provision was relatively narrow. The Report of the Senate Committee on Banking, Housing, and Urban Affairs indicated that the controls were intended to prevent corporations from concealing bribes to foreign officials by requiring corporations to maintain accurate accounting records.\textsuperscript{46} The Securities and Exchange Commission (SEC) in 1981 pledged to interpret the requirements set forth in section 13(b)(2)

\begin{itemize}
\item \textsuperscript{41} In re Walt Disney Co. Derivative Litig. (\textit{Disney I}), 907 A.2d 693, 760 (Del. Ch. 2005).
\item \textsuperscript{42} Disney II, 906 A.2d at 62.
\item \textsuperscript{43} Stone, 911 A.2d at 370.
\item \textsuperscript{45} 15 U.S.C. § 78m(b)(2) (2000).
\item \textsuperscript{46} S. Rep. No. 95-114, at 132 (1977), \textit{reprinted in} 1977 U.S.C.C.A.N. 4098, 4105 ("This legislation imposes affirmative requirements on issuers to maintain books and records which accurately and fairly reflect the transactions of the corporation and to design an adequate system of internal controls to assure, among other things, that the assets of the issuer are used for proper corporate purpose. The committee believes that the imposition of these affirmative duties under our securities laws coupled with attendant civil liability and criminal penalties for failure to comply with the statutory standard will go a long way to prevent the use of corporate assets for corrupt purposes. Public confidence in securities markets will be enhanced by assurance that corporate recordkeeping is honest.")
\end{itemize}
narrowly. At the time the SEC made this pledge, Ronald Reagan had just been elected President and the Republican Party had gained control of the Senate. The business community was threatening a political backlash against the SEC if it elected to broadly interpret section 13(b)(2). The SEC never went back on this pledge. The SEC only raised these provisions in enforcement actions when there was actual evidence of misreporting by an issuer.

Given the breadth of the language in section 13(b)(2), some of the requirements that Congress enacted with the Sarbanes-Oxley Act could have been imposed by the SEC if it had chosen to reconsider its 1981 pledge. The SEC in 1988 did consider requiring management to evaluate and report on its internal controls but ultimately declined to do so.

3. Federal Organizational Sentencing Guidelines

The Sentencing Reform Act of 1984 created the U.S. Sentencing Commission, which was given the task of promulgating sentencing guidelines for both individual and organizational offenders. The Sentencing Reform Act also substantially increased the maximum fines for corporate felonies. Prior to 1984, the maximum fines for most federal offenses were relatively small. The maximum corporate fine for federal wire fraud before 1984 was only $1,000 per offense. With such low fines, crime did pay. The Allegheny Bottling Company and the Mid-Atlantic Coca-Cola Bottling Company conspired to illegally fix prices for the soft drinks that they distributed. Allegheny made roughly $5 million in profits from this scheme, but the maximum fine that it faced was only $1 million. The Sentencing Reform Act raised the maximum fines for all corporate felonies and corporate misdemeanors that resulted in loss of life to $500,000 per offense. In 1987, additional legislation was enacted that raised the maximum penalty to twice the gross loss or gain resulting from a corporation’s violation of the law.

In 1991, the U.S. Sentencing Commission promulgated the Guidelines, which employed a “carrot and stick” approach to encourage corporate compli-

47. Langevoort, supra note 29, at 953.
48. Id.
49. Id.
50. Id. at 954.
54. Id. at 857-58.
55. Id. § 3571(c).
56. Id. § 3571(d).
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ance with federal laws. The idea behind the Guidelines was that an organization that encourages or tolerates violations of federal law is more culpable than one that makes good faith attempts to prevent such violations and that the penalties imposed should reflect these different levels of culpability.\(^5\) In addition, since the federal government does not have the resources to police every business operation, it was deemed worthwhile to encourage self-policing by corporations.

The Guidelines add "points" and increase the penalties a corporation faces if it has had prior violations, if it violates injunctions, or if its senior officials have approved illegal actions.\(^6\) On the other hand, the Guidelines reduce the penalties a corporation faces if it accepts responsibility and voluntarily reports its violations or if it adopts a code of conduct and an effective compliance program to try to prevent officers and employees from violating the law.\(^7\)

The Guidelines define an effective compliance program as one pursuant to which "the organization exercised due diligence in seeking to prevent and detect criminal conduct by its employees and other agents."\(^8\) The Guidelines set forth seven criteria for an effective compliance program. These criteria require that the business:

1. establish compliance standards and procedures for its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct,
2. appoint an individual to oversee compliance with the code,
3. use due care to avoid delegating too much discretion to persons who have a propensity to engage in illegal activities,
4. take steps to communicate effectively its standards and procedures,
5. take reasonable steps to achieve compliance with its standards,
6. enforce the standards through appropriate disciplinary measures, and
7. take all reasonable steps to respond appropriately when it detects a violation and to prevent future similar violations.\(^9\)

Many major corporations adopted codes of conduct in order to qualify for the more lenient treatment offered under the Guidelines.\(^10\) In fact, so many companies adopted codes of conduct and created ethics officer positions in the wake of the Guidelines promulgation that the Ethics Officers Association was


\(^{6}\) Id.

\(^{7}\) Id.

\(^{8}\) Id.

\(^{9}\) Id.

\(^{10}\) In a benchmarking study conducted by PG&E in 1995, 80% of the responding corporations indicated that the federal Organizational Sentencing Guidelines were a major factor in the decision to adopt a code of ethics and compliance program. Eric Pressler, Marketing Business Ethics in Corporations: A Review of Key Legal and Financial Incentives, Preventive L. Rep., Summer 1997, at 23; see also Richard Zitrin & Carol M. Langford, The Moral Compass of the American Lawyer: Truth, Justice, Power and Greed 111 (1999).
formed in 1992. Ethics officers sometimes wear two hats and also serve as the compliance officer for the business.

What difference, if any, exists between what an ethics officer does and what a compliance officer does? A compliance officer is solely concerned with meeting the requirements established by laws and regulations. A corporation could define the role of an ethics officer more broadly to ask the question, "What does virtue require of us?" This broader question might lead some corporations to contemplate adopting codes that require them to do more than what they are legally required to do. In other words, the answer to this broader question might require corporations to adopt aspirational codes of conduct.

The Guidelines, however, do not include any such requirement for aspirational codes of conduct. It is sufficient under the Guidelines for a corporation to merely adopt a code and a compliance program that parallels the existing requirements under the law.

4. Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 spurred a closer look at codes of conduct and how they were being implemented. The Enron Corporation had one of the most impressive codes of conduct among the large, publicly traded companies. Yet its code did not save it from being riddled with fraudulent accounting practices and other shady business deals. Enron’s code did not save it because its board of directors waived its provisions, particularly the conflict of interest provisions, in order to allow Andrew Fastow and others to form special purpose vehicles that would assume Enron’s debt and take it off Enron’s books to make Enron look more profitable than it was in fact.

As a result of the Enron debacle, Congress included a requirement in the Sarbanes-Oxley Act that forces publicly traded corporations to disclose if they have a code of ethics and, if not, why not. The Sarbanes-Oxley Act defines a code of ethics as “written standards that are reasonably designed to deter wrongdoing.” Such a code promotes five things: (1) honest and ethical conduct; (2) full, fair, accurate, timely, and understandable disclosure in reports and documents filed with the SEC; (3) compliance with applicable governmental laws, rules, and regulations; (4) prompt internal reporting of any violation of...
the corporation's code of ethics; and (5) accountability for adherence to the code.68

The Sarbanes-Oxley Act also requires a publicly traded corporation to report immediately to the SEC on a Form 8-K any time that its board of directors waives any of the provisions in the code of ethics or changes or amends the code.69 Neither the definition for the code of ethics nor the requirement to report changes or amendments to the code force corporations to undertake conduct that is more ambitious than merely complying with their existing legal duties.

5. Judicially Created Self-Auditing Privilege

Beginning with Bredice v. Doctors Hospitals, Inc.,70 some courts have found that a self-audit or self-evaluation privilege exists under certain circumstances, particularly in the context of medical peer review,71 securities audits,72 academic peer reviews,73 product safety assessments,74 equal employment compliance records,75 accounting records,76 railroad accident investigations,77 prior accident investigations,78 and environmental audits.79

Not all courts, however, recognize the self-critical analysis privilege. The federal courts are split on whether such a privilege exists and when it applies.80 The only time that the Supreme Court has addressed the self-audit privilege was in the context of academic peer review in University of Pennsylvania v. EEOC.81 In that case, the Supreme Court noted that Federal Rule of Evidence 501 gives the courts the power to develop new rules of privilege but declined to create

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68. Id.
69. Id. § 406(b).
71. Id.
80. Cox, supra note 79, at 3-4.
such a privilege against disclosure of academic peer review materials on the
grounds that Congress did not create such a privilege when it extended Title VII
to educational institutions. Federal courts also have declined to uphold a self-
auditing principle in other contexts. The federal district court in Louisiana En-
nvironmental Action Network, Inc. (LEAN) v. Evans Industries, Inc., refused to
find a self-critical analysis privilege for voluntary environmental audits on the
grounds that such audits would be done even if no privilege existed, because
they would be needed to ensure that corporations were in compliance with state
and federal environmental laws. Even though the Supreme Court and some
federal courts have declined to create self-analysis privileges, other federal
courts have continued to uphold the privilege in other contexts.

To the extent that courts have recognized a self-critical analysis privilege,
they have required four factors to be present in order for the privilege to apply.
These factors are: (1) the information must come from a critical self-analysis
done by the party seeking to have the information protected, (2) the informa-
tion must be the kind of information that the public has a strong interest in
maintaining its free flow, (3) the information must be the kind of information
the production of which would be in danger of being stifled if discovery were
allowed, and (4) the information must have been prepared with the expectation
that it would be kept confidential and must have been actually kept confiden-
tial.

As the LEAN case shows, codes of conduct and compliance programs that
merely seek to ensure that a business is conforming to its legal requirements
might not qualify for the self-audit privilege under these four criteria because of
the second factor: the need to prove that the information would not be sought
or created if discovery were allowed. As noted in the LEAN case, businesses that
face strong sanctions for failure to comply with the law have a significant incen-
tive to conduct such audits even if the results are discoverable.

On the other hand, the availability of a self-audit privilege might encourage
businesses to adopt aspirational codes of conduct and compliance programs.
Aspirational codes of conduct require businesses to fulfill higher standards than
those mandated by law. As a result, businesses do not have the heavy threat of
legal sanctions forcing them to adopt and verify compliance with an aspira-
tional code of conduct. Indeed, if the results of audits of such programs were
disclosable, businesses could be deterred from trying to engage in such pro-
grams.

82. Id. at 189.
84. Id. at *7.
6. Environmental Self-Auditing Privileges

Both at the state and federal level, laws and regulations are on the books that provide incentives for businesses to engage in environmental self-audits. The federal Environmental Protection Agency created the Incentives for Self-Policing: Discovery, Disclosure, Correction, and Prevention of Violations policy. Under this policy, the EPA offers reduced gravity-based penalties (by a factor of 75%) to businesses that voluntarily discover, promptly disclose, and timely remediate any violation of EPA-administered environmental statutes or regulations. In addition, if the violation was found through an environmental audit, the EPA will not seek any gravity-based penalties. The EPA policy does not provide any statutory evidentiary privilege for self-audits.

As of September 1, 2007, twenty-seven states offer either a statutory evidentiary privilege or immunity or both for businesses that conduct environmental self-audits. Four of the states only offer an evidentiary privilege against discovery of environmental audits. Three of the states only offer some level of immunity from prosecution for violations found, reported, and remediated in connection with an environmental audit. The remaining states offer both an evidentiary privilege and some level of immunity from prosecution.

In most states, the evidentiary privilege is lost if it is claimed for fraudulent purposes. Some states allow for an exception to the evidentiary privilege when a prosecutor asserts a need for the information. In all states with the evidentiary privilege, the person seeking the information has the burden of proof to show that they have a compelling need for the information.

Conflicts can arise between these federal and state laws when a case involves both federal and state claims. In the Reichhold case, Florida law did not recognize an evidentiary privilege for environmental audits, but the court held that a federal common-law privilege existed for such audits.

88. Id.
89. Id. at 19,620.
90. Id. at 19,623.
92. Id. The four states are Arkansas, Illinois, Indiana, and Oregon.
93. Id. The three states are Minnesota, New Jersey, and Rhode Island.
94. Cox, supra note 79, at 15-16.
95. Id.
96. Id. at 16.
held that the federal common-law privilege for self-audits governed the entire case and superseded Florida's state policy. 98

A conflict can also arise if a federal court holds that there is no federal common-law privilege for self-audits, as the court in the LEAN case did, but the case also involves state claims in a state like Colorado that offers an evidentiary privilege for environmental self-audits. It is unclear how such cases would be resolved, although courts in such cases are likely to be pressured to apply the state evidentiary privilege to the entire case. It is not certain that such a court would give in to such pressures.

These potential conflicts create a great deal of uncertainty for national businesses that are contemplating adopting a code of conduct and compliance program that includes environmental protections. Given these uncertainties, some businesses may conclude that the incentives to conduct environmental audits offered by federal and state authorities do not outweigh the downside of creating a record concerning environmental violations that could be used against them in other jurisdictions.

A survey of manufacturing facilities in the United States in 1998 determined that nearly one third were not conducting internal environmental audits because they were afraid that a regulatory agency might get the audit report and use the information in it to bring enforcement actions against the business. 99 A majority of the officials at the manufacturing facilities in states without immunity or privilege laws indicated that they would conduct internal audits if their state enacted such laws. 100

One of the problems with enacting laws that provide incentives for businesses to adopt codes of conduct and compliance programs is that other government entities may not respect those incentives when enforcing their own laws. As a result, the code of conduct and the compliance program may reduce the entity’s liabilities to the federal government but increase liabilities with respect to state governments—or vice versa.

7. Other Laws Encouraging the Adoption of Codes of Conduct

Under the doctrine of respondeat superior, a corporation also would be liable for the crimes of its employees conducted while they are employed in the furtherance of the business, even if the corporation never adopted any code of conduct or policy statement. The only way that a business can escape liability for the crimes of its employees is if it can prove that the employees were acting outside of the scope of their employment. 101 An act will be outside of the scope

98. Id.
100. Id.
of employment if it has "no connection with the act which the employee is required to perform." 102

Some jurisdictions allow juries to use a business’s code of conduct when determining if an employee was acting to benefit the corporation.103 If the employee was not, then the employee’s criminal activities cannot be held against the corporation. In order for corporations to benefit from this view, they must show that they have tried to effectively enforce the code.104

A code of conduct can undermine or block a corporation’s attempt to claim that it was ignorant that the acts undertaken were against the law.105 Others try to use the code to prove that the business did not intend to violate the law but this defense generally fails if it can be shown that the business profited from the acts.106

Some statutes expressly provide corporations with a due diligence defense that allows them to avoid liability for the criminal acts of their employees if the managers of the corporation acted in good faith and with due diligence to learn about and prevent criminal violations.107 Other statutes grant corporations a good faith defense if their managers acted with good faith and due care and did not directly or indirectly induce the criminal acts.108 In allowing the due diligence and good faith defenses, courts will examine the effectiveness of the code in operation and will determine whether the corporation acted reasonably under the circumstances.109

B. Legal Disincentives to Adopting Aspirational Codes of Conduct

Some business leaders are deterred from adopting aspirational codes of conduct—and compliance programs to ensure that they are met—out of fear that such codes and programs will increase the potential liabilities of the business. Ramon Mullerat echoes these concerns:

A related issue is to determine whether the violation of self-imposed standards of conduct ([i.e.,] codes of conduct) engenders legal liability

102. Id.
103. United States v. Beusch, 596 F.2d 871, 878 (9th Cir. 1979).
104. Id.
105. United States v. Dolgaard, 57 F.3d 1078 (9th Cir. 1995) (using a code to show that an individual knew his actions were illegal); United States v. Bank of New Eng., 821 F.2d 844 (1st Cir. 1987) (using a code to show that the bank knew its actions were illegal); BUSINESS ETHICS, supra note 60, at 201.006.
109. Pitt & Groskaufmanis, supra note 26, at 1617.
or, in other words, the violator can be legally sued for damages. Can a corporation that has publicised, internally and externally, that it complies with high labour, environmental and human rights standards, just break one of them with impunity, or would it have some sort of economic sanction?\footnote{110}

The answer to Mullerat’s question is that corporations will sometimes be held liable for violating the voluntary standards that they adopt in their codes of conduct, even if those standards are higher than the obligations imposed on the corporations by the law. These legal liabilities can arise in several contexts, including suits for false and deceptive advertising and breach of contract.

1. Breach of Fiduciary Duties

In determining how corporations ought to be managed, one view emphasizes that they should be managed to maximize shareholder wealth. The Model Business Corporation Act (MBCA), which some states have enacted as their state corporation law, requires directors to act “in the best interests of the corporation” when managing the corporation.\footnote{111} The MBCA does not define “the best interests of the corporation.” Half of all publicly traded U.S. corporations are incorporated in Delaware.\footnote{112} The Delaware General Corporation Law generally does not define the duties of directors, which are defined by judicial decisions. Delaware courts also state that directors have a duty to act in the best interests of the corporation.\footnote{113}

Courts and commentators frequently have interpreted “the best interests of the corporation” to mean that directors ought to maximize shareholder wealth.\footnote{114} Some commentators consider the holding by the Michigan Supreme


\footnote{111. MODEL BUS. CORP. ACT § 8.30 (2003).}


\footnote{113. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).}

\footnote{114. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919). Certainly, many conservative corporate legal scholars view shareholder wealth maximization as the goal towards which directors should manage the corporation. Stephen M. Bainbridge, In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green, 50 WASH. & LEE L. REV. 1423 (1993); Macey, supra note 20. Even progressive law scholars, however, have acknowledged that shareholder wealth maximization has been the bedrock principle of corporate law. David Millon, Frontiers of Legal Thought I: Theories of the Corporation, 1990 DUKE L.J. 201, 220-25. Shareholder wealth maximization is not necessarily the same as maximizing profits. Shareholder wealth maximization focuses on increasing the overall value of the business and, thus, increasing the value of each share or ownership interest in the
Court in *Dodge v. Ford Motor Co.* to be the classic articulation of this view. Looking only at the court records, this case appears to be one in which a business tried to place the principles of corporate social responsibility ahead of the interests of the shareholders and was told that the law did not permit this. In the case, Henry Ford, as the majority shareholder and President of Ford Motor Company, prevented the company from paying any dividends to the shareholders beginning in 1916. He alleged in his testimony that his reasons were a mixture of business strategy and altruism, as he wanted to use the profits to grow the business, which would enable him to “employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes.” While the Michigan Supreme Court was willing to allow a corporation the power to make an “incidental humanitarian expenditure,” it held that Ford’s actions violated the law. The court commented:

A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.

*Dodge v. Ford Motor Co.* and its progeny do not provide much guidance regarding what factors directors should take into account or give priority to when attempting to maximize the wealth of shareholders. It is unclear, for example, whether directors ought to be more concerned with short term or long term shareholder wealth maximization. In the *Shlensky v. Wrigley* case, a group of minority shareholders sued to force the directors to install lights in Wrigley Field to enable the field to hold night games. The directors conceded that they had made the decision not to install lights in order to benefit the neighborhood. The court rationalized the directors’ decision as being in the sharehold-

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116. Bainbridge, supra note 114, at 1423.
118. *Id.* at 683.
119. *Id.*
121. *Id.* at 778.
ers’ long term interests, even if it harmed their short term financial gains. The court concluded that the lights might cause a deterioration of the neighborhood, which in turn might deter future patrons from attending games at Wrigley Field and thus harm long term profits.

Other commentators have argued that framing *Dodge v. Ford Motor Co.* as advancing the principle of shareholder wealth maximization is a misreading of the case. They have pointed out that *Dodge* was not a case of directors and officers expanding the goals of the business to address the needs of other stakeholders, but was in fact a case of a majority shareholder using his power to subvert the economic interests of the minority shareholders.

Adolf Berle and Gardiner Means, in their book *The Modern Corporation and Private Property*, published in 1932, provide another source for the foundation of the shareholder wealth maximization norm. They argued that directors should be required to maximize the interests of the shareholders as a way of addressing the agency problem created by the separation of ownership from control in corporations.

This agency problem primarily arises in a publicly traded corporation. In a publicly held corporation, the common denominator among the shareholders is the desire for a return on their interest and preferably the highest return on

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122. *Id.* at 780.

123. *Id.*


125. Smith, *supra* note 124; Henderson, *supra* note 124; Stout, *supra* note 124. Henry Ford owned 58% of Ford Motor Company and John and Horace Dodge owned 10% of the company. Smith, *supra* note 124, at 315-320. The Dodge Brothers not only were some of the initial investors in Ford, but their business had supplied Ford with the facilities to build the chassis for Ford’s cars. *Id.* at 315-316. In 1914, they started their own automobile company and began to compete directly with Ford. *Id.* at 316. Henry Ford did not want the profits of Ford to be used to fund the expansion of a competitor, and the easiest way to prevent that from happening was for the Ford Motor Company to simply stop paying dividends. *Id.*. If he had expanded the Ford Motor Company and cut the price of its cars as he claimed to want to do, Ford would have had lower profits in the future. The strategy of cutting the price of the cars and expanding the number produced could also have been conceived of as a means to drive the Dodge brothers’ company out of business. Ford Motor Company could have survived with lower profits, but it is unclear if the Dodge brothers could have competed if Ford substantially slashed the price of its cars.

their investment legally possible. Most shareholders in publicly held corporations do not have the power to control the behavior of the directors individually. While they can elect or remove directors as a group, their holdings are so diffuse that collective action problems make it difficult for them to act in concert to add or remove specific directors, except in especially egregious cases of malfeasance. As a result, the rule to maximize profits for shareholders is intended to limit the discretion of officers and directors and to discourage or prevent managerial abuse, primarily in publicly held corporations.

Unfortunately, courts did not begin to distinguish between publicly traded and closely held corporations until the middle of the twentieth century. As a result, the courts applied the shareholder primacy norm to a broader range of decisions by directors and officers than just those made by directors and officers of publicly held corporations.\textsuperscript{127}

Applying rules that may be beneficial for publicly held corporations to all corporations could distort the rules that should apply to closely held corporations. In terms of sheer numbers, if not the size of the assets held or revenues generated, closely held businesses outnumber publicly held businesses. Roughly 22.7 million businesses existed in the United States in 2003.\textsuperscript{128} Of that number, about 17 million were sole proprietorships.\textsuperscript{129} Only 170,898 of these businesses were large enterprises.\textsuperscript{130} Of the large enterprises only about 2,800 were listed on the New York Stock Exchange and only about 3,200 were listed on Nasdaq.\textsuperscript{131}

Just because a business is closely held does not mean that it is small. The SC Johnson Corporation, a family-owned business, had annual revenues of $7 billion in 2005.\textsuperscript{132} Another large but closely held business is the Cargill Corporation, which had $69.9 billion in revenues in 2005.\textsuperscript{133}

Corporate law is equivocal on how much primacy shareholders should be accorded over other constituencies. The state laws generally allow the owners of closely held businesses to determine how they will manage their businesses within certain limits. They must manage them so that they remain solvent and can meet their obligations to their creditors, suppliers, and employees. As long

\textsuperscript{127} Smith, supra note 124, at 279-80.


\textsuperscript{129} Id.

\textsuperscript{130} Id.


as the owners of a business agree that it will be managed to be profitable, not to maximize profits, the law will not intervene to force the business to maximize profits. As a result, the managers of many closely held businesses enjoy a great deal of latitude when making decisions that allow them to take into account the interests of the other stakeholders (employees, creditors, suppliers, customers, the community, and the environment). On the other hand, if someone was induced to invest in the business with the understanding that it would be managed to maximize profits, then deliberately not managing the business in that fashion would be fraudulent.

Regardless of whether a corporation is publicly or privately held, courts do not require corporations to strictly adhere to a shareholder wealth maximization norm. Corporate law permits directors to take certain actions to benefit non-shareholders. All corporate law statutes, for example, allow corporations to make charitable contributions even though such contributions cannot be proven to benefit shareholders in some fashion. Courts have upheld corporate charitable giving that has been explicitly challenged by shareholders on the grounds that it decreases the corporation's profits. In addition, the corporation laws in thirty-three states explicitly allow managers to take into account constituencies other than shareholders when making decisions. Usually, however, these laws do not allow directors to sacrifice the interests of the shareholders for the interests of these other groups.

Shareholders seeking to enforce the norm of shareholder wealth maximization also face a serious obstacle in the form of the business judgment rule.


\[135. \text{Theodora Holding Corp. v. Henderson, 257 A.2d 398, 405 (Del. Ch. 1969)} \]


\[137. \text{Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).} \]
courts have articulated two broad conceptions for applying the business judgment rule in the context of violations of a director's fiduciary duties: (1) business judgment rule as a doctrine of abstention and (2) business judgment rule as an objective review of the merits. Under the business judgment rule as a doctrine of abstention, courts generally avoid replacing their judgment for that of the corporation's directors in instances where no conflict of interest exists. The business judgment rule in these instances assumes that a director acted with due care when making a decision unless there is evidence of a conflict of interest or lack of good faith. In the Dodge v. Ford Motor Co. case, the court refused to interfere with Henry Ford's plans to expand production despite his avowed purpose of aiding society, not maximizing profits, on the grounds that "judges are not business experts."

No single formulation of the business judgment rule as a standard for liability on the merits of the board's decision exists. Some courts have held that the decision must be made in good faith, others have held that the decision must be rational, and others have held that the decision must not be grossly negligent or worse. In most cases, a decision by directors to adopt a code of conduct that takes into account other stakeholders' interests will survive judicial scrutiny and receive the protection of the business judgment rule if any business case can be made for such a code.

2. False and Deceptive Advertising

Corporations are also deterred from adopting aspirational codes of conduct because they fear that if they should fail to live up to the standards in the codes that they will be sued for false and deceptive advertising under state and federal laws. Nike, Inc. became the poster child for these concerns when it was sued in the 1990s for statements in its annual CSR report concerning working conditions in the factories that made its shoes.


140. Gevurtz, supra note 138, at 295-303; Bainbridge, supra note 138, at 9.

Nike was founded in the United States in 1964 by Phil Knight and Bill Bowerman. Nike had outsourced at least some of its shoe production to overseas subcontractors since the early 1970s. In the early 1980s, Nike closed its U.S. factories and began sourcing all of its shoe production from overseas suppliers. At that time Nike began to be criticized for outsourcing its shoe production to nations with poor working conditions, low wages, and human rights problems.

In the 1990s, numerous articles in a wide range of publications, including the New York Times, the New Republic, Rolling Stone, Foreign Affairs, and The Economist, criticized the working conditions and practices at Nike’s suppliers in Indonesia, Vietnam, and Pakistan. Initially, Nike attempted to deflect critics by pointing out that Nike did not own or operate the factories, it was not legally liable under local law for the violations of its subcontractors, and it was not obligated under U.S. law to assume liability for its subcontractors’ compliance with local laws and regulations. While Nike’s statements were accurate descriptions of its legal obligations, they did not mollify Nike’s critics among consumer and labor groups, who organized boycotts of Nike’s products.

In 1992, Nike decided to change approach and adopted a code of conduct for its suppliers, which required the suppliers to comply with local labor, environmental, and health and safety laws and to post a copy of the code of conduct in their factories. In March 1993, Nike entered into a memorandum of understanding with each of its subcontractors, under which Nike assumed responsibility for the subcontractors’ compliance with laws governing minimum wage, overtime, occupational health and safety, and environmental protection. Nike’s code of conduct evolved to require its suppliers to do more than meet the local standards. The code began requiring subcontractors to comply with U.S. Occupational Safety and Health Administration standards and raised the minimum age for footwear factory employees to eighteen and factory workers producing apparel and equipment to sixteen.

Despite adopting this code of conduct, Nike continued to be criticized in the media over the poor working conditions in the facilities producing Nike’s products. Critics claimed that the code was solely for public relations purposes.

142. Locke, supra note 3, at 44.
143. Id. at 46.
144. Id.
145. Id. at 50.
146. Id. at 51-54.
147. Id. at 54-55.
148. Id. at 54.
149. Id.
151. Locke, supra note 3, at 55.
and that the employees in the factories lacked the ability to enforce the code’s provisions. The media reports peaked in 1996 and 1997. These reports continued to find problems in the factories operated by Nike’s subcontractors, including the failure to pay the minimum wage in the relevant locality; the failure to comply with requirements to work overtime; physical, verbal, and sexual abuse of workers; and exposure of workers to safety and environmental hazards. Nike denied that unsafe working conditions existed in the factories that made its shoes in China, Vietnam, and Indonesia.

In April 1998, Marc Kasky sued Nike and five of its corporate officers claiming that Nike’s corporate social responsibility reports and advertising violated California’s prohibitions on unfair business practices and false advertising under California’s Unfair Business Practices Act and California’s Business and Professions Code § 17500. Kasky alleged that Nike and the individual defendants made numerous false and misleading statements in an effort to respond to the adverse publicity and maintain Nike’s sales. Nike made these statements in press releases, letters to newspapers, letters to university presidents and athletic directors, and in other documents. In addition, Nike bought advertisements in leading newspapers to publicize the report by GoodWorks International LLC. Nike had contracted with GoodWorks to have Andrew Young, the former U.S. Ambassador to the United Nations under President Carter, evaluate the conditions at the factories of its contracting partners. Ambassador Young visited twelve of the factories as part of the evaluation of labor practices at the facilities and declared that he found no evidence of mistreatment or abuse of workers.

Another audit commissioned by Nike from Ernst and Young of one of the factories visited by Andrew Young, however, reached dramatically different conclusions from the GoodWorks report. This audit covered Tae Kwang Vine Company, one of Nike’s South Korean subcontractors operating in Vietnam. This audit found Toluene, a chemical solvent known to cause damage to the liver and kidneys, skin and eye irritations, and depression of the central nervous system, in concentrations exceeding acceptable safety standards by between six

152. Id. at 54.
153. Id. at 64-65.
154. Nike I, 45 P.3d at 248.
155. Id. at 247-48.
158. Id.
159. Id.
160. Id.
161. Locke, supra note 3, at 53.
Despite the dangers posed, the audit reported that workers were not being given personal protective equipment. In addition, the audit reported that the other working conditions and work hours at the plant were in violation of Nike’s code of conduct. This audit was leaked to the press in November 1997.

Nike claimed that its statements in its CSR report and elsewhere regarding the conditions in the factories amounted to noncommercial speech, which should be afforded the highest level of protection under the First Amendment. The California Supreme Court, however, found that Nike’s statements were commercial speech which could be regulated. The U.S. Supreme Court agreed to hear the case but ultimately dismissed it as being too premature for the Court to decide the case. So the case was sent back to the California courts to determine if Nike’s commercial speech violated California’s laws against false or misleading advertising and practices.

The California unfair competition law and the false advertising law both prohibit misleading advertising. Misleading is interpreted as creating a “capacity, likelihood or tendency to deceive or confuse the public” under California law. This is a very low threshold. It would encompass not only false advertising but also advertising that was true but misleading or likely to deceive or confuse. In his dissent to the California Supreme Court’s decision in Kasky v. Nike, Inc., Justice Brown noted that the majority’s limited-purpose test for commercial speech would classify all corporate speech about business operations, products, or services as commercial speech and subject to the California unfair competition law and the false advertising law. He went on to comment that the majority’s holding would deter corporations from speaking whenever their statements related to business operations, products, or services and may deceive or confuse the public—even if the statements are truthful.

In September 2003, Nike settled the lawsuit with Marc Kasky. Nike agreed to donate to the Fair Labor Association $1.5 million. As a result of this settle-

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162. Id.
163. Id.
166. Id. at 657-58.
167. CAL. BUS. & PROF. CODE §§ 17200, 17500 (West 2004).
168. Nike I, 45 P.3d at 247-48 (citing Leoni v. State Bar, 39 Cal. 3d 609, 626 (1985)).
169. Id.
170. Id. at 272.
171. Id. at 272-73.
172. Nike Settles, supra note 156, at 5.
173. Id.
ment, no court ever ruled on whether Nike’s statements regarding the conditions in the factories were truthful. During the discovery phase of the case, Nike turned over a wide range of internal documents discussing the conditions in factories, and some news stories speculated that the contents of those documents led Nike to settle, rather than shoulder the costs of pursuing the litigation.\footnote{Russell Mokhiber, \textit{Nike’s Come-from-Behind Win}, \textit{Multinat’l Monitor}, Oct. 2003, at 7.} In the settlement announcement, Nike commented: “Due to the potential difficulties posed by the application of California Statute section 17200, Nike has decided not to issue its corporate responsibility report externally for its fiscal year 2002 and will continue to limit its participation in public events and media engagements in California.”\footnote{Id.}

The Nike case sent ripples of unease throughout the worldwide CSR community, which feared that it would deter other businesses from incorporating CSR principles in their codes of conduct.\footnote{See, e.g., \textit{Corporate Social Responsibility: What Should the EU Guidelines Look Like?}, \textit{EURActiv.com}, Oct. 9, 2002, http://www.euractiv.com/en/socialeurope/corporate-social-responsibility-eu-guidelines-look/article-117284. Alan Christie, the Chairman of the Board of Directors for CSR Europe, commented that the Nike case was “a glorious example of why the European system is superior to the American system” and that the Nike case was an example of American companies being punished for seeking ways of meeting their responsibilities. He also stated that “for Nike to be accused of false advertising is just nonsense.” \textit{Id.}} Unfortunately, no empirical evidence appears to exist that measures how many corporations reconsidered adopting CSR principles in their codes of conduct in the wake of the Nike case.

Not only can private litigants use state laws forbidding false or deceptive advertising against corporations that publicize the fact that they have adopted a code of conduct and their actions to implement it, but the Federal Trade Commission (FTC) can bring enforcement actions to punish businesses that adopt codes of conduct with aspirational goals that they fail to achieve on the grounds that the public notices about such codes amounted to deceptive advertising.\footnote{Federal Trade Commission Act, 15 U.S.C. \textsection 45 (2000); Su-Ping Lu, \textit{Corporate Codes of Conduct and the FTC: Advancing Human Rights Through Deceptive Advertising Law}, 38 \textit{Columbia J. Transnat’l L.} 603, 603 (2000).} Section 5 of the Federal Trade Commission Act prohibits “unfair or deceptive acts or practices in or affecting commerce.”\footnote{In re Cliffdale Associates, Inc., 103 F.T.C. 110, 165 (1984).} The FTC must find three elements to be present in order for it to hold that a practice is deceptive: (1) someone has made a representation, omission, or practice towards consumers; (2) this representation, omission, or practice is likely to mislead consumers acting reasonably under the circumstances; and (3) this representation, omission, or practice is misleading in a material respect.\footnote{In re Cliffdale Associates, Inc., 103 F.T.C. 110, 165 (1984).}
In order for a corporation's activities in connection with its code of conduct to run afoul of the FTC under the deceptive practices test, the corporation would have to publicize the fact that it had a code of conduct. Companies that have adopted codes with aspirational goals generally do advertise them in order to build goodwill among their customers and potential customers. Next, the FTC would need to find that the advertisements of these codes were likely to mislead consumers acting reasonably under the circumstances. This does not require that the FTC find that any consumers actually were deceived. Finally, the FTC must find that the advertisement was a material misrepresentation, omission, or practice. To be material, the information presented must be something that was "important to consumers and, hence, likely to affect their choice of, or conduct regarding, a product." If a business claims to be implementing certain standards or policies and it falls materially short of achieving those standards or policies, then the FTC could initiate an action against the business for unfair or deceptive acts or practices.

3. Torts

Corporations are responsible for the torts of their agents and employees made in the furtherance of the corporations' businesses. The common law memorialized this rule in the doctrine of respondeat superior. Under this doctrine, corporations cannot absolve themselves from such liability merely by instructing their employees or agents not to engage in certain behavior.

A corporation that adopts a code of conduct or policy statement, however, must comply with the procedures and policies set forth in that statement, even if that statement adopts procedures and policies greater than those required by the law. If the corporation fails to implement or enforce its code of conduct, it may be subject to a greater level of liability than if it had not adopted any code at all. For example, a corporate code of conduct that prohibits sexual harassment of subordinates by supervisors will not absolve the corporation from liability if a supervisor sexually harasses a subordinate, because the code provides evidence that such activities were foreseeable.

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181. Goodman v. FTC, 244 F.2d 584, 604 (9th Cir. 1957) (stating that a critical element is the advertisement's capacity to deceive); Charles of the Ritz Distrib. Corp. v. FTC, 143 F.2d 676, 680 (2d Cir. 1944).
183. Pitt & Groskaufmanis, supra note 26, at 1563.
184. Id.
Some jurisdictions in limited cases will use a code of conduct to shield a corporation from liability. The code may be used as evidence in close cases to determine if an act was done within the scope of employment. If a store has adopted a code or policy that imposes higher standards on its employees before they can detain someone suspected of theft than the law requires, some jurisdictions do not allow this code to be introduced as evidence against the store if its employees have met the legal standard but violated the store’s policy. Other courts, however, will allow the code to be admitted into evidence on the grounds that it may indicate what the industry standards are.

4. Codes May Be Interpreted as Contracts

Codes of conduct frequently cover a range of policies and procedures governing employees. They also include all of the policies and procedures found in the employee handbook. Some state courts have ruled that if the codes or employee handbooks do not clearly state that they do not alter the employees’ status as at-will employees, then the terms of the code or employee handbook may be deemed an employment contract between the corporations and the employees. Corporations try to avoid this problem now by expressly disclaiming in writing that the code or employee handbook forms a contract with the employees. Some courts will, however, still find that the code does constitute a contract even if it has such a disclaimer, if the code gives more than one message.

The above list is not meant to be exhaustive. It does provide some idea of the types of liability that a business can incur if it adopts a code of conduct. These liabilities form part of the costs that each business must weigh against the benefits provided by such a code when determining if it will implement a code and what standards and procedures the code will cover.

C. Market Incentives and Disincentives Regarding Codes of Conduct

Business magazines and the business press recently have been full of news articles touting the ways that businesses can “do well by doing good.” These sto-

188. Restatement (Second) of Agency § 230 cmt. c (1957).
190. Kmart Corp. v. Washington, 866 P.2d 274, 280 (Nev. 1993) (noting that states were split on whether to admit merchant codes to determine what is reasonable behavior).
191. Chapter 2: The Impact of Corporate Codes of Conduct and Other Corporate Policy Statements on Criminal and Civil Liability, in Business Ethics, supra note 60, at 201.004.
192. Id. at 201.005.
ries focus on how corporations can use CSR principles to improve their bottom lines. Generally these stories of how CSR principles aid corporations fall into four categories: (1) the CSR principles embodied in the code are part of the corporation’s business strategy, (2) the code will help the business avoid negative public relations campaigns by activists, (3) the code will encourage public investment by qualifying for social investment funds, and (4) the code will enhance the ability of corporations to find and retain qualified employees.193

Corporate social responsibility as a market strategy, however, currently only makes business sense in the near term for two types of businesses: (1) those businesses likely to be targets of activists’ campaigns that will differentiate them adversely from their competitors and (2) those businesses that use CSR as part of their corporate strategy to differentiate themselves from their competitors.194 Non-governmental organizations (NGOs) have used their ability to mobilize public opinion to mount protests, boycotts, and other actions against corporate practices that they find objectionable.195 All corporations are not equally subject to these actions. NGOs usually target only the largest and most visible corporations.196 This pattern of confrontation between large corporations and NGOs may be changing. Some corporations and NGOs now engage each other rather than fight with one another.197 This cooperation has led to the development of new operating standards such as those devised under the Apparel Industry Partnership, the Forest Stewardship Council, and the Marine Stewardship Council.198

Currently, the number of companies that use CSR as part of their corporate strategy to differentiate themselves from their competitors is small but growing. Corporations like the Body Shop, Ben & Jerry’s, and Whole Foods are examples of businesses that have incorporated following CSR principles as part of their strategic plans for gaining market share.

193. Vogel, supra note 2, at 46-47; Ernest Beck, Do You Need to Be Green?, BusinessWeek SmallBiz, Summer 2006, at 42, 46-47; Brugmann & Prahalad, supra note 24, at 83; Joseph Hart, The New Capitalists, Utne, May-June 2006, at 40. Motto, a business magazine aimed at “purpose, passion and profit,” was launched in recent years. The premiere issue contained articles aimed at the businessperson who wanted to make a difference in the world in addition to making a profit.

194. Vogel, supra note 2, at 73; Doane, supra note 9, at 25-26.

195. Brugmann & Prahalad, supra note 24, at 83. Surveys of consumers indicate that at least some of them view a corporation’s ethics and values as important when assessing the reputation of a business. Pressler, supra note 62, at 24 (describing a survey by Bozell Worldwide and Nihon Keizai Shimbun of the Wall Street Journal International Edition that found that 55% of American, 47% of Japanese, and 35% of European participants stated that they “always” take ethics and values into account when purchasing services or products).

196. Vogel, supra note 2, at 73.

197. Brugmann & Prahalad, supra note 24, at 85.

198. Id. at 84.
Companies that do not fall into either of those two categories generally have received neither significant benefits nor significant penalties from financial markets for engaging in or failing to engage in CSR activities.\textsuperscript{199} Part of the reason for this is due to the fact that following CSR principles is more expensive than not and these added costs cannot always be passed along to the corporation's clients. Part of those added costs are the costs associated with increased risk of litigation that corporations adopting codes that embody CSR principles face.

In addition, public corporations that do not rely on CSR strategies to differentiate themselves from their competitors are more likely to be penalized in the stock markets for engaging in CSR activities because of the emphasis in the stock markets on short term financial performance and the need to maximize profits.\textsuperscript{200} If a corporation moves away from being managed to maximize profits towards other goals, its shares may be priced lower than the shares of corporations that do maximize profits, because investors will move their funds to corporations that will offer them the chance at a larger rate of return on their investment.

The prices for the shares of Costco and Wal-Mart illustrate this phenomenon.\textsuperscript{201} Costco pays its workers higher salaries and offers them better benefit packages than Sam's Club, the Wal-Mart warehouse retailer that competes directly with Costco, offers to its workers.\textsuperscript{202} Costco's treatment of its workers reflects the more stakeholder-oriented view of its CEO, Jim Sinegal, who commented: "The last thing I want people to believe is that I don't care about the shareholder. . . . But I happen to believe that in order to reward the shareholder in the long term, you have to please your customers and workers."\textsuperscript{203} Wall Street analysts, however, hold these practices against Costco despite the fact that Costco's workforce is more productive and loyal than Sam's Club's workforce.\textsuperscript{204} Bill Dreher, an analyst for Deutsche Bank Securities Inc., complained: "From the perspective of investors, Costco's benefits are overly generous. . . . Public companies need to care for shareholders first. Costco runs its business

\textsuperscript{199} Vogel, supra note 2, at 71-72.
\textsuperscript{200} Id. at 72.
\textsuperscript{202} Id.
\textsuperscript{203} Id.
\textsuperscript{204} Ann Zimmerman, Costco's Dilemma: Be Kind to Its Workers or Wall Street?, Wall St. J., Mar. 26, 2004, at B1, available at http://online.wsj.com/article_email/SB1080259178543659041Njje0Nplav3qlo2pan2bau5lm4.html. In 2004, Costco made $13,647 profit per hourly employee in the United States while Sam's Club only made $11,039. Holmes & Zellner, supra note 201, at 76. Only 6% of Costco's employees leave after the first year while 21% of Sam's Club's employees leave after one year. Id.
like it is a private company."205 As a result, Costco's shares only traded at twenty times projected-per-share earnings in 2004 while Wal-Mart's traded at twenty-four times projected-per-share earnings.206 This market penalty is potentially more problematic than the risk that a disgruntled shareholder will bring a shareholder derivative suit against the directors and officers for breaching their fiduciary duties to the corporation.

Markets work well when they are competitive and when corporate and societal interests align.207 Under these circumstances, the most profitable corporation is the best one for society.208 Markets fail to properly align corporate and societal interests under a number of circumstances, including when corporations produce externalities or when market participants have imperfect information.209 Codes that embody CSR principles can be useful in addressing these instances of market failure, particularly those that involve private-social cost differences. They can identify and help businesses address areas of potential conflict between corporate goals and societal interests.210 In the worst case scenario, such conflicts can threaten the survival of a business.211

British Petroleum's (BP) actions illustrate how adopting higher standards than those required by law can potentially head off future long term threats to a business's financial well-being. In 1997, BP accepted that global warming was a problem to which its business was contributing. It adopted a firm-wide cap-and-trade system for greenhouse gas emissions. This program allowed the corporation to reduce its overall emissions and save $600 million. It also protected BP's brand equity and the public's goodwill towards the company. It potentially deterred lawmakers from imposing more onerous and less flexible regulatory mandates on BP to force a reduction in its emissions.

BP's experience also suggests that corporations may miscalculate the private costs that they are bearing for some of their activities.212 In BP's case, it failed to include opportunity costs into its financial calculations. One way that it was contributing to greenhouse gas emissions was by flaring natural gas from some of its oil wells. There was little or no cash cost to account for in its financial statements for doing this. BP, however, was losing the revenues that it could have received if it collected and sold the natural gas. Adopting aspirational codes and compliance programs can remedy such miscalculations of the differences between private and social costs and save corporations money in the process.

205. Zimmerman, supra note 204, at 76.
206. Id.
207. Heal, supra note 11, at 2.
208. Id.
209. Doane, supra note 9, at 24; Heal, supra note 11, at 4.
210. Heal, supra note 11, at 3.
211. Id.
212. Id. at 7-8.
In order to work at addressing potential societal conflicts, such codes must be acceptable to the stakeholders or members of society that are on the other side. Both McDonalds and Shell tried to adopt CSR policies in order to accrue some goodwill with their customers from how each was addressing the environmental impacts of disposing of their waste. In both cases, the environmental community, however, strongly believed that alternative solutions were better than the policies pursued by McDonalds and Shell. As a result, both companies provoked a confrontation with such groups and emerged with their reputations damaged rather than enhanced by their CSR policies. In addition to proposing acceptable solutions to the other side, corporations need to credibly document that they are implementing these solutions, which usually means allowing an outside audit to be completed. If a corporation’s efforts are viewed merely as a public relations stunt and not as a meaningful program, the corporation will not reap the potential gains to its brands or goodwill.

Providing a safe harbor for aspirational codes of conduct would improve the business case for some firms. A safe harbor law could address the concern that adopting aspirational codes of conduct would increase a company’s costs due to litigation and regulatory enforcement actions. It would not address the concern that doing more than what a company is legally required to do would add costs that the company’s competitors would not be bearing. Unless the company is able to use its code of conduct to differentiate itself from its competitors in the marketplace to attract more customers, it is unlikely to adopt such a code, even with the availability of a safe harbor statute.

II. Creation of a Safe Harbor for Aspirational Codes of Conduct

The legal and market forces outlined above make it extremely difficult for businesses to seek ethical aspirational goals that exceed what they are legally required to do. In fact, the market forces may encourage some businesses to try to get as close to the line of what is legally permissible behavior in order to maximize profits. The danger with that sort of behavior is that businesses frequently

213. Id. at 8. McDonalds had initially adopted a recycling program for its polystyrene packaging. Alan Liddle, McDonald’s Pulls Plastic Packaging, Nation’s Restaurant News, Nov. 12, 1990, http://findarticles.com/p/articles/mi_m3190/isn45_v24/ai_9116064. Environmental groups objected to polystyrene packaging on the grounds that it took a long time to breakdown in landfills and the gases used in its manufacture harmed the atmosphere. After just a few months of criticism from consumers and environmental groups over its recycling program, McDonalds switched to using paper packaging. Shell had planned to dispose of its Brent Spar oil buoy in the North Sea but Greenpeace and other environmental groups strongly objected. Final Resting Place for Brent Spar, BBC News, Aug. 26, 1998, http://news.bbc.co.uk/2/hi/europe/138613.stm. Thousands of people boycotted Shell’s products to protest the disposal. The European Parliament and several European nations spoke against the disposal. Eventually, Shell decided to have the buoy cut up and its parts used to build a quay in Norway.

misjudge where the line is and end up owing large penalties and legal bills for violations of the law.

How can the law be amended in order to encourage businesses to seek to achieve higher standards of behavior than the bare legal minimum? One possible solution might be for states or the federal government or both to enact laws that limit the ability of corporations to be sued if they make good faith efforts to achieve aspirational standards of behavior but fail as long as their conduct still met the legal standards embodied in statutes, regulations, and the common law. Such a safe harbor law might look like the draft Promoting Aspirational Codes Enactment (PACE) Act in the Appendix to this Article.

How would such a safe harbor act work? First, the act needs to define what an aspirational code of conduct is. The PACE Act defines an aspirational code of conduct as:

a code of conduct adopted by a business organization, which imposes stricter requirements than currently required by existing Federal, State, or local laws and which conforms to the general guidelines of one of the acceptable aspirational codes of conduct certified by the Secretary of State (for Federal law, the Securities and Exchange Commission (SEC)).

In order to avoid confusion and litigation over when a code meets the criteria of the Act, a state official, such as the secretary of state, or a federal official or agency, such as the SEC, would need to certify a list of codes that they have determined embody standards higher than those legally required. These codes may be promulgated by international organizations, like the Organization for Economic Co-operation and Development (OECD) or the United Nations; by industry self-regulatory organizations, like the Financial Regulatory Association; or by NGOs, like the Caux Roundtable. The certification process is necessary if the safe harbor’s benefits are to exceed its costs. Some mechanism, other than litigation, must be implemented in order to verify that a corporation’s code truly is aspirational and not merely a restatement of its legal requirements. While it would be theoretically possible for a state or federal agency to review and verify that the potentially hundreds or thousands of codes of conduct that businesses could adopt do in fact contain standards that exceed their legal obligations, it would be excessively costly both in terms of time and money to do so. In addition, the certification process provides some assurance to customers, investors, and other stakeholders that the corporation is not merely engaging in a public relations stunt but has in fact adopted an aspirational code and compliance program.

The business would then adopt a code of conduct that conforms to one of these certified codes. Conformity does not mean that the standards set forth in the certified codes would become the new ceiling for the corporation’s conduct. Instead, the standards set forth in the certified codes would act as floors, and corporations would be free to implement even higher standards than the ones established in the certified codes. As a result, businesses would still have the freedom to experiment and to use the differences in their codes to differentiate themselves from their competitors in the marketplace.
What should state or federal officials require in an aspirational code of conduct in order to be certified for this safe harbor? Codes need to be clear and precise in order to permit the standards to be adopted and compliance monitored effectively. In order to be clear, the language in the code must provide definitions for key terms and standards. Take for example, the phrase, "continuous improvement." If this phrase is repeated in various sections within the code, confusion might arise as to what constitutes "continuous improvement" and how it ought to be measured. In some areas, such as environmental protection, quantitative measures showing declining amounts of pollution might be appropriate, but quantitative measures might not be appropriate in the area of labor rights. Rather than using the ambiguous phrase "continuous improvement," clear, concise, and precise standards would provide the corporation with a better goal to shoot for and a more accurate means of measuring the corporation's performance toward these goals.

References to how the code is to exceed the legal standards set forth in state or federal laws would also enhance clarity and accountability. By making reference to existing laws, standards, and practices, the code makes it easier to measure how well the corporation is complying. Strong and unambiguous statements within the code signal a higher degree of commitment to abide by the code. In addition, language in the code that indicates what types of actions or penalties the corporation will take against its employees or business partners who violate the code provisions further enhances the corporation's commitment to achieving the goals embodied in the code.

State or federal officials should not allow corporations to cherry-pick rules or standards from a variety of organizations or sources. Citing multiple sources may create confusion regarding how to apply and interpret the standards, and it could create gaps or internal conflicts among the provisions within the code or between the code and state and federal laws.

What areas should be covered in the aspirational codes of conduct that would qualify for safe harbor treatment? Codes of conduct should include provisions covering many, but not necessarily all, of the following subjects: (1) labor rights, (2) health and safety, (3) environmental protection, (4) disclosure of information, (5) competition, (6) taxation, (7) prohibitions against bribery and corruption, (8) intellectual property, (9) consumer protection, and (10) financial accountability. The codes qualifying for the safe harbor probably should cover many, if not most, of these topics listed above in order to qualify for the safe harbor provisions. Obviously, the state legislature or Congress could specify

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216. Id. at 48.
217. Id. at 41.
218. Id. at 41-42.
219. Id. at 49-54.
which of these elements must be present. Alternatively, they could delegate that
decision to the agency responsible for administering the Act. The agency ad-
ministering the Act would then select a portfolio of possible codes that busi-
nesses could use as a basis for their codes. As noted above, the codes selected by
the government would be developed by multilateral bodies, like the United Na-
tions or the OECD, or respected NGOs. Those bodies should also develop im-
plementation and compliance programs for their codes.

One advantage of allowing businesses to select from a portfolio of possible
codes is that it provides greater flexibility for businesses to choose the code that
will work best for the business realities that they face. In addition, it allows for a
degree of experimentation among businesses with different codes of conduct
that can produce valuable information for government regulators which may
help them determine if they need to mandate certain standards because not
enough businesses are voluntarily addressing a problem and which rules will
produce the greatest benefits at the least cost for the businesses subject to those
new regulations.

After adopting an acceptable aspirational code of conduct, a business would
need to implement a compliance program to ensure that it makes a good faith
effort to meet the higher standards set forth in the code. Even if the code is pub-
licly available, the corporation may refuse to disclose publicly its implementa-
tion guidelines on the grounds that they are “privileged communications, con-
fidential business information or trade secrets.”

Businesses currently use three different methods for ensuring compliance
with their codes of conduct. One is to create an internal compliance depart-
ment which promotes and monitors implementation of the code. Another
method builds compliance mechanisms into the existing structures of the busi-
ness, such as quality control. A third method uses an outside party, such as an
auditor or a multi-stakeholder initiative like Social Accountability International
(SAI), to monitor compliance.

In order to fit within the safe harbor, the business would be required to fol-
low the third method and have an outside party monitor its compliance with its
code. Because of this need to have the company’s compliance audited, state and
federal governments may want to give preference to codes that can easily be au-
dited by independent auditors when choosing which codes to include in the
portfolio. The outside party could either be a state or federal official, a private
corporation, such as PricewaterhouseCoopers, or an auditor supplied by the multilat-
eral organization or by the NGO that originally created the code on which the
business’s code of conduct is based. In the case of private firms, the government
could help ensure the quality of the audits by requiring firms that conduct them
to be certified as qualified to do so either by the organization that devised the
standards on which the code is based or by the relevant state or federal agency.
At least initially, it would be preferable to allow private firms to conduct the au-

220.  Id. at 55.
221.  Id. at 56.
dits rather than expand existing state and federal agencies to cover this function. Expanding existing government agencies to handle this function would be very expensive and seems unnecessary given the number of existing private auditing firms who could handle the job.

Allowing the business being audited to directly pay the firm auditing it does pose conflict of interest problems. The auditing firm may be reluctant to turn in a negative report against the business that is paying for its services. To deter this state or federal officials could fine auditing firms that routinely fail to provide accurate audits or could seek to enjoin them from being allowed to conduct any such audits in the future. Alternatively, this problem could be avoided by having each business adopting one of the approved codes pay the government a set fee to be audited. The government would randomly selected one of the firms off of the list of qualified auditors to audit the business. The firm selected would receive either the entire fee paid by the business or everything but a small amount to cover the costs of the government running the auditing program.

Numerous organizations already exist that could be used to audit businesses that have adopted aspirational codes of conduct. Corporations currently can hire consultants or auditing firms to help them with “double bottom line” or “triple bottom line” accounting. These methods require the corporation to evaluate its business not only in terms of its financial performance but along other indices as well. Double bottom line requires corporations to evaluate the public bottom line as well as the financial bottom line.\textsuperscript{222} The public bottom line requires corporations that are providing public services that are “fundamental to the health and welfare of the nation,” such as hospitals, to assess how well they are delivering those services in addition to being concerned with their profitability.\textsuperscript{223} Triple bottom line accounting requires corporations to evaluate their performance not only based on the traditional financial measures but with respect to how they treat the environment and society.

Social Accountability International (SAI) and the International Organization for Standardization (ISO) are examples of two organizations that currently help corporations audit their compliance with non-financial standards of conduct and performance. In 1997, SAI developed a standard for evaluating workers rights called “Social Accountability 8000” or “SA8000.”\textsuperscript{224} SAI developed its standards in SA8000 based on the norms of International Labor Organization conventions, the Universal Declaration of Human Rights, and the U.N. Convention on the Rights of the Child and modeled the structure for implementing


\textsuperscript{223} Id.

SA8000 on the ISO series. The standards set forth in SA8000 cover the following areas: (1) child labor, (2) forced labor, (3) health and safety, (4) freedom of association and right to collective bargaining, (5) prohibitions on discrimination, (6) discipline, (7) working hours, (8) compensation, and (9) management systems.

SAI allows corporations to verify their implementation of SA8000 in two ways. One is for corporations to be certified as complying with SA8000 by having accredited monitors audit factories and verify their compliance with SA8000. The other is to join the Corporate Involvement Program, under which SAI assists corporations to evaluate SA8000 and implement it and to dis-

225. Social Accountability International—Overview of SA8000, supra note 224.
226. SA8000 does not permit employers to hire anyone under the age of fifteen, although it has lowered the minimum age to fourteen for countries operating under the ILO Convention 138 developing-country exception. It requires remediation of any child found to be working. Id.
227. SA8000 prohibits forced labor, including prison or debt bondage labor; it also prohibits lodging of deposits or identity papers by employers or outside recruiters. Id.
228. SA8000 requires employers to provide a safe and healthy work environment, take steps to prevent injuries, provide regular health and safety worker training, maintain a system to detect threats to health and safety, and provide access to bathrooms and potable water. Id.
229. SA8000 requires employers to respect the right to form and join trade unions and to bargain collectively. Where law prohibits these freedoms, employers must facilitate parallel means of association and bargaining. Id.
230. SA8000 prohibits discrimination based on race, caste, origin, religion, disability, gender, sexual orientation, union or political affiliation, or age. It also prohibits sexual harassment. Id.
231. SA8000 prohibits corporal punishment, mental or physical coercion, and verbal abuse. Id.
232. SA8000 requires employers to comply with the applicable law but, in any event, requires workers to work no more than forty-eight hours per week with at least one day off for every seven day period. It also specifies that voluntary overtime be paid at a premium rate and that overtime not exceed twelve hours per week on a regular basis. Finally, it allows overtime to be mandatory if it is part of a collective bargaining agreement. Id.
233. SA8000 requires that wages paid for a standard work week meet the legal and industry standards and be sufficient to meet the basic need of workers and their families. It prohibits disciplinary deductions from wages. Id.
234. Finally, SA8000 requires facilities seeking to gain and maintain certification to go beyond simple compliance to integrate the standard into their management systems and practices. Id.
235. MAMIC, supra note 215, at 44.
close publicly on their implementation progress. SAI has certified as meeting SA8000 over 1,200 facilities that employ over 626,000 workers worldwide. The majority of these facilities are certified in Italy (503), India (190) and China (140). While only one facility is certified in the United States, several U.S. corporations participate in this program, including Cutter & Buck, Eileen Fisher, and Toys "R" Us.

ISO is a private, non-governmental organization focused on developing and promoting the implementation of uniform standards for the international exchange of goods and services. Between 1946, when ISO was created, and 2006, ISO has issued almost 16,000 standards. ISO only allows one standards organization from each country to be a member of ISO and the member organization from the United States is the American National Standards Institute (ANSI). The most widely accepted set of standards promulgated by ISO is the ISO 9000 series concerning Quality Assurance and Quality Management, which was published in 1987. ANSI adopted the ISO 9000 series standards, and as a result, many companies in the United States have adopted and complied with these standards. ISO 9000 includes a certification process under which ISO certifies that a company’s quality management system is in place and applied consistently in accordance with ISO 9001, 9002, or 9003 standards. As of June 2006, 776,608 ISO 9001 certificates had been issued.

ISO developed an environmental management standard, ISO 14000, in 1996. ISO 14000 is part of a movement by business organizations to create their own set of environmental management guidelines with the encouragement of the Sierra Club, the Natural Resource Defense Council, and other environmental organizations. Other examples of these types of efforts include the Responsible Care Program of the Chemical Manufacturers’ Association, the Global Environmental Management Initiative, and the Coalition for Environmentally Responsible Economies (CERES).

236. Social Accountability International—Overview of SA8000, supra note 224.

237. Id.

238. Id.


242. Id. at 249.

243. Id.
Business leaders, however, found the language of the programs or guidelines that were developed by these other groups ambiguous and problematic. They were concerned that, if their businesses adopted these principles or guidelines, their businesses might face additional lawsuits if they failed to meet the standards set in the principles or guidelines, even if those standards were higher than those required by law.

ISO 14000 was designed to address these litigation concerns. In addition, it aims to promote global harmonized standards and to enable businesses to self-regulate rather than be subject to government-determined command-and-control regulation. ISO 14000 requires businesses to adopt process standards, not performance standards. It requires a business to adopt an environmental management system, to demonstrate that it is in compliance with the environmental statutes and regulations of the countries in which it operates, and to demonstrate its commitment to continuous improvement in environmental protection and pollution prevention.

The ISO 14000 series establishes the procedures for certifying a business's environmental management system, which assesses the business's compliance with environmental laws. ISO 14001 outlines the criteria for certification, which require a business to develop (1) an environmental policy statement, (2) plans to meet environmental goals and to fulfill legal requirements, (3) a program for implementing the policy and incorporating it into operations, (4) a means of monitoring and measuring progress and auditing the programs to work on continuous improvement, and (5) a system for management review and continuous improvement. ISO 14010, 14011, and 14012 consist of the auditing standards for a business’s environmental management system.

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244. CERES developed a set often principles, which required, among other things, that the board of directors of a company have a “demonstrated environmental commitment.” Stenzel, supra note 241, at 251. It is difficult to determine what would constitute such an environmental commitment on the part of the board.

245. Id. at 252.

246. Id. at 252-255. Multinational corporations in particular are concerned about the number and variety of environmental regulations that are being adopted by different nations and by multinational organizations, like the European Union and the United Nations Conference on the Environment and Development. For example, the EPA developed three different environmental management programs: the XL Program, the Star Program, and the Environmental Leadership Program. The British Standards Institute created its own environmental management standards program called British Standard 7750. The European Union created the Eco-Management and Audit System program to encourage businesses to voluntarily adopt environmental auditing, management, and reporting standards. Id.

247. Id. at 260.

248. Id.

249. ISO 14010 sets forth the general environmental auditing principles, ISO 14011 sets forth the guidelines for auditing the environmental management system, and ISO
SAI and ISO provide two examples of businesses that might be used to both develop aspirational codes of conduct and to certify such programs when they are implemented by businesses. They are both well regarded by business leaders. Some national regulators and the EPA already allow businesses to use these entities and their standards to verify their compliance with national laws and regulations. For example, a company that obtains ISO 14001 certification can participate in the EPA's Environmental Leadership Program (ELP). Companions that participate in the ELP qualify for lower penalties in the event that they are found not to be in compliance with EPA regulations.

If a state or the federal government adopted a law similar to the PACE Act and a business obtained the initial certification for its aspirational code of conduct, the business would then need to be periodically re-certified or audited. The PACE Act would require that these periodic re-certification processes occur once every three years. It does not require that they occur every year, because such audits might be very costly to conduct. In addition, if the re-certification process must be done by government officials, hiring, training, and maintaining the staff necessary to conduct these audits every year would be considerably more time consuming and expensive than the staff needed to conduct these audits every three years. If three years ends up being too long a time between one audit and another to ensure that the business is making good faith efforts to comply with its aspirational code, the law could easily be amended to require more frequent audits.

If a business fulfills these requirements, then the courts, administrative courts, arbitral tribunals, and other judicial bodies would be prevented from using the aspirational code of conduct to impose higher legal obligations on the business than the business would face if it had not adopted such a code. In addition, the law should grant the business an evidentiary privilege that would prevent it from being compelled to disclose any information that it collected as part of its compliance program or periodic audits. This privilege could be limited to only the information that related to its activities that exceeded its legal obligations. Any information gathered merely to verify compliance with various laws and regulations would only be granted the same evidentiary privileges that already exist under state or federal laws.

The business would lose these benefits if either the state or federal authorities who certify aspirational codes or a court determines that the business was not making a good faith effort to comply with its aspirational code of conduct. In addition, the business may be forced to disclose information gathered in connection with implementing or auditing its aspirational code of conduct if a court determines that the information is necessary as part of a criminal proceeding. The business may also be forced to disclose such information if the state or federal authorities who certify aspirational codes consider the informa-

14012 sets forth the criteria for creating the qualifications for environmental auditors. *Id.* at 261.

250. *Id.* at 263-264.
tion necessary for them to do their work and achieve the goals of the PACE Act or similar laws.

III. Benefits and Costs of Creating a Safe Harbor

A. Benefits of a Safe Harbor

Creating a safe harbor for aspirational codes of conduct would result in a number of benefits to both the corporations adopting such codes and society at large. These benefits include the following:

1. Eliminating the Disincentives That May Discourage Better Behavior

   Market forces currently are not strong enough to overcome the legal disincentives that discourage businesses from adopting aspirational codes of conduct, except in very rare cases. Large, multinational firms that NGOs target to raise public awareness about certain issues or businesses, are trying to provide products or services to niche customers who view the ethical component as part of the desirable traits in the product or service are the only ones right now motivated to adopt aspirational codes of conduct because they face strong market incentives for such actions. Other businesses lack such market incentives and are reluctant to adopt aspirational codes because of the legal disincentives against such codes.

   By carving out this safe harbor, the PACE Act or similar laws would eliminate or minimize the legal disincentives that exist and which discourage some businesses from doing more than what they are legally required to do. If courts are prevented from treating aspirational goals as legally enforceable contracts or other legal obligations, it will eliminate the corporations' fear that adopting such higher standards will make them targets for litigation if they are unable to always attain those goals. These acts would reduce the threat of litigation and its attendant costs, which changes the cost-benefit equation for corporations. Under this new equation, more corporations would find that the benefits of adopting aspirational codes of conduct outweigh the costs. As a result, more corporations would be willing to adopt such codes. By eliminating the existing disincentives built into some laws and regulations, legal mandates would become floors for corporate behavior and not ceilings.

2. Encouraging Better Behavior

   Lawyers are sometimes overly concerned with compliance. This concern can lead to some worthwhile laws or regulations not being adopted. Even if businesses do not always achieve the goals set forth in their aspirational codes of conduct, adopting laws or regulations encouraging businesses to adopt such codes may lead to better behavior and, thus, would achieve a great deal.
Laws and regulations encouraging businesses to adopt aspirational codes of conduct may mold people's perspectives regarding what is and is not acceptable behavior. This type of molding of society's values has occurred in the area of human rights. The Universal Declaration of Human Rights spelled out the general rights that everyone should enjoy. Many governments, however, routinely disregarded these rights. Nevertheless, this statement encouraged other governments and NGOs to form to put pressure on governments that routinely violated human rights to improve their human rights records. Over time these efforts have changed the political discourse from one that took for granted that governments could generally do what they wanted to their own citizens within their borders to one that placed limits on governmental activities and built greater legitimacy for outsiders speaking out against violations of human rights taking place within another nation.

The law can be overly concerned with punishing failures to comply with laws and rules and fail to provide sufficient rewards for positive behavior. Providing rewards for businesses adopting aspirational codes of conduct can have four benefits that will lead to better behavior: generative, preclusive, cognitive, and normative. It would provide a generative benefit because it would create new options for how businesses can operate and interact with their shareholders, employees, creditors, suppliers, customers, and society. It would provide a preclusive benefit because it would foreclose avenues of behavior if businesses want to receive the rewards granted only to those with a verified aspirational code in place. It would provide a cognitive benefit because the aspirational codes would serve to educate business persons and the rest of society about what modes of behavior are in the long term interest of themselves and of society. It would provide a normative benefit because it would serve to create and strengthen the norms of behavior that society wants businesses and individuals to follow.

Finally, corporations that fail to implement these codes in good faith would not be entitled to the protections of the safe harbor. Good faith implementation does not mean that such corporations always succeed in meeting the goals set forth in the code. If a corporation attempts to achieve a particularly difficult standard or goal, it could make substantial progress towards that goal even if it falls short of reaching it. Nevertheless, if it makes an honest attempt to comply and adopts reasonable procedures to help it comply, a corporation would still be entitled to the safe harbor protection. A corporation that fails to adopt reasonable procedures to meet the standards in its code and does not make an honest attempt to comply with its code would lose the protections afforded by the safe harbor. In addition, such a corporation would be revealed as engaging in empty public relations exercises and would potentially see its brands and goodwill damaged in the marketplace. As a result, safe harbor statutes are likely to produce real and positive changes in corporate behavior.
3. Building a Constituency for Stronger Legal Protections or Regulations

Businesses that buy into the standards set forth in their aspirational codes may over time want to see such standards imposed on other companies in their industries. Businesses may come to this conclusion for a couple of reasons. First, the executives running these firms or the owners of these firms may honestly believe that these standards would be the best for society as a whole and, therefore, may want them to be legally mandated because not all businesses will voluntarily adopt these standards.

Second, the businesses that have adopted aspirational standards may face higher costs to comply with those standards. These higher costs may put them at a competitive disadvantage with some of their competitors. As a result, they would like the laws changed to force their competitors to abide by the same higher standards and face the same higher costs as they currently do. One can see such moves already occurring in other areas. For example, a number of large multinational corporations have recently publicly declared their support for some form of national healthcare in the United States. They have done this because the cost of providing health insurance to their employees is becoming increasingly burdensome. In addition, healthcare is a cost not borne by their competitors in Germany or the United Kingdom. They do not feel that they can terminate the healthcare benefits to their employees without suffering significant negative publicity, which may harm their bottom lines.

The enactment of laws encouraging the adoption of aspirational codes of conduct would thus overcome some of the public choice problems that currently block incorporating certain CSR principles into law. The political activities of businesses often dwarf the impact that their CSR efforts have on society. To the extent that laws encouraging the adoption of aspirational codes would help build business constituencies for these CSR principles, it will make it easier to see them enacted into law.

251. Over 50 corporations formed the Coalition to Advance Healthcare Reform (CAHR). See Coalition To Advance Healthcare Reform, Who We Are, http://www.coalition4healthcare.org/about/?_adctld=v%7Cskins_je1zntt0gpppsien%7Cxototng328ts0 (last visited Mar. 12, 2008). These businesses are concerned that their healthcare costs are harming their competitiveness. Id. CAHR members include, among others, Aetna Inc.; Coca-Cola Enterprises; General Mills; Kohlberg Kravis Roberts & Co.; Medtronic, Inc.; Playtex Products, Inc.; Norfolk Southern Corporation; and Safeway Inc. Coalition to Advance Healthcare Reform, Our Members, http://www.coalition4healthcare.org/about/members/?_adctld=v%7Cskins_je1zntt0gpppsien%7Cxototng328ts0 (last visited Mar. 12, 2008).

252. Vogel, supra note 2, at 171-73. Vogel believes that CSR principles need to be redefined to recognize the relationship between business and government and the "critical connections among corporate responsibility, corporate political activity, and public policy." Id. at 172.
4. Promoting Fewer Violations of Laws and Regulations

Under the current legal structure, businesses are encouraged to get as close to the line of what is legally permissible as possible and, in some cases, actually violate the law if it will enhance their profitability. To the extent that aspirational codes encourage businesses to behave well within the range of legally acceptable behavior, such codes could lead to fewer violations of the existing laws and regulations. Fewer violations would in turn reduce the costs to society as well as the enforcement costs that state or federal agencies would incur to police the existing laws and regulations. Kent Greenfield has commented: “External regulations aimed at reaching certain ends may require greater ongoing enforcement costs than would changes in the internal governance procedures intended to move toward the same ends.”

Businesses that adopt aspirational codes of conduct may enjoy higher profitability if such codes enhance their reputations, help them attract better employees, or support the businesses’ strategic plan. Proponents of CSR argue that the adoption of an aspirational code of conduct by a business will increase the reputation of the company within the community and with consumers. The increasing number of large corporations that have corporate social responsibility reports indicates they think that touting what they are doing for workers or the environment will encourage consumers to buy their products and investors to buy their stock. Businesses have changed their behavior in response to other government programs, which rely on using reputational pressures by naming and shaming businesses that violate the law. For example, the EPA’s Toxic Release Inventory is published annually and lists the annual toxic releases by certain industry groups. This program is credited with increasing corporations’ compliance with environmental regulations in order to preserve their reputations.

Corporations may be able to attract more qualified employees if they are seen as having more desirable working conditions. Numerous lists ranking businesses in different fields on how well they treat their employees exist. The American Lawyer periodically ranks the top law firms in the United States based on a survey of their associates’ satisfaction. Law firms at the bottom of these lists find it harder to attract the best and the brightest from America’s law schools to work for them. As a result, the firms that the bottom of these lists

256. Zitrin & Langford, supra note 62, at 112.
frequently take substantive measures to address the concerns raised by their associates in order to place higher on the list in the future.257

B. Costs of a Safe Harbor

1. CSR Is Misguided

Some economists object to corporations seeking to employ CSR principles on the grounds that it encourages officers and directors of corporations to manage corporations inefficiently. Economists think that the goal of maximizing profits will focus the efforts of officers and directors towards making the business operate most efficiently. Changing the goals of management away from profit maximization will lead to less efficient business operations. Economists like Milton Friedman question the right and capacity of corporate officers to determine what actions taken by corporations will advance the common good. Milton Friedman commented in his book Capitalism and Freedom:

Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible. This is a fundamentally subversive doctrine. If businessmen do have a social responsibility other than making maximum profits for stockholders, how are they to know what it is? Can self-selected private individuals decide what the social interest is?258

Instead of allowing corporate officers to make those choices, they would prefer that the government determine what is in the common good and legislate it.259

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This view can lead to framing the debate between the false choice of laissez faire capitalism and heavy government regulation. Creating a safe harbor for aspirational codes could provide a useful third way between these two extremes. By picking which codes will qualify for the safe harbor, the government would be defining what is in the common good. In addition, the safe harbor act may help the government determine when adopting new regulations may be appropriate. For example, if the costs borne by the corporations are relatively equal for two or more of the codes but the benefits for society from one of the codes clearly exceed the others, legislators and regulators may want to consider regulations that mandate that all corporations adopt those rules.

Even those who object to corporate officers adopting codes of conduct that attempt to implement CSR principles recognize that these officers will and, in some cases, must exercise independent moral judgments that will cause them to sacrifice profits for other societal goals. Critics of CSR argue that these exercises in ethical judgment are limited exceptions to the rule of profit maximization and should not become routine procedures. It is not clear, however, that these decisions are in fact rare. Allowing corporations to be open about when and how they are making such decisions by having them adopt aspirational codes and compliance programs can build trust with the public by proving that the corporations' actions are more than just a public relations exercise.

2. Few Will Adopt Such Codes Because the Costs Outweigh the Benefits

As discussed earlier, implementing higher standards may increase the costs of doing business for corporations. Corporations in highly competitive markets with narrow profit margins will be reluctant to increase their costs of doing business if their competitors are not saddled with similar costs. Doing so would put them at a competitive disadvantage in the marketplace.

In addition, bearing these additional costs will be easier for some firms. Critics of CSR have pointed out that CSR is most heavily promoted within the business world by multinational enterprises (MNEs) that face a significant amount of pressure from anti-globalization groups to do more for society. MNEs can afford to bear the costs of some CSR activities because of their economies of scale. Applying the same rules or procedures to small or medium-sized enterprises (SMEs), however, could drive them out of business because they lack the economies of scale to bear these costs.

As already discussed, the safe harbor act will reduce the costs that corporations may face due to the threat of litigation under the current system. In addition, as previously noted, corporations sometimes miscalculate the private costs

260. Id. at 22.
261. Id. at 25.
262. Id.
263. Id.
that they will bear if they adopt aspirational codes and compliance programs. By giving corporations a range of codes to choose from, the government can gain valuable information about the costs and benefits from implementing the rules set forth in the codes. In addition, different codes may work better for different types of businesses, either because the rules are more in keeping with the market realities of that industry or because the codes work better for small businesses than large businesses or vice versa. This information can be shared to enable corporations to accurately assess whether the costs of an aspirational code will outweigh its benefits. If the costs of following one set of rules are too onerous and outweigh the benefits, corporations will pick one of the other codes on the list.

3. Safe Harbor May Be Abused

Little evidence exists that self-policing programs have resulted in increased compliance or attracted better performers.\textsuperscript{264} In considering the question, "Why do businesses comply with laws?", two different theories exist to determine when a business will comply. One is deterrence theory, which assumes that persons are amoral, rational actors who will only comply with the law if the costs of any penalties for failing to comply exceed the benefits of failing to comply.\textsuperscript{265} The other is a normatively-based theory, which finds that people act from a sense of duty or a desire to do the right thing.\textsuperscript{266}

If the safe harbor statute allows businesses to hide information on illegal corporate activities from discovery by plaintiffs' attorneys, then the act might encourage less compliance rather than more compliance. Certainly, evidence exists that some corporations may attempt to abuse the privileges granted to corporations that adopt aspirational codes of conduct.


Some corporations already attempt to use their in-house legal departments as a means of keeping information about the corporation and its activities confidential and outside of the scope of discovery. Corporations and their in-house legal departments argue that the attorney-client privilege should protect any documents produced or sent to the legal department from being disclosed during discovery. In these contexts, in-house attorneys face a potential conflict of interest because their employer, the corporation, is also their only client.

In 1915, the Supreme Court mentioned that corporations were entitled to the attorney-client privilege when it was ruling on other issues in a case involving railroads. The right of corporations to this privilege was cemented in the Radiant Burners case of 1963. In that case, Chief Judge John Hastings of the federal appeals court overturned the lower court’s ruling and upheld the corporation’s right to the attorney-client privilege. The Supreme Court refused to hear the case, and corporations have been strongly exercising this privilege ever since.

It is ironic that in the Radiant Burners case, Chief Judge Hastings stated, “Certainly, the privilege would never be available to allow a corporation to funnel its papers and documents into the hands of its lawyers for custodial purposes and thereby avoid disclosure.” In fact, corporations have done just that. The tobacco companies deliberately attempted to keep all damaging documents, including those related to industry research, from being discoverable by claiming that they were “prepared ... in anticipation of litigation.” This strategy was outlined in a memo prepared by Brown & Williamson’s in-house counsel J. Kendrick Wells in 1979. In 1984, Wells crafted another memo that advocated that the lawyers participate in every stage of a project so that the entire project would be subject to attorney-client privilege.

This advice was not limited to in-house counsel. Arnold & Porter, a major Washington law firm, advised the tobacco companies that a survey regarding Americans’ knowledge of the harms of tobacco be commissioned and supervised by Arnold & Porter so that the results would be subject to attorney-client privilege if they proved unfavorable to the tobacco companies’ interests. The
Council for Tobacco Research established a special projects group that was supervised by lawyers so that all of its documents could be subject to the attorney-client privilege if the scientific results proved problematic for the tobacco industry.\textsuperscript{278}

In 1997, Minnesota judge Kenneth J. Fitzpatrick required the tobacco companies initially to release 865 documents that they previously had claimed should be confidential due to the attorney-client privilege.\textsuperscript{279} The U.S. Supreme Court refused to reverse Judge Fitzpatrick's decision.\textsuperscript{280}

In order for business matters to receive the attorney-client privilege, lawyers must be giving legal advice on those matters, not merely be present at the meetings discussing those matters.\textsuperscript{281} Nevertheless, asserting a claim of privilege can lead to a long and costly battle in court. As a result, merely asserting the privilege (even if it is not valid) is often enough to prevent the other side in litigation from pursuing those documents.\textsuperscript{282} The attorney-client privilege can cover almost every conversation between an employee of a corporation and an attorney regarding legal advice connected to business matters.\textsuperscript{283}

Corporations have sought to expand or obtain a self-audit privilege in a variety of contexts.\textsuperscript{284} As noted above, corporations already enjoy such a privilege under certain state and federal environmental laws or regulations. If these privileges were expanded to cover a much greater range of information, it would make it very easy for corporations to use these self-audit privileges to hide information and avoid prosecution for civil or criminal penalties as some of them have done with the attorney-client privilege.

Attorneys representing corporations that have officers or directors who seek to hide illegal conduct by asserting self-audit privileges can attempt to prevent such a cover-up by reporting up-the-ladder to higher corporate officials. The American Bar Association (ABA) Model Rules of Professional Conduct require that attorneys report up-the-ladder if they suspect that the employees or officers of the corporation are engaging in conduct that has or will cause substantial injury to the organization and when such reporting is in the best interest of the corporation. Attorneys, however, may only breach their obligation of confidentiality in order to prevent serious physical or financial injury. The attorney can, of course, resign if his efforts fail to change the corporation's conduct. This resignation, however, may do little or nothing to help the other stakeholders being harmed by the corporation. The attorney generally cannot

\textsuperscript{278} \textit{Id.}


\textsuperscript{280} ZITRIN & LANGFORD, supra note 62, at 102.

\textsuperscript{281} \textit{Id.} at 104.

\textsuperscript{282} \textit{Id.} at 104.


\textsuperscript{284} ZITRIN & LANGFORD, supra note 62, at 105.
publicly disclose the reasons for his resignation because of the how the ABA Rules are structured concerning confidentiality.

If the attorney does not resign but refuses to assist the corporation’s officers or employees in carrying out the illegal activities, the attorney may be fired. Attorneys who have been fired for refusing to aid the illegal activities of the businesses for whom they worked or for speaking out about the businesses’ conduct, are not necessarily covered by state whistle-blower statutes in many instances.385 In addition, if they are in-house counsel, they face an extremely difficult challenge if they try to sue for retaliatory discharge. Part of the problem rests with the ABA rules regarding attorney-client confidentiality. Attorneys suing for retaliatory discharge cannot breach their confidentiality obligations in order to provide additional evidence in support of their case.286

Other nations do not follow the same rules that the United States uses for attorney-client privilege. The European Court of Justice in 1982 held that no member country of the European Union could allow in-house lawyers to maintain confidential communications with their employers.287 Amending the Rules of Professional Conduct to follow the European model may make it easier for in-house attorneys to provide evidence of retaliatory discharge. On the other hand, such a rule change would face strong opposition within the ABA. The ABA opposed the proposed mandatory reporting requirement288 that was initially contained in the SEC’s proposed standards of conduct for attorneys on the grounds that it would undermine the attorney-client relationship and lead to clients keeping information from their attorneys. Attorneys would then not be in a position to provide the best legal advice to their clients since they would lack all of the facts. The SEC dropped the mandatory reporting out requirement from the final rule.

Another problem with giving aspirational codes a safe harbor is who would be responsible for their implementation within the corporation? Many ethics officers within corporations are middle management auditors who have little power to force upper management to change how the business is operated.289 In other cases, an attorney is tasked as being the ethics officer and as a result, any audit reports to the attorney can potentially be privileged under the attorney-client privilege.290

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285. Id. at 112-13.
286. Id. at 113-14. Only New Jersey treats lawyers in the same manner as other whistle-blowers. Id. at 114.
287. Id. at 107.
288. This requirement would have forced attorneys to report suspected violations of securities laws and regulations to the SEC if their client failed to take steps to adequately prevent such violations.
289. ZITRIN & LANGFORD, supra note 62, at 110.
290. Id.
4. Businesses Will Only Do It for Public Relations Purposes

Another potential problem with adopting a safe harbor for corporations that adopted aspirational codes of conduct is that they may primarily be motivated for the public relations gain that they hope to achieve and not out of any sincere concern for the principles espoused in the code. Ramon Mullerat in an article on CSR for the International Business Lawyer had this response to similar criticisms leveled in general at CSR activities of corporations:

Do corporations subscribe to CSR programmes by conviction, or to entice employees or consumers to buy their products, or even to avoid boycotts of their products? The morals of the Catholic Church distinguish two sorts of repentance for sins: contrition and attrition. By the first one, the sinner is sorry to have sinned because to sin is an offense against God. By the second, attrition of his or her repentance, the sinner is sorry because he or she fears suffering in hell. The first concept is a much better one. But the important thing is that the sinner no longer sins, irrespective of the motive. The important thing for corporations is to engage in some of the many CSR activities. So much the better if they have the right conviction, but it is also useful if they carry out the activities for other, less laudable reasons.291

Businesses that adopt aspirational codes of conduct will still have to prove that they are making a good faith effort to comply with these codes or they will not qualify for the benefits provided by the PACE Act or similar acts. As a result, they will not be able to use such codes as mere “window dressing” to bolster their public image. The fact that some corporations that adopt aspirational codes of conduct will benefit from improving their public image does not detract from the actual changes or improvements in their behavior that they must undertake in order to receive the benefits under this program.

Conclusion

Adopting laws to encourage corporations and other businesses to adopt aspirational codes of conduct will only work if they are adopted by both the states and the federal government. If they are not adopted by both levels of government, then businesses will continue to be concerned that they will expose themselves to additional litigation risks by potentially building the case for their opponents through their self-audits. This problem has arisen with the different treatment accorded to environmental audits by state and federal regulators. The EPA refuses to provide an evidentiary privilege for such audits on the grounds that it would encourage corporations to hide violations and that corporations have sufficient motivation to conduct such audits even without such a privilege because of the penalties that they face if they violate environmental regulations.

291. Mullerat, supra note 110, at 237.
Corporations, however, do not have the same incentives when considering adopting aspirational codes of conduct as they do when adopting codes and compliance programs that seek to meet their minimum legal obligations. Instead, they currently face creating additional legal obligations and providing opponents with the rope to hang them with if they adopt aspirational codes of conduct and audit programs to verify their progress toward meeting the higher goals of such codes. As a result, corporations and other businesses would need the same evidentiary privileges at both the state and the federal level if one wants to encourage them to adopt such codes. Failure to adopt laws at both the state and the federal level will significantly reduce the effectiveness of such laws in encouraging the adoption of aspirational codes of conduct.

In addition, the acts granting businesses immunity from prosecution for failing to meet the goals set forth in their aspirational codes and granting an evidentiary privilege for audits related to such codes needs to be carefully tailored in order to avoid creating a blanket shield behind which businesses can hide their illegal activities. It may prove very difficult, if not impossible, to draft a code that protects a firm from liability for its good faith efforts to meet aspirational standards while still allowing access to information about how well the firm is complying with its legal obligations.

The difficulty of drafting a law that encourages the adoption of aspirational codes while not shielding corporate misconduct and of enacting such laws at both the state and the federal level means that the prospects for laws promoting the adoption of aspirational codes of conduct are probably dim. Nevertheless, they do provide one possible solution toward eliminating the existing legal disincentives toward corporations seeking to meet higher standards of conduct than those set forth under the current laws and regulations.
APPENDIX: DRAFT PROMOTING ASPIRATIONAL CODES ENACTMENT (PACE) ACT

Section 1. Short Title.—This Act may be cited as the “PACE Act.”

Section 2. Definitions.

(a) Aspirational business organization work product—
   (1) In general.—The term “aspirational business organization work product” means any data, reports, records, memoranda, analyses, or written or oral statements which are assembled or developed by an agent of an aspirational business organization for reporting to an aspirational business organization and are reported to an aspirational business organization regarding its compliance with the aspirational code of conduct that it has adopted.

(b) Aspirational code of conduct. The term “aspirational code of conduct” means a code of conduct adopted by a business organization, which imposes stricter requirements than currently required by existing Federal, State or local laws and which conforms to the general guidelines of one of the acceptable aspirational codes of conduct certified by the Secretary of State [for Federal law, the Securities and Exchange Commission (the SEC)].

(c) Acceptable Aspirational Codes of Conduct. The term “acceptable aspirational code of conduct” means one of the codes of conduct issued by a non-profit organization, non-governmental organization or self-regulatory organization and certified as acceptable by the Secretary of State [for Federal law, the SEC] as imposing stricter requirements than currently required by existing Federal, State, or local laws.

(d) Agent. The term “agent” means any individual or entity classified under State law or Federal law as an agent of a business organization.

Section 3. Privilege and confidentiality protections.

(a) Privilege. Federal, State, or local civil, criminal or administrative courts, arbitral tribunals, and other legal bodies may not use evidence that an aspirational business organization has adopted an aspirational code of conduct to impose higher legal obligations on the aspirational business organization than it would otherwise have if it had not adopted an aspirational code of conduct. Notwithstanding any other provision of Federal, State, or local law, aspirational business organization work product shall be privileged and shall not be
   (1) subject to a Federal, State, or local civil, criminal, or administrative subpoena or order, including in a Federal, State, or local civil or administrative disciplinary proceeding against an agent;
   (2) subject to discovery in connection with a Federal, State, or local civil, criminal, or administrative proceeding, including in a Federal, State, or local civil or administrative disciplinary proceeding against an agent;
(3) subject to disclosure pursuant to section 552 of title 5, United States Code (commonly known as the Freedom of Information Act) or any other similar Federal, State, or local law;

(4) admitted as evidence in any Federal, State, or local governmental civil proceeding, administrative rulemaking proceeding, or administrative adjudicatory proceeding, including any such proceeding against an agent; or

(5) admitted in a professional disciplinary proceeding of a professional disciplinary body established or specifically authorized under State law or Federal law.

(b) Confidentiality of Aspirational Business Organization Work Product.—Notwithstanding any other provision of Federal, State, or local law, and subject to subsection (c), aspirational business organization work product shall be confidential and shall not be disclosed.

(c) Exceptions. Except as provided in subsection (f)(3)—

(1) Exceptions from privilege and confidentiality. Subsections (a) and (b) shall not apply to (and shall not be construed to prohibit) one or more of the following disclosures:

(A) Disclosure of relevant aspirational business organization work product for use in a criminal proceeding, but only after a court makes an in camera determination that such aspirational business organization work product contains evidence of a criminal act and that such aspirational business organization work product is material to the proceeding and not reasonably available from any other source.

(B) Disclosure of aspirational business organization work product to the extent required to carry out subsection (e)(4)(A).

(C) Disclosure of identifiable aspirational business organization work product if authorized by each agent identified in such work product.

(2) Exceptions from confidentiality. Subsection (b) shall not apply to (and shall not be construed to prohibit) one or more of the following disclosures:

(A) Disclosure of aspirational business organization work product to carry out aspirational business organization activities.

(B) Disclosure of nonidentifiable aspirational business organization work product.

(C) Disclosure of aspirational business organization work product to grantees, contractors, or other entities carrying out research, evaluation, or demonstration projects authorized, funded, certified, or otherwise sanctioned by rule or other means by the Secretary [or the SEC], for the purpose of conducting research to the extent that disclosure of such information would be permitted under Federal, State, or local law.
(D) Disclosure by an agent to Federal or State government agencies with respect to a product or activity regulated by such agencies.

(E) Voluntary disclosure of aspirational business organization work product by an agent to an accrediting body that accredits that agent.

(F) Disclosures that the Secretary [or the SEC] may determine, by rule or other means, are necessary for business operations and are consistent with the goals of this act.

(G) Disclosure of aspirational business organization work product to law enforcement authorities relating to the commission of a crime (or to an event reasonably believed to be a crime) if the person making the disclosure believes, reasonably under the circumstances, that the aspirational business organization work product that is disclosed is necessary for criminal law enforcement purposes.

(H) With respect to a person other than an aspirational business organization, the disclosure of aspirational business organization work product that does not include materials that—
   (i) assess the performance of an identifiable agent; or
   (ii) describe or pertain to one or more actions or failures to act by an identifiable agent.

(3) Exception from privilege. Subsection (a) shall not apply to (and shall not be construed to prohibit) voluntary disclosure of non-identifiable aspirational business organization work product.

(d) Continued protection of information after disclosure.
   (1) In general. Aspirational business organization work product that is disclosed under subsection (c) shall continue to be privileged and confidential as provided for in subsections (a) and (b), and such disclosure shall not be treated as a waiver of privilege or confidentiality, and the privileged and confidential nature of such work product shall also apply to such work product in the possession or control of a person to whom such work product was disclosed.

   (2) Exception. Notwithstanding paragraph (1), and subject to paragraph (3)—
      (A) if aspirational business organization work product is disclosed in a criminal proceeding, the confidentiality protections provided for in subsection (b) shall no longer apply to the work product so disclosed; and
      (B) if aspirational business organization work product is disclosed as provided for in subsection (c)(2)(B) (relating to disclosure of nonidentifiable aspirational business organization work product), the privilege and confidentiality protections provided for in subsections (a) and (b) shall no longer apply to such work product.
(3) Construction. Paragraph (2) shall not be construed as terminating or limiting the privilege or confidentiality protections provided for in subsection (a) or (b) with respect to aspirational business organization work product other than the specific aspirational business organization work product disclosed as provided for in subsection (c).

(4) Limitations on actions.

(A) Aspirational business organizations.

(i) In general. An aspirational business organization shall not be compelled to disclose information collected or developed under this act whether or not such information is aspirational business organization work product unless such information is identified, is not aspirational business organization work product, and is not reasonably available from another source. Courts, administrative courts, arbitral tribunals and other legal bodies may not use evidence that an aspirational business organization has adopted an aspirational code of conduct to impose higher legal obligations on the aspirational business organization than it would otherwise have if it had not adopted an aspirational code of conduct.

(ii) Nonapplication. The limitation contained in clause (i) shall not apply in an action against an aspirational business organization or with respect to disclosures pursuant to subsection (c)(1).

(B) Agents. An accrediting body shall not take an accrediting action against an agent based on the good faith participation of the agent in the collection, development, reporting, or maintenance of aspirational business organization work product in accordance with this act. An accrediting body may not require an agent to reveal its communications with any aspirational business organization established in accordance with this act.

(e) Enforcement.

(1) Civil monetary penalty. Subject to paragraphs (2) and (3), a person who discloses identifiable aspirational business organization work product in knowing or reckless violation of subsection (b) shall be subject to a civil monetary penalty of not more than $10,000 for each act constituting such violation.

(2) Equitable relief.

(A) In general. Without limiting remedies available to other parties, a civil action may be brought by any aggrieved individual to enjoin any act or practice that violates subsection (e) and to obtain other appropriate equitable relief (including reinstatement, back pay, and restoration of benefits) to redress such violation.
(B) Against State employees. An entity that is a State or an agency of a State government may not assert the privilege described in subsection (a) unless before the time of the assertion, the entity or, in the case of and with respect to an agency, the State has consented to be subject to an action described in subparagraph (A), and that consent has remained in effect.

(f) Rule of construction. Nothing in this section shall be construed—

1. to limit the application of other Federal, State, or local laws that provide greater privilege or confidentiality protections than the privilege and confidentiality protections provided for in this section;

2. to limit, alter, or affect the requirements of Federal, State, or local law pertaining to information that is not privileged or confidential under this section;

3. to limit the authority of any agent, aspirational business organization, or other entity to enter into a contract requiring greater confidentiality or delegating authority to make a disclosure or use in accordance with this section;

4. as preempting or otherwise affecting any State law or Federal law requiring an agent to report information that is not aspirational business organization work product; or

5. to limit, alter, or affect any requirement for reporting to the Federal or State government agencies information regarding the safety of a product or activity regulated by such agencies.

(g) Clarification. Nothing in this act prohibits any person from conducting additional analysis for any purpose regardless of whether such additional analysis involves issues identical to or similar to those for which information was reported to or assessed by an aspirational business organization or a patient safety evaluation system.

Section 4. Network of aspirational business organizations databases.

(a) In general. The Secretary [or the SEC] shall facilitate the creation of, and maintain, a network of aspirational business organization databases that provides an interactive evidence-based management resource for agents, aspirational business organizations, and other entities. The network of databases shall have the capacity to accept, aggregate across the network, and analyze nonidentifiable aspirational business organization work product voluntarily reported by aspirational business organizations, agents, or other entities. The Secretary [or the SEC] shall assess the feasibility of providing for a single point of access to the network for qualified researchers for information aggregated across the network and, if feasible, provide for implementation.

(b) Data standards. The Secretary [or the SEC] may determine common formats for the reporting to and among the network of aspirational business organization databases maintained under subsection (a) of nonidentifiable aspirational business organization work product, in-
including necessary work product elements, common and consistent definitions, and a standardized computer interface for the processing of such work product. To the extent practicable, such standards shall be consistent with the administrative simplification provisions of the relevant Federal, State, or local laws.

(c) Use of information. Information reported to and among the network of aspirational business organization databases under subsection (a) shall be used to analyze national and regional statistics, including trends and patterns of business practices. The information resulting from such analyses shall be made available to the public and included in the annual reports prepared by the Secretary [or the SEC].

Section 5. Aspirational business organization certification and listing.

(a) Certification.

(1) Initial certification. An entity that seeks to be an aspirational business organization shall submit an initial certification to the Secretary [or the SEC] that the entity—

(A) has policies and procedures in place to perform each of the aspirational business organization activities described in section 1; and

(B) upon being listed under subsection (d), will comply with the criteria described in subsection (b).

(2) Subsequent certifications. An entity that is an aspirational business organization shall submit every 3 years after the date of its initial listing under subsection (d) a subsequent certification to the Secretary [or the SEC] that the entity—

(A) is performing each of the aspirational business organization activities described in section 1; and

(B) is complying with the criteria described in subsection (b).

(b) Criteria.

(1) In general. The following are criteria for the initial and subsequent certification of an entity as an aspirational business organization:

(A) The mission and primary activity of the entity are to conduct activities that are in accordance with the goals and standards set forth in its aspirational code of conduct.

(B) The entity has appropriately qualified staff (whether directly or through contract).

(C) The entity, within each 24-month period that begins after the date of the initial listing under subsection (d), has bona fide contracts, each of a reasonable period of time, with more than 1 agent for the purpose of receiving and reviewing aspirational business organization work product.

(D) The entity shall fully disclose—

(i) any financial, reporting, or contractual relationship between the entity and any agent that contracts with the entity; and
(ii) if applicable, the fact that the entity is not managed, controlled, and operated independently from any agent that contracts with the entity.

(E) To the extent practical and appropriate, the entity collects aspirational business organization work product from agents in a standardized manner that permits valid comparisons of similar cases among similar agents.

(F) The utilization of aspirational business organization work product for the purpose of providing direct feedback and assistance to agents to effectively minimize patient risk.

(2) Additional criteria for component organizations. If an entity that seeks to be an aspirational business organization is a component of another organization, the following are additional criteria for the initial and subsequent certification of the entity as an aspirational business organization:

(A) The entity maintains aspirational business organization work product separately from the rest of the organization, and establishes appropriate security measures to maintain the confidentiality of the aspirational business organization work product.

(B) The entity does not make an unauthorized disclosure under this act of aspirational business organization work product to the rest of the organization in breach of confidentiality.

(C) The mission of the entity does not create a conflict of interest with the rest of the organization.

(c) Review of certification.

(1) In general.

(A) Initial certification. Upon the submission by an entity of an initial certification under subsection (a)(1), the Secretary [or the SEC] shall determine if the certification meets the requirements of subparagraphs (A) and (B) of such subsection.

(B) Subsequent certification. Upon the submission by an entity of a subsequent certification under subsection (a)(2), the Secretary [or the SEC] shall review the certification with respect to requirements of subparagraphs (A) and (B) of such subsection.

(2) Notice of acceptance or non-acceptance. If the Secretary [or the SEC] determines that—

(A) an entity's initial certification meets requirements referred to in paragraph (1)(A), the Secretary shall notify the entity of the acceptance of such certification; or

(B) an entity's initial certification does not meet such requirements, the Secretary shall notify the entity that such certification is not accepted and the reasons therefore.

(3) Disclosures regarding relationship to agents. The Secretary [or the SEC] shall consider any disclosures under subsection (b)(1)(D) by
an entity and shall make public findings on whether the entity can fairly and accurately perform the aspirational business organization activities of an aspirational business organization. The Secretary [or the SEC] shall take those findings into consideration in determining whether to accept the entity's initial certification and any subsequent certification submitted under subsection (a) and, based on those findings, may deny, condition, or revoke acceptance of the entity's certification.

(d) Listing. The Secretary [or the SEC] shall compile and maintain a listing of entities with respect to which there is an acceptance of a certification pursuant to subsection (c)(2)(A) that has not been revoked under subsection (e) or voluntarily relinquished.

(e) Revocation of acceptance of certification.

(1) In general. If, after notice of deficiency, an opportunity for a hearing, and a reasonable opportunity for correction, the Secretary [or the SEC] determines that an aspirational business organization does not meet the certification requirements under subsection (a)(2), including subparagraphs (A) and (B) of such subsection, the Secretary [or the SEC] shall revoke the Secretary's [or the SEC's] acceptance of the certification of such organization.

(2) Supplying confirmation of notification to agents. Within 15 days of a revocation under paragraph (1), an aspirational business organization shall submit to the Secretary [or the SEC] a confirmation that the organization has taken all reasonable actions to notify each agent whose aspirational business organization work product is collected or analyzed by the organization of such revocation.

(3) Publication of decision. If the Secretary [or the SEC] revokes the certification of an organization under paragraph (1), the Secretary [or the SEC] shall—
(A) remove the organization from the listing maintained under subsection (d); and
(B) publish notice of the revocation in the [State equivalent of the Federal Register].

(f) Status of data after removal from listing.

(1) New data. With respect to the privilege and confidentiality protections described in section 3, data submitted to an entity within 30 days after the entity is removed from the listing under subsection (e)(3)(A) shall have the same status as data submitted while the entity was still listed.

(2) Protection to continue to apply. If the privilege and confidentiality protections described in section 3 applied to aspirational business organization work product while an entity was listed, or to data described in paragraph (1), such protections shall continue to apply to such work product or data after the entity is removed from the listing under subsection (e)(3)(A).
(g) Disposition of work product and data. If the Secretary [or the SEC] removes an aspirational business organization from the listing as provided for in subsection (e)(3)(A), with respect to the aspirational business organization work product or data described in subsection (f)(1) that the aspirational business organization received from another entity, such former aspirational business organization shall—

1. with the approval of the other entity and an aspirational business organization, transfer such work product or data to such aspirational business organization;
2. return such work product or data to the entity that submitted the work product or data; or
3. if returning such work product or data to such entity is not practicable, destroy such work product or data.

Section 6. Technical assistance. The Secretary of State [or the SEC] may provide technical assistance to aspirational business organizations, including convening annual meetings for business organizations to discuss methodology, communication, data collection, or privacy concerns.

Section 7. Severability. If any provision of this act is held to be unconstitutional, the remainder of this act shall not be affected.