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CHAPTER 1

BUSINESS ETHICS

ANSWER TO CRITICAL THINKING QUESTION IN THE FEATURE

DIGITAL UPDATE—CRITICAL THINKING

From an ethical point of view, is there any difference between managers calling subordinates during off hours for work-related questions and sending e-mails or text messages? The basic ethical issue is whether employees should be compensated for time spent on work-related electronic communications for which they are not paid. Under the FLSA, managers are normally not eligible for overtime pay. But what about employees who are, in fact, covered by the overtime rules of the FLSA? If an employee is required to check and respond to e-mails, texts, or other electronic communications, then should be entitled to overtime pay under FLSA. If the employee checks and responds to electronic communications voluntarily, however, it is not likely that the employee would be entitled to overtime pay.

ANSWERS TO QUESTIONS AT THE ENDS OF THE CASES

CASE 1.1—CRITICAL THINKING ETHICAL

Are Salvatore's actions likely to affect his business's ability to profit in the long run?
Discuss. Any successful business has a plan to attain certain goals in the short run and in the long run. In many, if not most situations, the overriding objective is profit maximization. In attempting to maximize profits, however, businesspersons need to distinguish between short- and long-run profit maximization. In the short run, a business may increase its profits by engaging in misconduct. In the long run, however, because of civil suits, criminal charges, settlements, judgments, and bad publicity, such unethical conduct will cause profits to suffer. Overemphasizing short-term profit is the most common cause of ethical problems in business.

In the facts of this case, Salvatore opted for short-run profits by engineering wrongful transfers and expenditures of Scott's money. Due to the judgment of compensatory and punitive damages against Salvatore, and the subsequently likely bad publicity, the profits of his business will be sorely affected going forward.

LEGAL ENVIRONMENT

Did Carmela Carpanzano meet the minimum acceptable standard for ethical business behavior? Explain. The minimum acceptable standard for ethical business behavior is compliance with the law. This is sometimes called the moral minimum. If a person only complies with the law, he or she is behaving at the lowest ethical level society accepts. And simply because an action is legal does not mean it is ethical.

In this case, Carmela appears to have met these standards at their lowest level—she did not participate in the fraud against Scott and her lack of participation in the ensuing litigation can be ascribed to her reliance on her father Salvatore to protect her interests. As arguably misplaced as that reliance might have been, she seems to have been truthful and straightforward with the court.

CASE 1.2—CRITICAL THINKING

WHAT IF THE FACTS WERE DIFFERENT?

Suppose that Case Western had tolerated Al-Dabagh's conduct and awarded him a diploma. What impact might this result have had on other students at the school? Why? Al-Dabagh's expulsion for unprofessional, unethical behavior stood as an example for other students. If Case Western had tolerated Al-Dabagh's conduct and awarded him a diploma, it is likely that other students would have taken their cue from this result to engage in their own misconduct, and they would have expected their misbehavior to be accepted.

Just as the administration of a university sets the ethical tone of the school by its adoption and enforcement of an ethics policy, so does management's behavior set a firm's ethical tone. Top management demonstrates its commitment to ethical decision making by maintaining an ethical workplace. Discharging an employee for ethical reasons, for instance, acts as a deterrent to unethical behavior in the workplace.

A manager who is not committed to an ethical workplace is not likely to succeed in creating one. For example, a manager who looks the other way when he or she knows about an employee's unethical behavior sets an example—one indicating that transgressions will be tolerated.

CASE 1.3—LEGAL REASONING QUESTIONS

1A. *Using duty-based ethical principles, what facts or circumstances in this case would lead Moseley to disclose Herzog's behavior?* Using the duty-based principles, Moseley would have been led to report the behavior because it was not fair. Fairness would be an example of a fundamental right or a religious teaching. In addition, the categorical imperative would lead Moseley to feel that if no one reported this sort of behavior, then only relatives of the

rich who own the companies would get promoted or hired. If everyone reported the behavior, then the behavior would stop and the hiring and promotion processes would become fairer.

2A. Using outcome-based ethical principles, what issues would Moseley have to analyze in making the decision to report Herzog's behavior? What would be the risks to Moseley? The benefits? The things which Moseley would have to consider would be culture of the company. He would have to evaluate whether the policies at issue (nepotism, posting of positions) are taken seriously by the company or if they are ignored by company culture regularly. Moseley would have to analyze the chances of the company taking action compared to the risk of retribution. The risks to Moseley are that the company would not investigate or would find no wrongdoing and that he would suffer adverse employment actions. He also would risk potential ostracism by colleagues for being a whistleblower. The potential benefits would be that Herzog may have to stop the behavior or may be forced to leave the company leaving a better environment.

3A. Under the Business Pragmatism™ steps, what alternatives might Moseley have had in this situation? In the second step of the Business Process Pragmatism™ process, Moseley should list his alternatives. One alternative is to ignore the behavior. Another is to report the behavior on the ethics survey. A third alternative would be to meet with someone in the Human Resources department (if there is one), share the information without using names, and try to get some feedback or advice on how to proceed given the corporate policies and culture. A fourth alternative would be to do an anonymous report.

ANSWERS TO QUESTIONS IN THE REVIEWING FEATURE AT THE END OF THE CHAPTER

1A. Principle of rights

If one of the fundamental rights is the right to be treated fairly and to be able to invest one's money with full understanding of the risks, then it would be unethical for Smithson to sell these viaticals without full disclosure that some may be subject to cancellation.

2A. Categorical imperative

The categorical imperative asks the decision maker to assess the results of the action as if everyone in a similar situation made the same decision. If all insurance companies participated in the viatical industry and did not disclose the risk of cancellation, then investors would become leery of investing in the products and the market would disappear. The people for whom the sale of these policies is necessary to sustain a respectable life as it ends would not be able to get the cash to help them die with dignity. This would make the world a worse place and therefore the actions are not ethical.

3A. Utilitarianism

Utilitarianism asks the decision maker to perform a cost/benefit analysis of the alternatives. Smithson should evaluate the risks or chances of an investor buying a void policy compared to the benefits gained from purchasing legitimate policies. The cost/benefit analysis also should include whether he sells individual policies to individual investors or whether he sells a share of a bundle of policies. If he does the former, the risks to the individual investor are greater than if the latter. If the latter, the benefit of the legitimate policies may offset any loss from cancelled policies.

4A. Decision process

First, Smithson must recognize that there is a problem. He should identify the stakeholders as the investors, the sellers, his employees and the insurance companies that are at risk of being defrauded. He should be familiar with laws related to insurance. Second, he should list his alternatives and determine the goals for the decision. This is where Smithson really must analyze the mission and goals of his company and brainstorm different actions. In step three, Smithson selects his proposed decision with consultation and buy-in from the main stakeholders. Fourth, Smithson should formalize and articulate the reasons for the decision based on his analysis in prior steps. Finally, Smithson will need to later evaluate whether the selected course of action met his goals.

ANSWER TO DEBATE THIS QUESTION IN THE REVIEWING FEATURE AT THE END OF THE CHAPTER

Executives in large corporations are ultimately rewarded if their companies do well, particularly as evidenced by rising stock prices. Consequently, should we let those who run corporations decide what level of negative side effects of their goods or services is “acceptable”? The first problem with this attitude is that executives and managers (and even directors) may be looking at only short-run profits. They therefore might ignore the long-run profitability to their company. If a drug that works well against a potential pandemic causes severe side effects in some people, in the short run, this same drug may save many lives and reduce human suffering. Thus profits could be great initially, with a consequent rise in the stock price. In the longer run, though, when the news gets around that some of those who took the drug suffered severe side effects, future sales of the drug might fall, thus reducing profits and causing the stock to price to drop.

One now has to ask the question about who is in the best situation to decide the optimum level of side effects of any drug or good or service sold. (It's impossible to create drugs with zero negative side effects.) Any government regulator will want to make sure that there are few, if any, people who suffer from negative side effects. After all, the government regulator will look bad if the press reports about those who reacted badly to a drug. Therefore, there is a bias within any government regulatory apparatus against any good or service that has bad side effects. More limits on drugs, though, that help millions just because few suffer side effects will cost those who don't obtain the drug—perhaps with their lives.

ANSWERS TO ISSUE SPOTTERS AT THE END OF THE CHAPTER

1A. *Acme Corporation decides to respond to what it sees as a moral obligation to correct for past discrimination by adjusting pay differences among its employees. Does this raise an ethical conflict between Acme's employees? Between Acme and its employees? Between Acme and its shareholders? Explain your answers.* When a corporation decides to respond to what it sees as a moral obligation to correct for past discrimination by adjusting pay differences among its employees, an ethical conflict is raised between the firm and its employees and between the firm and its shareholders. This dilemma arises directly out of the effect such a decision has on the firm's profits. If satisfying this obligation increases profitability, then the dilemma is easily resolved in favor of "doing the right thing."

2A. *Delta Tools, Inc., markets a product that under some circumstances is capable of seriously injuring consumers. Does Delta have an ethical duty to remove this product from the market, even if the injuries result only from misuse? Why or why not?* Maybe. On the one hand, it is not the company's "fault" when a product is misused. Also, keeping the product on the market is not a violation of the law, and stopping sales would hurt profits. On the other hand, suspending sales could reduce suffering and could stop potential negative publicity.

ANSWER TO BUSINESS SCENARIO AT THE END OF THE CHAPTER

1–1A. *Business ethics*

Of course, it was unethical to sell goods that their maker knew were defective and could cause harm. This is the most reasonable and likely conclusion under any set of standards, even if it were possible to eventually obtain a negative result with respect to a defect from testing that repeatedly yielded a positive result. Under the six basic guidelines outlined in the text for making ethical business decisions, this is certainly true. The first consideration under those guidelines is whether a contemplated action is legal. It may have been legal to avoid reporting the initial test results to the Food and Drug Administration, but liability can attach through tort and contract law principles to the sale of goods that the seller knows or should know are defective. Thus, the baker's action in this problem does not pass muster under the first consideration. The second question is whether an action is consistent with company policies and procedures. The facts do not indicate what those policies and procedures are for this bakery, but if the steps taken in the problem are consistent with those directives, they also betray a lack of ethics—a company-mandated procedure to test defective goods until they seem to be adequate and a policy to then sell those goods could only be founded on a lack of concern for the buyers and indirectly the company's other stakeholders. The third guideline asks whether an action could survive

publicity. The action in this problem likely could not, because customers would stop buying the products, lawsuits would be filed to recover for the injuries, and a responsible government agency would issue new regulations, if none apply, and begin to investigate. Each of these consequences would undercut business and profits, which are arguably to the reasons for making the goods in the first place. Selling defective goods does not satisfy a promised commitment to their buyers, nor does it fulfill the seller's duty to provide a clean working environment for employees, both of which fall under the fifth guideline. Finally, the sixth consideration is how a hero would regard the action. Unless a villain is the seller's hero, the action is unlikely to be regarded well.

ANSWERS TO BUSINESS CASE PROBLEMS AT THE END OF THE CHAPTER

1–2A. SPOTLIGHT ON PFIZER—*Corporate social responsibility*

It could be argued that the defendants have an ethical responsibility to society to voluntarily take steps to reduce the availability of their products to meth makers. This might have become a more certain obligation once the defendants were aware that their products were used in the manufacture of meth. Retailers might have been asked to place the products behind the counter or lock them in display cases and limit sales or require consumers to sign for purchases. Retailers might have been educated about the suspicious behavior of buyers with illegal intent. (These measures were imposed as federal regulations in 2005.) The defendants might have developed alternative medications that did not contain ephedrine or pseudoephedrine.

It could also be argued that the defendants have an ethical responsibility to their shareholders and other stakeholders in their companies to fight regulatory efforts to limit the availability of their products so they could continue making profits. The central purpose of their businesses is to make money, not to affect social change. And the effects on society of the meth epidemic are not the natural and foreseeable consequences of the sales of the defendants' products.

In the actual case, the court compared the counties' claims to other plaintiffs' attempts to recover from gun manufacturers the costs associated with the criminal use of guns. In terms of legal liability, the circumstances connecting the sales of the medications to the provision of government services were too weak for the counties to recoup their costs from the defendants on a theory of implied contract. Also, the sales of the medications were legal, the operations of the STLs were not, the latter were not likely consequences of the former, and thus, in terms of proximate cause for tort liability, the costs to the counties were not reasonably foreseeable. The suit was dismissed.

1–3A. BUSINESS CASE PROBLEM WITH SAMPLE ANSWER—*Online privacy*

Facebook created a program that makes decisions for users. Using duty-based ethics, many believe that privacy is an extremely important right that should be fiercely protected. Accordingly, any program that has a default of giving out information is unethical. Facebook should create the program as an opt-in program. In addition, under the Kantian categorical

imperative, if every company created opt-out programs that disclosed potentially personal information, the concept of privacy may be reduced to a theoretical concept only. One could argue that this reduction or elimination of privacy would not make the world a better place. From a utilitarian or outcome-based approach, the benefits of an opt-out program might be in ease of creation and start-up, as well as ease of recruiting partner programs. The detriment is that the elimination of choice on the part of users to disclose information about themselves. An opt-in program maintains that user control but may be harder to start, as it requires more marketing up front to convince users to opt in.

1–4A. *Business ethics on a global scale*

The Foreign Corrupt Practices Act relates to the payments of foreign officials to make discretionary decisions in favor of the payer. In this circumstance, Kozeny was paying members of a royal family who also held positions of authority in the government to use their influence in order to have decisions made to benefit Kozeny. The payment was structured so that it would happen on an ongoing basis once the decisions were made, but that would still count as bribery of a foreign official under the FCPA. As a general ethical principle, Kozeny is eliminating fair competition with this scheme. That could be considered a violation of fundamental rights under a duty-based analysis.

1–5A. *Business ethics*

Business ethics might have been violated in these circumstances by Mark Ramun, John Ramun, and the employees and managers of Genesis.

The “tense relationship” between John and Mark at Allied may have been caused or exacerbated by either or both of them. And instead of confronting whatever it was that made their relationship “tense,” they may have exacted revenge—John by forcing Mark out of the firm, or Mark by leaving it, after ten years. Of course, this is speculation.

What is not speculation, however, is that Mark took 15,000 pages of Allied’s documents on DVDs and CDs (trade secrets) when he left the firm. This act was likely a violation of the law (theft or misappropriation) and clearly a violation of business ethics. Later, Mark joined Allied’s competitor, Genesis Equipment & Manufacturing, Inc. Genesis soon developed a piece of equipment that incorporated elements of Allied equipment. This points to a second violation of the law and ethics (use of stolen property) by both Mark and Genesis. Mark appears to have been competing against his family in the marketplace and trying to sell his products through another company. Assuming that Genesis profited from its sale of the equipment, this would have caused losses to Allied and unjustly enriched Genesis. If Mark was paid a bonus or given a promotion, he too would have gained undeservedly.

In the actual case on which this problem is based, Allied filed a suit in a federal district court against Genesis and Mark for misappropriation of trade secrets. A jury awarded Allied more than \$3 million in damages, but the court issued a judgment as a matter of law in favor of the defendants. On appeal, the U.S. Court of Appeals for the Sixth Circuit reversed. “It is neither speculative nor conjectural that Genesis unjustly benefitted from its use of Allied’s trade secrets.”

1–6A. Business ethics

Ethics is the study of what constitutes right and wrong behavior. It is a branch of philosophy focusing on morality and the way moral principles are derived and implemented. Ethics has to do with the fairness, justness, rightness, or wrongness of an action. Those who study ethics evaluate what duties and responsibilities exist or should exist for its practitioners. The circumstances set out in this problem underscore the importance of ethics by illustrating the consequences of engaging in ethical misconduct. Those consequences can extend beyond the short run.

Clearly, Glass engaged in ethical misconduct. By fabricating material for more than forty articles for *The New Republic* magazine and other publications whose reputations are founded on truth, Glass betrayed the trust of his editors. He further behaved unethically by fabricating supporting materials to delude *The New Republic's* fact checkers. And once he was suspected, he tried to avoid detection. Later, based on these misdeeds and others, the California Supreme Court refused to admit Glass to the California bar.

Does Glass deserve a “second chance”? Based on the facts in this problem, it can be argued that no, he does not—he had more than one “second chance” and blew them all. This is indicated by the California Supreme Court’s citation of “numerous instances of dishonesty and disingenuousness” during Glass’s “rehabilitation” following “the exposure of his misdeeds.” From a more forgiving perspective, it could be argued that he does deserve another chance—because of his misdeeds, his every move will be closely scrutinized and any misconduct would most likely be swiftly spotted and thwarted.

In the actual case on which this problem is based, Glass had earlier applied for, and been denied, admission to the New York bar. Then, as stated in the facts, on Glass’s application to the California bar, the California Supreme Court denied him.

1–7A. Business ethics

It seems obvious from the facts stated in this problem that Hrach Ilanjian behaved unethically in the circumstances. Ethics, of course, involves questions relating to the fairness, justness, rightness, or wrongness of an action. Business ethics focuses on the decisions that businesses and businesspersons apply moral and ethical principles to make their decisions and whether those decisions are right or wrong.

In this problem, from an apartment, Ilanjian defrauded Vicken Setrakian, the president of Kenset Corp., into believing that Ilanjian was an international businessman who could help Kenset turn around its business in the Middle East. Ilanjian insisted that Setrakian provide confidential business documents. Then, claiming that they had an agreement, Ilanjian demanded full and immediate payment. He threatened to disclose the confidential information to a Kenset supplier if payment was not forthcoming. Kenset denied that they had a contract. In the ensuing litigation, during discovery, Ilanjian was uncooperative. Each of these acts was unethical.

In the actual case on which this problem is based, in negotiations with Setrakian, Ilanjian misrepresented himself. Later, he threatened to use Kenset’s information in violation of the confidence between the parties. And during discovery, he was uncooperative. The court concluded that there was no contract, ordered the return of confidential documents, and

enjoined Ilanjan from using the information. The U.S. Court of Appeals for the Third Circuit affirmed.

1-8A. **Business ethics**

Ethical behavior on the part of employees is an important issue—as important as the ethics of their employers. In any set of employment circumstances, an unethical employee may engage in wrongful conduct.

In this problem, Priscilla Dickman worked for the University of Connecticut Health Center. Her employer received complaints that she was getting non-business-related phone calls and that she was absent from her work area when she should have been present. Based on materials found on her work computer, the state investigated her for violations of state law. She was convicted of engaging in “personal business for financial gain on state time utilizing state resources.” Separate investigations resulted in convictions for forgery and filing an unrelated fraudulent insurance claim. She “retired” from her job and filed a claim against the health center, alleging that her former employer had initiated the investigations to harass her and force her to quit. The claim was dismissed for lack of “credible evidence or legal support.”

All of Dickman’s acts noted in these facts can be perceived as unethical—the conduct complained of to her employer, the activities revealed by the state’s investigations, and the filing of the claim against her employer. The factor that these acts have in common is *fraud*. The conduct for which she was convicted of engaging in “personal business for financial gain on state time utilizing state resources” was presumably undertaken without her employer’s knowledge or there would have been no conviction. The activities on which her other convictions were based would also have involved deceit. And the reasons for the dismissal of her claim indicate that it, too, was knowingly false.

In the actual case on which this problem is based, Dickman appealed her claim’s dismissal. A state intermediate appellate court affirmed it.

1-9A. **A QUESTION OF ETHICS—Consumer rights**

(a) In this case, the court found that the company did not violate any laws and that the disclosures were adequate. From an ethical perspective, the question becomes whether the word “may” on the website gave adequate notice to the potential user or borrower that a charge would occur. It is settled legally that it is up to a contract signer to read all the components of a contract. In the online environment, it is hard to ever prove that a web page was not edited or changed from one day to the next. A consumer may read the terms and conditions just before a round of edits and then agree and seem bound by changes that did not exist at the time they read them. From a fairness perspective, that would be unethical. At the same time, presumably the reader could print off a copy of the agreement and keep it filed. Underlying societal questions exist as to whether it is fair to assume that a purchaser in an online environment would print off that form contract language in the same way that a signer of a contract keeps a copy of the written contract.

(b) The law often is considered the minimum ethical standard that society will allow. If a company follows the law, there will be no formal, societally-imposed consequences. There are many instances, and this is one, where following the law strictly may not be the most ethical

action. If the purpose of the Truth-in-Lending Act is to ensure that consumers have full information before making a decision, there may be more ethical ways (warnings, bigger text announcing continuation of terms, more specific language than “may” in the terms) that a company can help consumers be fully informed.

ANSWERS TO LEGAL REASONING GROUP ACTIVITY QUESTIONS AT THE END OF THE CHAPTER

1–10A. *Global business ethics*

(a) In Pfizer’s case, it would appear that the potential for short-run profit maximization, by quickly testing and marketing Trovan, took precedence over any consideration of ethics. This action alone arguably violates ethical standards, particularly in light of its results.

(b) The principal pro-Pfizer argument might be that the firm did not violate the law. Whether the test was legal is the question at the heart of the problem. In the actual case on which this problem is based, the trial court dismissed the suit, but the U.S. Court of Appeals for the Second Circuit reversed the dismissal, on the ground that the lower court should have looked more extensively at international law, and remanded the case. Meanwhile, Nigeria and one of its states filed criminal charges and civil claims against Pfizer, seeking over \$9 billion in damages and restitution—but not as compensation for the children.

(c) As a corporation, Pfizer might have applied the five-step procedure set out in the text to review the ethical conflicts in a test of Trovan. The first step is to specify the facts, the problem, and the ethical principles at issue. The second step is to discuss potential actions and their effects. The third step is to come to a consensus as to what to do. This consensus should withstand moral scrutiny (the fourth step) and fulfill corporate, community, and individual values (the fifth step). It seems unlikely that a proposed Trovan test on the facts described in the problem would have survived the fourth step, under either a duty-based or an outcome-based ethical standard.

Pfizer’s executives or employees who authorized the Trovan test might have evaluated their decision according to the six guidelines noted in the text. Is the action legal? Is it in line with the company’s rules? If so, is it in accord with the “spirit” of the law, those policies, and one’s conscience? Could it withstand the glare of publicity and satisfy promises made to others? It seems probable that the test would have violated Pfizer’s rules and that, as conducted, it could not have withstood publicity, promises to others, or any individual’s conscience.

ALTERNATE CASE PROBLEMS

CHAPTER 1

BUSINESS ETHICS

1-1. Employment Relationships. Matt Theurer, an eighteen-year-old high school senior, worked part-time at a McDonald's restaurant in Oregon. Theurer volunteered to work an extra shift one day, in addition to his regular shifts (one preceding and one following the extra shift). After working about twelve hours during a twenty-four-hour period, Theurer told the manager that he was tired and asked to be excused from his next regularly scheduled shift so that he could rest. The manager agreed. While driving home from work, Theurer fell asleep at the wheel and crashed into a van driven by Frederic Faverty. Theurer died, and Faverty was severely injured. Faverty sued McDonald's, alleging, among other things, that McDonald's had been negligent in permitting Theurer to drive a car when it should have known that he was too tired to drive safely. Do employers have a duty to prevent fatigued employees from driving home from work? Should such a duty be imposed on them? How should the court decide this issue? How would you decide the issue if you were the judge? [*Faverty v. McDonald's Restaurants of Oregon, Inc.*, 133 Or.App. 514, 892 P.2d 703 (1994)]

1-2. Ethical Conduct. Richard and Suzanne Weinstein owned Elm City Cheese Co. Elm City sold its products to three major customers that used the cheese as a "filler" to blend into their cheeses. In 1982, Mark Federico, a certified public accountant, became Elm City's accountant and the Weinstains' personal accountant. The Weinstains had known Federico since he was seven years old, and even before he became their accountant, he knew the details of Elm City's business. Federico's duties went beyond typical accounting work, and when the Weinstains were absent, he was put in charge of operations. In 1992, Federico was made a vice president of the company, and a year later he was placed in charge of day-to-day operations. He also continued to serve as Elm City's accountant. The relationship between Federico and the Weinstains deteriorated, and in 1995, he resigned as Elm City's employee and as its accountant. Less than two years later, Federico opened Lomar Foods, Inc., to make the same products as Elm City by the same process and to sell the products to the same customers. Federico located Lomar close to Elm City's suppliers. Elm City filed a suit in a Connecticut state court against Federico and Lomar, alleging, among other things, misappropriation of trade

secrets. Elm City argued that it was entitled to punitive damages because Federico's conduct was "willful and malicious." Federico responded in part that he did not act willfully and maliciously because he did not know that Elm City's business details were trade secrets. Were Federico's actions "willful and malicious"? Were they ethical? Explain. [*Elm City Cheese Co. v. Federico*, 251 Conn. 59, 752 A.2d 1037 (1999)]

1-3. Ethical Conduct. Charles Zandford was a securities broker for Prudential Securities, Inc., in Annapolis, Maryland. In 1987, he persuaded William Wood, an elderly man in poor health, to open a joint investment account for himself and his mentally retarded daughter. The stated investment objectives for the account were "safety of principal and income." The Woods gave Zandford discretion to manage their account and to engage in transactions for their benefit without prior approval. Relying on Zandford's promise to "conservatively invest" their money, the Woods entrusted him with \$419,255. Zandford immediately began writing checks to himself on the account. Paying the checks required selling securities in the account. Before William's death in 1991, all of the money was gone. Zandford was convicted of wire fraud and sentenced to more than four years in prison. The Securities and Exchange Commission filed a suit in a federal district court against Zandford, alleging in part misappropriation of \$343,000 of the Woods' securities and seeking disgorgement of that amount. Was Zandford's conduct sufficiently "in connection with a sale or purchase of securities" to constitute a violation of securities law? Did Zandford behave ethically? What effect might such conduct have on third parties? Discuss. [*SEC v. Zandford*, 535 U.S. 813, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002)]

1-4. Ethical Conduct. Eden Electrical, Ltd., owned twenty-five appliance stores throughout Israel, at least some of which sold refrigerators made by Amana Co. Eden bought the appliances from Amana's Israeli distributor, Pan El A/Yesh Shem, which approached Eden about taking over the distributorship. Eden representatives met with Amana executives. The executives made assurances about Amana's good faith, its hope of having a long-term business relationship with Eden, and its willingness to have Eden become its exclusive distributor in Israel. Eden signed a distributorship agreement and paid Amana \$2.4 million. Amana failed to deliver this amount in inventory to Eden, continued selling refrigerators to other entities for the Israeli market, and represented to others that it was still looking for a long-term distributor. Less than three months after signing the agreement with Eden, Amana terminated it, without explanation. Eden filed a suit in a federal district court against Amana, alleging fraud. The court awarded Eden \$12.1 million in damages. Is this amount warranted? Why or why not? How does this case illustrate why business ethics is important? [*Eden Electrical, Ltd. v. Amana Co.*, 370 F.3d 824 (8th Cir. 2004)]

1-5. Ethical Conduct. Richard Fraser was an "exclusive career insurance agent" under a contract with Nationwide Mutual Insurance Co. Fraser leased computer hardware and software from Nationwide for his business. During a dispute between Nationwide and the Nationwide Insurance Independent Contractors Association, an organization representing Fraser and other exclusive career agents, Fraser prepared a letter to Nationwide's competitors asking whether they were interested in acquiring the represented agents' policyholders. Nationwide obtained a

copy of the letter and searched its electronic file server for e-mail indicating that the letter had been sent. It found a stored e-mail that Fraser had sent to a co-worker indicating that the letter had been sent to at least one competitor. The e-mail was retrieved from the co-worker's file of already received and discarded messages stored on the server. When Nationwide canceled its contract with Fraser, he filed a suit in a federal district court against the firm, alleging, among other things, violations of various federal laws that prohibit the interception of electronic communications during transmission. In whose favor should the court rule, and why? Did Nationwide act ethically in retrieving the e-mail? Explain. [*Fraser v. Nationwide Mutual Insurance Co.*, 352 F.3d 107 (3d Cir. 2004)]

1–6. Ethical Conduct. Unable to pay more than \$1.2 billion in debt, Big Rivers Electric Corp. filed a petition to declare bankruptcy in a federal bankruptcy court in September 1996. Big Rivers' creditors included Bank of New York (BONY), Chase Manhattan Bank, Mapco Equities, and others. The court appointed J. Baxter Schilling to work as a "disinterested" (neutral) party with Big Rivers and the creditors to resolve their disputes and set an hourly fee as Schilling's compensation. Schilling told Chase, BONY, and Mapco that he wanted them to pay him an additional percentage fee based on the "success" he attained in finding "new value" to pay Big Rivers' debts. Without such a deal, he told them, he would not perform his mediation duties. Chase agreed; the others disputed the deal, but no one told the court. In October 1998, Schilling asked the court for nearly \$4.5 million in compensation, including the hourly fees, which totaled about \$531,000, and the percentage fees. Big Rivers and others asked the court to deny Schilling any fees on the basis that he had improperly negotiated "secret side agreements." How did Schilling violate his duties as a "disinterested" party? Should he be denied compensation? Why or why not? [*In re Big Rivers Electric Corp.*, 355 F.3d 415 (6th Cir. 2004)]

1–7. Ethics and the Law. Prudential Insurance Co. of America has a company guideline not to change the amount of a salesperson's commission once a client has been quoted a price for insurance. Despite this principle, in order to reduce the quoted price for insurance offered to York International Corp., Prudential cut the fee that it paid to a broker. A competing broker, Havensure, LLC, filed a suit, arguing that the reduced quote caused it to lose York as a potential customer. Is a company's violation of its own policy unethical? Is it a basis for legal liability? Explain. [*Havensure, LLC v. Prudential Insurance Co. of America*, 595 F.3d 312 (6th Cir. 2010)]

1–8. Ethical Leadership. David Krasner, who worked for HSH Nordbank AG, complained that his supervisor, Roland Kiser, fostered an atmosphere of sexism that was demeaning to women. Among other things, Krasner claimed that career advancement was based on "sexual favoritism." He objected to Kiser's relationship with a female employee, Melissa Campfield, who was promoted before more qualified employees, including Krasner. How do a manager's attitudes and actions affect the workplace? [*Krasner v. HSH Nordbank AG*, 680 F.Supp.2d 502 (S.D.N.Y. 2010)]

1–9. Ethical Misconduct. Frank Pasquale used his father’s Social Security number to obtain a credit card. Later, pretending to act on behalf of his father’s firm, Pasquale borrowed \$350,000. When he defaulted on the loan and his father confronted him, he produced forged documents that showed the loan had been paid. Adams Associates, LLC, which held the unpaid loan, filed a suit against both Pasquales. Should the court issue a judgment against the father and the son? Discuss. [*Adams Associates, LLC v. Frank Pasquale Limited Partnership*, 2011 WL 112665 (N.J.Super. A.D. 2011)]

1-10. A QUESTION OF ETHICS

Three-year-old Randy Welch climbed up to a shelf and picked up a disposable butane cigarette lighter. Randy then used the lighter to ignite a flame, which set fire to his pajama top. Welch and his parents brought a product-liability suit against the lighter’s manufacturer, Scripto-Tokai Corp., for damages. One of the questions raised in this case was whether the risks attending the lighter were sufficiently “open and obvious” that the manufacturer did not need to warn of those risks. [*Welch v. Scripto-Tokai Corp.*, 651 N.E.2d 810 (Ind.App. 1995)]

1. If you were the judge, how would you decide this issue? Explain your reasoning.
2. Generally, how can a court decide what kinds of risks should be open and obvious for the ordinary consumer? How can a business decision maker decide such questions?

ALTERNATE CASE PROBLEM ANSWERS

CHAPTER 1

BUSINESS ETHICS

1-1A. *Employment relationships*

The court ruled in favor of Faverty. McDonald's argued that under the *Restatement (Second) of Torts*, Sections 315, that "[t]here is no duty so to control the conduct of a third person as to prevent him from causing physical harm to another unless (a) a special relation exists between the actor and the third person which imposes a duty upon the actor to control the third person's conduct, or (b) a special relation exists between the actor and the other which gives to the other a right to protection." In this case, the "third person" was Theurer. The court explained, however, that "unless a defendant invokes a special status or relationship, or is subject to a particular statutory standard of conduct, it is subject to the general duty to avoid conduct that unreasonably creates a foreseeable risk of harm to a plaintiff." This is the same duty that we all have. The jury decided that McDonald's "knew or should have known that Theurer was so exhausted or fatigued that it should have foreseen that working him three shifts in one 24-hour period would create a foreseeable risk of harm to motorists such as plaintiff." In other words, by not preventing Theurer from driving home from work, McDonald's "unreasonably create[d] a foreseeable risk of harm to [the] plaintiff."

1-2A. *Ethical conduct*

The court enjoined the defendants, for a period of three years, "from disclosing, using or selling any of [Elm City's] confidential customer information, trade secrets, procedures, technical data or know-how relating to the products, processes, methods, research and development plans, equipment or business operations of [Elm City]." The court also awarded Elm City \$461,239 in compensatory damages, \$300,000 in punitive damages, and \$100,000 in attorney's fees. The defendants' appeal went to the Connecticut Supreme Court, which upheld the injunction and the damages. The court emphasized that "Federico used confidential business information that he was duty bound, by both statute and the ethics of his profession, to keep confidential. He cannot do so and then hide behind professed ignorance that the information he used improperly is part of Elm City's trade secret." The court concluded that "Federico should have known that he was using information that was a trade secret and that he was duty bound to keep confidential." The court added that Federico was "on a course for Elm City's demise rather than to enter into fair competition." For example, the choice of location for Lomar was closer to the suppliers

than Elm City's location and would "chok[e] off" Elm City's supplies. Federico would be "choking off further the distribution of Elm City's life lines by getting the three major customers of Elm City's product." The court also noted the animosity between Federico and the Weinstains when Federico resigned.

1-3A. Ethical conduct

The court entered a judgment in part ordering Zandford to disgorge \$343,000 in "ill-gotten gains." On Zandford's appeal, the U.S. Court of Appeals for the Fourth Circuit reversed this judgment. The SEC appealed to the United States Supreme Court, which reversed this decision and remanded the case, holding that Zandford's conduct was sufficiently "in connection with the purchase or sale of any security" to violate securities law. The Court explained that "[t]his is not a case in which, after a lawful transaction had been consummated, a broker decided to steal the proceeds and did so. Nor is it a case in which a thief simply invested the proceeds of a routine conversion in the stock market. Rather, respondent's fraud coincided with the sales themselves. . . . [E]ach sale was made to further respondent's fraudulent scheme; each was deceptive because it was neither authorized by, nor disclosed to, the Woods. With regard to the sales of shares in the Woods' mutual fund, respondent initiated these transactions by writing a check to himself from that account, knowing that redeeming the check would require the sale of securities." As to others, respondent's fraud represents [a great] threat to investor confidence Not only does such a fraud prevent investors from trusting that their brokers are executing transactions for their benefit, but it undermines the value of a discretionary account like that held by the Woods. The benefit of a discretionary account is that it enables individuals, like the Woods, who lack the time, capacity, or know-how to supervise investment decisions, to delegate authority to a broker who will make decisions in their best interests without prior approval. If such individuals cannot rely on a broker to exercise that discretion for their benefit, then the account loses its added value."

1-4A. Ethical conduct

You can infer from the problem that the damage award included not only actual damages to compensate Eden for Amana's failure to fulfill its contractual obligations but also *punitive damages*. The real question here is thus whether such a high amount of punitive damages was appropriate, or warranted, in this case. One would assume that behavior such as Amana's should be punished somehow. Amana had clearly ignored its ethical and legal obligations to Eden. Moreover, Amana is a major appliance dealer with global operations, and \$12.1 million would not likely cause the company to go bankrupt. The award is sufficiently high, though, to severely punish Amana and let Amana know that its conduct toward Eden was outrageous. Indeed, the trial court referred to Amana's actions as "a reprehensible case of business fraud." On appeal, the U.S. Court of Appeals for the Eighth Circuit emphasized that due to "the egregious nature of Amana's conduct," the damages award appropriately furthered "the state's twin goals of punishment and deterrence." This case illustrates that business ethics is important to the long-run viability of a corporation. Too much unethical conduct by a firm's representatives and consequent financial penalties would likely result in the end of the firm's capacity to do business.

1-5A. Ethical conduct

The court concluded that the federal laws in question protect only electronic communications in the course of transmission, and granted a summary judgment in favor of Nationwide. Here, of course, the e-mail had already been sent and was in storage in Nationwide's computers. "[R]etrieval of a message from post-transmission storage is not covered" by the federal laws in question. Those laws provide protection "only for messages while they are in the course of transmission. The facts of this case are that Nationwide retrieved Fraser's e-mail from storage after the e-mail had already been sent and received by the recipient. Nationwide acquired Fraser's e-mail from post-transmission storage. Therefore, Nationwide's conduct is not prohibited under" federal law. As for the ethics of Nationwide's retrieval of Fraser's e-mail from Nationwide's file server, the court acknowledged that it "may in fact be ethically 'questionable' as [an internal board that reviewed Nationwide's cancellation of Fraser's contract] indicated in its report. But it is not legally actionable under" federal law. Why might it be unethical? It could be interpreted as "unfair" or as an invasion of privacy, somewhat like searching through someone's trash. It could be seen as a violation of a duty to "employees," even though Fraser was technically an independent contractor. Fraser appealed the decision to the U.S. Court of Appeals for the Third Circuit, which affirmed the lower court's judgment on these points and remanded for consideration of other questions. On remand, the court again ruled in Nationwide's favor.

1-6A. Ethical conduct

The bankruptcy court held that Schilling was not entitled to any fees because he was not a "disinterested" party: "The moment that [Schilling] approached three of Big Rivers' largest * * * creditors and broached the subject of his compensation * * * he was no longer a disinterested party." The court also found that Schilling's failure to disclose the fee negotiations was a violation of the law, and ordered him to remit to Big Rivers the amount that he had already been paid. Schilling appealed to the U.S. Court of Appeals for the Sixth Circuit, which affirmed the bankruptcy court's order. The appellate court held that to be "disinterested" means a person in Schilling's position "may not have a material adverse interest to any party to the bankruptcy for any * * * reason. * * * An agreement with a single creditor that links * * * compensation to the creditor's recovery qualifies as such an interest because it creates the risk that [a person in Schilling's position] will favor one creditor at the expense of other creditors. * * * Opportunities abound, moreover, for [persons] paid in this manner to benefit selected creditor[s]" at the expense of others. "That Schilling reached the agreement * * * in secret only makes matters worse."

1-7A. Ethics and the law

The law does not codify all ethical requirements. A firm may have acted unethically but still not be legally accountable unless the party that was wronged can establish some basis for liability. Rules of law are designed to require plaintiffs to prove certain elements that establish a defendant's liability in order to recover for injuries or loss. Ethical codes and internal guidelines may have significance in evaluating a company's conduct, but they are not rules of law—a

violation of a company policy is not a basis for liability. In this case, Havensure had the burden of proving liability. Prudential's violation of its own company guideline was clearly wrongful—and might be a matter of concern for insurance regulators—but this misconduct did not create an obligation to Havensure. Havensure cannot establish a cause of action against Prudential for violating its own policy. In the actual case on which this problem is based, the court ruled in Prudential's favor.

1–8A. Ethical leadership

Ethical leadership is important to create and maintain an ethical workplace. Management can set standards, and apply those standards to themselves and their firm's employees to encourage an ethical business environment. One of the most important factors in creating and maintaining an ethical workplace is the attitude of management. Management's behavior sets the ethical tone of a firm. Employees take their cue from management. If the manager's do not follow ethical norms, employees will be likely to follow that example.

The circumstances set out in this problem show how a manager's sexist attitudes and actions can affect a workplace. Even if Krasner was not a victim of a violation of a law or a company policy, his complaints reveal that his perspective of his workplace environment was clearly affected by his supervisor's attitudes and actions. Assuming Krasner's complaints were supported by fact, they also indicate that Kiser behaved unethically.

In the actual case on which this problem is based, HSH investigated but did not find a violation of its ethics policies. Krasner filed a suit in a federal district court against the firm, alleging gender-based discrimination, but the court did not find any such discrimination—a female employee in Krasner's position would have experienced the same consequences.

1–9A. Ethical misconduct

Ethics has to do with the rightness or wrongness of actions. Business ethics focuses on what is right and wrong in the business world. Business ethics can be more complicated than personal ethics. In the situation described in this problem, the son engaged in unethical personal and business conduct. His personal misconduct included the use of his father's Social Security number to obtain a credit card. His business misdeeds included the misrepresentation to obtain the \$350,000 loan. Producing forged documents to show his father that the loan had been paid was both a personal and a business breach of ethics. In each instance, the son did not tell the truth. The son perpetrated fraud on the lender and on his father. These circumstances call for a judgment against the son.

The son acted alone—the father did not contribute to the fraud nor ratify the son's misdeeds—and neither the father nor the partnership benefited from the fraud. By confronting the son, the father arguably attempted to repudiate the misconduct. These factors indicate that a judgment in favor of the father is warranted.

In the actual case on which this problem is based, the court entered a judgment in favor of Adams against the son, and a judgment in favor of the father against Adams. On Adams's appeal, a state intermediate appellate court affirmed this result.

1-10A. A QUESTION OF ETHICS

1. The court granted the manufacturer summary judgment, and Welch appealed. The state appellate court affirmed the lower court's decision. The appellate court pointed out in its discussion, "Under the open and obvious danger rule, a manufacturer of a product is liable only for defects which are hidden and not normally observable. . . . [T]he relative obviousness of a defect is . . . relevant in determining whether or not a product is defective and unreasonably dangerous. . . . In this case, the risks posed by a disposable butane lighter are open and obvious to an ordinary user of the lighter." With this in mind, the court concluded that "Scripto was not negligent in failing to design the lighter with child-resistant features and Scripto had no duty to warn Welch of the lighter's inherent dangers." The court noted that "although the manufacturer of a lighter does not have a duty to provide a warning to keep the lighter away from children, in this case, Scripto provided such a warning on the package in which the lighter was sold."

2. In discussing the openness and obviousness of the dangers of a disposable lighter, the appellate court based its conclusions on "[t]he physical characteristics of the lighter, including the fact that it would ignite when one pushed down on the thumb lever and that it could be operated by a small child." This, as the court saw it, "could be directly observed. Accordingly, the danger of allowing a lighter to fall into the hands of a small child is open and obvious."

Chapter 1



Business Ethics

INTRODUCTION

Among the concepts examined in this chapter are the nature of business ethics and the relationship between ethics and the law. Because of this relationship, a careful study of business law will help your students to understand what is and what is not considered by society to be ethical behavior in business. Throughout the text, the relation between particular laws and the broad, underlying ethical premises on which they rest is discussed.

This chapter also presents issues that are involved in determining business ethical responsibility. Business ethics involves the application of ethical standards to business activities.

Ultimately, the goal of this chapter is to provide students with basic tools for analyzing ethical and social responsibility issues in a business context. Exactly how to decide these issues is something each person must do alone, on the basis of his or her own convictions. **Questions students must ask themselves include: (1) What are their ethical criteria? (2) How would they apply those criteria in a particular situation? (3) How can they best adapt their standards to the kinds of ethical and social responsibility issues that they will face in the business world?**

CHAPTER OUTLINE

I. Business Ethics

Ethics is the study of what constitutes right and wrong behavior. Ethics focuses on morality and the application of moral principles in everyday life. Business ethics focuses on what constitutes ethical behavior in the world of business. Business ethics is *not* a separate kind of ethics.

A. WHY IS STUDYING BUSINESS ETHICS IMPORTANT?

An understanding of business ethics is important to the long-run viability of a business, the well being of its officers and directors, and the welfare of its employees.

1. Profit Maximization

When the only goal of a corporation is to maximize profits, in theory, resources flow to where they are most highly valued by society.

2. The Rise of Corporate Citizenship

When resources are not sufficiently allocated to cover social needs, a corporation can be viewed as a “citizen” with expectations that it participate in bettering communities and society.

ADDITIONAL BACKGROUND—

The Pursuit of Profit

Historically, the pursuit of profit was suspect because it pits self-interest against community-oriented interests. In the sixteenth century, with the spread of Calvinism, which valued hard work and regarded business success as evidence of God’s grace, business activity became more respectable. Calvinism grew out of the theological doctrines of French Protestant reformer John Calvin (1509-1564).

Calvin—whose name is an adapted form of Jean Cauvin—was familiar with the writings of Plato, Seneca, and St. Augustine. In a speech written to be delivered in an inaugural ceremony at the University of Paris in 1533, Calvin expressed radical theological views. Forced to flee France, Calvin settled in Geneva, Switzerland. Calvin’s works include *Institutes of the Christian Religion*.

Calvin’s theology is the foundation of the Presbyterian, or non-Lutheran, churches, recognizing only the Bible as the authority in questions of religious belief. Its premises include

- The total depravity of man resulting from Adam’s fall.
- The absolute power of God’s will.
- Because no human has a will of his or her own, the superiority of faith to good deeds.
- The possibility of Christian salvation through God’s grace alone.
- The predestination of those few who are to be saved. Because no one can be certain as to whether he or she is to be saved, however, everyone must lead lives according to religious tenets.

Calvin’s Protestant ethics stressed hard work, self-denial, and an organization of one’s life to serve God. The development of Protestant ethics was a motivating force for the rise of capitalism, because it encouraged hard work even when there was no need for it. Material success as a result of work was interpreted as a sign of faith and possible salvation.

With the Industrial Revolution, the pursuit of profit was firmly united with the welfare of society by the economic theory of capitalism. Profit is good, so the theory goes, because it shows that resources are being put to highly valued uses. The search for profit is not always in society's best interest, so the criticism goes, because of market imperfections—the lack of competition in some markets, the difficulty of obtaining perfect information about products and consumer desires, and costs and benefits that are either unknown or unaccounted for (pollution, for example). Today a socially responsible firm modifies the ethics of capitalism with other ethical standards and looks at more than simply profits. In making business decisions, social responsibility involves three basic considerations: an act's profitability, its legality, and whether it is ethically justifiable.

Striking the right balance between making profits and being ethically responsible is not easy. Usually some profits must be sacrificed in the process. *Optimum* profits are the maximum profits that can be realized while staying within legal and ethical limits.

B. THE IMPORTANCE OF ETHICS IN MAKING BUSINESS DECISIONS

To maximize profits and indicate good corporate citizenship, businesses should evaluate a decision's

- Legal implications.
- Public relations impact.
- Safety risks for consumers and employees.
- Financial implications.

1. Long-Run Profit Maximization

In the long run, the consequences (such as lawsuits and bad publicity) of unethical conduct cause profits to suffer. Business ethics is consistent only with long-run profit maximization.

2. The Internet Can Ruin Reputations

The Internet has increased the potential for damage to the reputation of a business by employees, consumers, and special interest groups because information that may have been previously unknown is now easier to discover and publicize.

ENHANCING YOUR LECTURE—



9

“SUCKS” SITES—CAN THEY BE SHUT DOWN?

8 8



In today's online environment, a recurring challenge for businesses is how to deal with cybergrippers—those who complain in cyberspace about corporate products, services, or activities. For trademark owners, the issue becomes particularly thorny when cybergripping sites add “sucks,” “fraud,” “scam,” “ripoff,” or some other disparaging term as a suffix to the domain name of a particular company. These sites, sometimes collectively referred to as “sucks” sites, are established solely for the purpose of criticizing the products or services sold by the companies that own the marks. In some cases, they have been used maliciously to harm the reputation of a competitor. Can businesses do anything to ward off these cyber attacks on their reputations and goodwill?

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THE TRADEMARK ISSUE

A number of companies have sued the owners of “sucks” sites for trademark infringement in the hope that a court or an arbitrating panel will order the owner of that site to cease using the domain name. To date, however, companies have had little success pursuing this alternative. In one case, Bear Stearns Companies, Inc., sued a cybergriper, Nye Lavalley, alleging that Lavalley infringed its trademark by creating Web sites including “Bear Stearns” in the domain names. Some of these sites were called “BearStearnsFrauds.com,” “BearStearnsCriminals.com,” and “BearStearnsComplaints.com.”

One of the tests for trademark infringement is whether consumers would be confused by the use of a similar or identical trademark. Would consumers mistakenly believe that Lavalley’s sites were operated by Bear Stearns? In the court’s eyes, no. The court concluded that Lavalley’s “Frauds.com” and “Criminals.com” sites were “unmistakenly critical” of the target companies and that no Internet user would conclude that Bear Stearns sponsored the sites. As to the “Complaints.com” site, however, the court concluded that consumers might be confused—because Bear Stearns could have a “complaints” page on its Web site. Therefore, the “Complaints.com” site violated trademark law, but the other two sites did not.^a

FOR CYBERGRIPERS, THE MORE OUTRAGEOUS THE SUFFIX, THE BETTER

For cybergrippers, the message seems to be clear: the more outrageous or obnoxious the suffix added to a target company’s trademark, the less likely it is that the use will constitute trademark infringement. This point is underscored in decisions reached by other courts as well. In *Taubman Co. v. Webfeats*,^b for example, a cybergripping case decided by the U.S. Court of Appeals for the Sixth Circuit, the court stressed that Internet users were unlikely be confused by “sucks” sites using the Taubman Company name. Because the allegedly infringing domain names all ended with “sucks.com,” the court concluded that they were unlikely to mislead Web site visitors into believing that the trademark owner was the source or sponsor of the complaint. The court also noted in its opinion that, generally, the more vicious an attack site’s domain name, the less likely that a cybergriper will be found liable for trademark infringement.

FOR CRITICAL ANALYSIS

How might cybergripping sites help to improve the ethical performance of the businesses they criticize? Can business owners do anything to prevent the use of their marks in “sucks” sites?

a. *Bear Stearns Companies, Inc. v. Lavalley*, 2002 WL 31757771 (N.D.Tex. 2002).

b. 319 F.3d 770 (6th Cir. 2003).

3. Image Is Everything

Ethics can affect a business’s image and the business’s impact on the environment, customers, suppliers, employees, the community, society, and the global economy.

C. THE RELATIONSHIP OF LAW AND ETHICS

The law does not, and cannot, codify all ethical requirements. Laws are general and broad in purpose and scope.

1. Moral Minimum

The minimal acceptable standard for ethical business behavior is compliance with the law. But an action that is legal may not be ethical. Excessive corporate salaries may be legal, for example, but may also be seen as unethical.

CASE SYNOPSIS—

Case 1.1: Scott v. Carpanzano

Rick Scott filed a suit in a federal district court against Salvatore Carpanzano and others, including Carpanzano’s daughter Carmela, alleging claims relating to Scott’s loss of about \$2 million in an escrow account. Carpanzano failed to cooperate with discovery, did not respond to attempts to contact him by certified mail, regular mail, or e-mail, refused to appear as requested and ordered, and did not finalize a settlement negotiated between the parties’ attorneys. Carmela denied that she was involved in her father’s business or the Scott transaction. The court awarded Scott more than \$6 million.

The U.S. Court of Appeals for the Fifth Circuit affirmed the judgment against Carpanzano, but reversed the decision against Carmela—Scott had made no allegations of acts on her part “Even if Scott were able to prove the entirety of the * * * complaint, we fail to see how it would justify a judgment * * * against Ms. Carpanzano.”

Notes and Questions

Suppose that Carmela had been an active participant in her father’s business. Would the result have been different? Yes, and the court in its opinion indicated this by affirming the liability of Salvatore’s spouse Marisa who, in contrast to Carmela, played an active role in the Scott transactions and whom the lower court included in the default judgment against the defendants. Of course, even if Carmela had participated in the fraud against Scott, if she had relied on her father to protect her interests in the litigation, as she did in the actual case, she would not likely have been held to have willfully defaulted.

Suppose that a basketball coach at State University (SU) engages in a scheme to obtain credits and scholarships for the players in violation of the rules of the National Collegiate Athletic Association (NCAA). Charged with conspiracy to commit fraud, the coach argues that he did not break the law because his intent was not to harm, but to help, SU by ensuring a successful basketball team. Should the coach be exonerated? No. The court should conclude that the coach’s intent was irrelevant. If SU had been aware the coach was cheating—activity that the coach kept secret—it would likely have changed its conduct to recruit players who satisfied NCAA requirements.

ADDITIONAL CASES ADDRESSING THIS ISSUE —

Unethical and Illegal Business Conduct

Cases involving **unethical and illegal business conduct** include the following.

- *United States v. Anderson*, 580 F.3d 639 (7th Cir. 2009): The nominal president of a company, with authority over its finances, met weekly with one of the men running it to discuss operations and knew that it was misleading customers, supporting a conviction for wire fraud, mail fraud, and conspiracy.
- *United States v. Maxwell*, 579 F.3d 1282 (11th Cir. 2009): A fraudulent scheme to obtain construction

contracts set aside for socially and economically disadvantaged companies resulted in a conviction for mail fraud, wire fraud, and conspiracy to commit mail and wire fraud.

- *United States v. Ware*, 577 F.3d 442 (2d Cir. 2009): The defendant issued, edited, or approved press releases with false and misleading statements about companies in which he held stock; sold the stock for substantial profits following the releases when the price rose; and was convicted for securities fraud and conspiracy to commit securities fraud and wire fraud.
- *United States v. Brockenborough*, 575 F.3d 726 (D.C. Cir. 2009): A scheme to obtain real property for a deflated price supported a conviction for wire fraud and conspiracy to commit wire fraud, in circumstances that included a forged deed and the defendant's impersonation of a U.S. marshal.
- *United States v. Carbo*, 572 F.3d 112 (3d Cir. 2009): A private contractor was convicted of conspiracy to commit honest services mail fraud, in connection with a scheme to conceal conflicts of interest in the awarding of government contracts by a municipal official.
- *United States v. Stephens*, 571 F.3d 401 (5th Cir. 2009): A conviction for conspiracy, wire fraud, and identity theft was based on a scheme to obtain donations for hurricane relief through a bogus Web site purporting to be a charitable organization.
- *United States v. Wyatt*, 561 F.3d 49 (1st Cir. 2009): A scheme to facilitate sizable loans to high-risk borrowers and retain substantial escrow payments from the borrowers led to a conviction for conspiracy to commit wire fraud.
- *United States v. Lewis*, 557 F.3d 601 (8th Cir. 2009): The secretive receipt of a \$1.4 million payment from a charitable organization that the recipient knew was misrepresenting its deteriorating financial condition led to a conviction for mail fraud, wire fraud, bank fraud, conspiracy, and money laundering.

2. Ethical Requirements

Acting ethically can include doing what is right for society—negotiating in good faith, for example.

3. Private Company Codes of Ethics

Company codes of conduct are not law but outlines of policy and how employees are expected to act.

4. Industry Ethical Codes

Professional associations (such as the American Institute of Certified Public Accountants) also issue codes of ethics. Effectiveness is determined by the commitment of the industry or company to enforce the codes.

5. “Gray” Areas in the Law

Ethics can be subjective and changeable. In the law, too, there are many “gray areas” in which it is difficult to predict how a court will rule. A company is more likely to succeed in a legal dispute if it can show that it acted ethically, responsibly, and in good faith.

II. Business Ethics and Social Media

A. HIRING PROCEDURES

Some employers review job candidates' Facebook pages, blogs, and tweets. Some may reject candidates who do *not* participate in social media. Judging a job candidate based on what she or he does outside of the workplace can be seen as unethical.

B. THE USE OF SOCIAL-MEDIA TO DISCUSS WORK-RELATED ISSUES

An employer cannot broadly prohibit employees from criticizing the company, or co-workers, via social media.

1. Responsibility of Employers

Companies that fire employees for “bad mouthing” other employees or managers in social media outlets may violate federal labor law, which protects employees’ right to engage in “concerted activities”—freely associate and converse about workplace issues without employer interference.

2. Responsibility of Employees

Is it ethical for employees to make negative—and sometimes exaggerated—social media posts about managers or other employees?

III. Ethical Principles and Philosophies

How business decision makers decide whether a given action is the “right” one for their firms depends on the ethical standards that are applied. Fundamental ethical reasoning approaches include the following.

A. DUTY-BASED ETHICS

Duty-based ethics are derived from religious authorities or philosophical reasoning. These standards are focused on concepts of right and wrong, of duties owed and rights to be protected.

1. Religious Ethical Principles

Religious standards dictate how one should treat others (“Do unto others as you would have them do unto you”) and are generally absolute. For businesses, religious principles can—

- Unify employees and increase employee motivation.
- Alienate those with different religious backgrounds or social or political beliefs.
- Cause negative publicity and even protests or boycotts.

2. Principles of Rights

According to the principle that persons have rights (to life and liberty, for example), a key factor in determining whether a business decision is ethical is how that decision affects the rights of others, including employees, consumers, suppliers, the community, and society.

a. Conflicting Rights

One question is which right takes priority.

b. Resolving Conflicts

One answer is whichever right is stronger in a particular circumstance takes priority.

3. Kantian Ethical Principles

Immanuel Kant believed that people should be respected because they are qualitatively different from other physical objects.

a. People Are Not a Means to an End

Treating human beings as a means to an end (profit, for example) denies their basic humanity. Empowered employees share solutions and are more productive.

b. Categorical Imperative

Kant's *categorical imperative* is that individuals should evaluate their actions in light of the consequences that would follow if everyone acted the same way.

ADDITIONAL BACKGROUND—**Immanuel Kant, Critic of Pure Reason**

A professor of logic and metaphysics at the University of Königsberg, where he had been educated, **Immanuel Kant** (1724-1804) devoted much effort to his philosophical works, including *Critique of Pure Reason*, *Critique of Practical Reason*, *Critique of Judgment*, and *Foundations of the Metaphysics of Morals*. Kant believed that reality can be perceived only to the extent that it complies with the aptitude of the mind that is doing the perceiving. Only phenomena, or things that can be experienced, can be understood; everything else is unknown. Applying this theory to metaphysics, Kant saw God, freedom, and immortality as incomprehensible because they can only be studied through contemplation. Their existences cannot be proven, Kant concluded, but they are of immeasurable importance in moral philosophy, because morality cannot exist without belief in God, freedom, and immortality.

In 1793, when Kant published his views on religion in *Religion within the Limits of Reasons Alone*, the government prohibited him from writing further on the subject. Kant's ideas influenced many later philosophers, including George Hegel and Friedrich von Schiller. Kant led a quiet and regular life in Königsberg. According to German poet Heinrich Heine, the residents of the town set their watches by Kant's daily walks.

B. OUTCOME-BASED ETHICS: UTILITARIANISM

Utilitarianism focuses on the consequences of an action, not its nature or a set of moral values or religious beliefs.

1. Cost-Benefit Analysis

An action is morally correct, or "right," when it produces the greatest amount of good for the greatest number of individuals. Applying this theory requires—

- A determination of who will be affected.
- A cost-benefit analysis—an assessment of the negative and positive effects on those affected.
- A choice among alternatives that will produce the maximum societal utility (the greatest positive benefits for the greatest number of individuals).

2. Problems with the Utilitarian Approach

An act that produces the greatest good for the most may not seem to be the most ethical.

ADDITIONAL BACKGROUND—**Jeremy Bentham, Founder of Utilitarianism**

Jeremy Bentham (1748-1832) achieved prominence as a philosopher, jurist, reformer, and founder of

utilitarianism. Bentham was educated at Oxford and admitted to the bar but did not practice law. Instead he pursued legal, political, and social reform, applying principles of ethical philosophy in his efforts. Bentham believed that the greatest happiness for the greatest number is the basis of morality. Happiness and pleasure were the same, and included social, intellectual, and moral as well as physical pleasures. Each pleasure has certain characteristics, including intensity and duration, and Bentham devised a scale of measurement to judge the worth of a pleasure or pain. Each person strives to do what makes him or her happiest. The happiness of an individual and the general welfare are complementary; the achievement of the greatest amount of happiness is the goal of morality. Bentham also believed that the purpose of law was to maximize total happiness within the limitations of government. Bentham applied these views to reform legislation and achieved great advances in prison reform, criminal law, health control, civil service, and insurance.

Bentham was also active in codifying laws. In 1816, he attempted to persuade President James Madison to adopt a code of laws devised by Bentham that included all pertinent rules and case precedents added as illustrations of the utilization of the legal theory involved. Madison rejected the idea, but twenty years later, Bentham's theories were adopted by reformers with the goal of formulating a code of American law.

Bentham has been much praised for the application of his philosophy in the area of legal reform. An essential part of legal utilitarianism is reliance on the free market and individual initiative. Bentham also believed in majority rule and the implementation of as much democracy as possible. He assumed that businesslike rationality could solve all human problems. On the other hand, Bentham has been much criticized for his failure to account for or to understand any human emotion other than rational self-interest. As John Stuart Mill pointed out in a famous essay, Bentham seemed not to understand honor, personal dignity, artistic passion, or human desires for perfection, order, power, and action. "Knowing so little of human feelings," Mill wrote, Bentham "knew still less of the influences by which those feelings are formed . . . and no one . . . who . . . ever attempted to give a rule to all human conduct, set out with a more limited conception of either of the agencies by which human conduct *is* or of those by which it *should* be influenced."

C. CORPORATE SOCIAL RESPONSIBILITY

Corporate social responsibility involves incorporating a commitment to good citizenship, with a commitment to making ethical decisions, improving society and minimizing environmental impact.

1. The Social Aspects of CSR

Corporations can actively promote social goals and move toward solving social problems. Some companies publish annual corporate social responsibility—or sustainability, or citizenship—reports to highlight their activities.

2. The Corporate Aspects of CSR

Any socially responsible activity—relevant, significant, and related to a corporation's business—can benefit the firm in terms of increasing goodwill and sales, decreasing operating costs, and more impressive, committed, and long-term employees.

3. Stakeholders

Stakeholders include employees, customers, creditors, suppliers, advocacy groups, and the community in which a business operates. It is sometimes said that duties to these groups should be weighed against the duty to a firm's owners.

IV. Making Ethical Business Decisions

Business decisions involve legal concerns, financial questions, health and safety concerns, and ethical components. All corporate actors should think broadly about how their decisions and actions will affect other employees, shareholders, customers, and the community.

A. A SYSTEMATIC APPROACH

Business Process Pragmatism—a practical method to investigate and solve ethics problems—includes five steps—

- ***Inquiry***: Identify the parties, specify the problem, and list the relevant ethical principles.
- ***Discussion***: Put together a list of action options and resolution goals.
- ***Decision***: Come to a consensus decision on an action plan.
- ***Justification***: Attach reasons to each proposed action and ask whether the corporate stakeholders will accept those reasons.
- ***Evaluation***: Consider whether the solution satisfies corporate, community, and individual values.

ADDITIONAL BACKGROUND—

Guidelines to Making Ethical Business Decisions

Guidelines for evaluating whether a decision or an action is ethical can be found in the law, business rules and procedures, social values, an individual's conscience, an individual's promises and obligations to others, and personal or societal heroes. An action is most likely ethical if it is consistent with the law, or at least the "spirit" of the law, as well as company policies, and if it can survive the scrutiny of one's conscience and the regard of one's heroes without betraying one's commitments to others.

These guidelines include—

- *The law*: Is the action you are considering legal?
- *Business rules and procedures*: Is the action you are considering consistent with company policies and procedures?
- *Social values*: Is your proposed action consistent with the "spirit" of the law, even if it is not specifically prohibited?
- *Your conscience*: How does your conscience regard your plan? Could your plan survive the glare of publicity?
- *Promises to others*: Will your action satisfy your commitments to others, inside and outside the firm?
- *The law*: Is the action you are considering legal?

B. THE IMPORTANCE OF ETHICAL LEADERSHIP

Management must set and apply the same ethical standards to themselves and their company's employees.

CASE SYNOPSIS—

Case 1.2: *Al-Dabagh v. Case Western Reserve University*

The curriculum at Case Western Reserve University School of Medicine identifies nine “core competencies.” At the top of the list is professionalism, which includes “ethical, honest, responsible and reliable behavior.” Amir Al-Dabagh enrolled at the medical school and did well academically. He even published several articles and won a special award for “Honors with Distinction in Research.” But he sexually harassed fellow students, often asked an instructor not to mark him late for class, received complaints from hospital staff about his demeanor, and was convicted of driving while intoxicated. The university decided that Al-Dabagh lacked professionalism and refused to give him a diploma. He filed a suit in a federal district court against Case Western, alleging a breach of good faith and fair dealing. The court ordered the university to issue a diploma. The university appealed.

The U.S. Court of Appeals for the Sixth Circuit reversed. “Nothing in the record suggests that the university had impermissible motives or acted in bad faith.”

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Notes and Questions

In this case, Case Western Reserve University School of Medicine decided that Al-Dabagh lacked professionalism and refused to give him a diploma. Is it appropriate to assess professionalism so early in a person’s career? Yes. As the U.S. Court of Appeals for the Sixth Circuit observed in the *Al-Dabagh* case, “Professionalism has been a part of the doctor’s role since at least ancient Greece.” And the court explained that “it is entirely reasonable to assess the presence of professionalism early. For once a medical student graduates, we must wait for a violation before we may punish the absence of it.”

ADDITIONAL CASES ADDRESSING THIS ISSUE—

Enforcing University Ethics Codes

Cases involving the **enforcement of ethics codes in universities** include the following.

- *Halpern v. Wake Forest University Health Sciences*, 669 F.3d 454 (4th Cir. 2012) (dismissing a medical student for lack of professionalism is “academic”).
- *Brown v. Li*, 308 F.3d 939 (8th Cir. 2002) (refusing to approve a Ph.D. thesis because its acknowledgement section was unprofessional is “academic”).
- *Richmond v. Fowlkes*, 228 F.3d 854 (8th Cir. 2000) (dismissing a student for “non-cognitive” problems like “sleeping in” is “academic”).
- *Harris v. Blake*, 798 F.3d 419 (10th Cir. 1986) (dismissing a student for failing to attend practical class sessions is “academic”).
- *Perez v. Texas A&M University at Corpus Christi*, ___ F.3d ___, 2014 WL 5510955 (5th Cir. 2014) (dismissing a student for tardiness is “academic”).

- 1. Attitude of Top Management**

Employees take their cues from management. Ethical conduct can be furthered by not tolerating unethical behavior, setting realistic employee goals, and periodic employee review.

2. Behavior of Owners and Managers

Those who actively foster unethical or illegal conduct encourage it in others.

CASE SYNOPSIS—

Case 1.3: Moseley v. Pepco Energy Services, Inc.

Moseley had worked for Pepco Energy Services, Inc. (PES), a subsidiary of Pepco Holdings, Inc. (PHI), in New Jersey for over twenty years when, in response to PHI’s annual “Ethics Survey,” he revealed what he believed to be violations of company policy by Thomas Herzog, a supervisor. After an investigation, Herzog was “escorted out of the building.” Subsequently, Moseley received his first negative performance review and was denied a promotion in favor of another employee despite his superior job performance and the other employee’s negative history. Moseley filed a suit in a federal district court against PES and PHI, alleging “retaliatory action.” The defendants filed a motion for summary judgment.

The court denied the motion. Under New Jersey state law, “a plaintiff must establish that: (1) he reasonably believed that [the complained-of] conduct was violating a law or rule or regulation promulgated pursuant to law; (2) he objected to the conduct; (3) an adverse employment action was taken against him; and (4) a causal connection exists between the whistleblowing activity and the adverse employment action.” Here, Moseley reported what he believed to be “unethical conduct, misappropriation of company funds, and theft.” Until this report, Moseley had never received a negative job evaluation. He was overlooked for a promotion. The “causal connection” could be inferred from the circumstances.

Notes and Questions

How does the behavior in this case betray a lack of ethics? Herzog’s violations of company policy are clearly unethical. He improperly used company assets and improperly hired immediate family members and friends who did not appear on the payroll. Moseley reported these actions to the company, which investigated and discharged Herzog. But the employer may have been tolerating Herzog’s transgressions, or even encouraging them, because Moseley appears to have been penalized for his report with a negative performance review and the denial of a job promotion. This retribution is as unethical as Herzog’s conduct.

Regardless of who wins this case in trial, in performing Step 5 (Evaluation) of the Business Process Pragmatism™ procedure, what changes should the company take with regard to the complaint process? Because this case did make it to trial, there is evidence that something was not right in the processes. One potential change for the company is to better document reasons for lack of hiring or promotion. If they company has good, objective reasons, then any claim for retaliation later is harder to make. A second change relates to the reporting of the information. It appears from the facts in the case that the reporter’s supervisor knew who shared the information and this resulted in negative performance appraisals and lack of promotion. The ethics survey process may be restructured so that the employee’s names are removed from the survey to protect from any real or perceived retribution.

How can business leaders encourage their companies to act ethically? Ethical leadership is important to create and maintain an ethical workplace. Managers can set standards, and apply those standards to themselves and their firm’s employees. Legal and ethical conduct can be furthered by not

tolerating illegal or unethical behavior.

Does an organization have an ethical obligation to secure a safe and harassment-free workplace for its employees? Why or why not? Yes, employers have a both legal ethical obligations to maintain a workplace free of harassment. Those who actively foster unethical or illegal conduct encourage it in others so employers should neither direct nor tolerate misconduct.

When an employer discovers harassment through a complaint, the employer has an obligation to take action. The employer must take significant action likely to result in a change in the workplace.

In addition, it can be argued that an employer must take action to ensure that there is no harassment occurring—not just wait for a complaint, but actively survey employees and monitor the workplace for harassing behavior. Acting in good faith and being concerned with doing the right thing dictates that a company be proactive to avoid harmful behavior.

3. The Sarbanes-Oxley Act

The Sarbanes-Oxley Act of 2002 requires firms to set up confidential systems for employees to report suspected illegal or unethical financial practices.

V. Global Business Ethics

There are important ethical differences among, and within, nations.

ENHANCING YOUR LECTURE—



9

GOOGLE CHINA

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Doing business on a global level can sometimes involve serious ethical challenges. Consider the ethical firestorm that erupted when Google, Inc., decided to market “Google China.” This version of Google’s widely used search engine was especially tailored to the Chinese government’s censorship requirements. To date, the Chinese government has maintained strict control over the flow of information in that country. The government’s goal is to stop the flow of “harmful information.” Web sites that offer pornography, government criticism, or information on other sensitive topics, such as the Tiananmen Square massacre in 1989, are censored—that is, they cannot be accessed by Web users. Government agencies enforce the censorship and encourage citizens to inform on one another. Thousands of Web sites are shut down each year, and the sites’ operators are subject to potential imprisonment.

Google’s Code of Conduct opens with the company’s informal motto: “Don’t be evil.” Yet critics of Google’s actions question whether Google is following this motto. Human rights groups have come out strongly against Google’s behavior, maintaining that the company is seeking profits in a lucrative marketplace at the expense of assisting the Communist Party in suppressing free speech. And in February 2006, Democratic congressman Tom Lantos, the only Holocaust survivor serving in Congress, stated that the “sickening collaboration” of Google and three other Web companies (Cisco Systems, Microsoft Corporation, and Yahoo!, Inc.) with the Chinese government was “decapitating the voice of dissidents” in that nation.^a

GOOGLE’S RESPONSE

Google defends its actions by pointing out that its Chinese search engine at least lets users know which sites are being censored. Google China includes the links to censored sites, but when a user tries to access a link, the program states that it is not accessible. Google claims that its approach is essentially the “lesser of two evils”: if U.S. companies did not cooperate with the Chinese government, Chinese residents would have less user-friendly Internet access. Moreover, Google asserts that providing Internet access, even if censored, is a step toward more open access in the future because technology is, in itself, a revolutionary force.

THE CHINESE GOVERNMENT’S DEFENSE

The Chinese government emphasizes that its censorship of the Internet is no different from the controls placed on information access by other national governments. As an example, it cites France, which bans access to any Web sites selling or portraying Nazi paraphernalia. The United States itself prohibits the dissemination of certain types of materials, such as child pornography, over the Internet. Furthermore, the U.S. government monitors Web sites and e-mail communications to protect against terrorist threats. How, ask Chinese officials, can other nations point their fingers at China for pursuing a common international practice?

FOR CRITICAL ANALYSIS

Do you agree with the assumption made by Google that technological advances and the desire of the Chinese people to embrace liberty will overcome, in time, the current limitations imposed by the Chinese government?

a. “As cited in Tom Ziller, Jr., “Web Firms Questioned on Dealings in China,” *The New York Times*, February 16, 2006.

A. THE MONITORING OF EMPLOYMENT PRACTICES OF FOREIGN SUPPLIERS

Concerns include the rights and the treatment of foreign workers who make goods imported and sold in the United States by U.S. businesses. U.S. firms usually refuse to deal with certain suppliers or arrange to monitor their workplaces to make sure that the workers are not being mistreated.

B. THE FOREIGN CORRUPT PRACTICES ACT

Side payments to government officials in exchange for favorable business contracts are not unusual in some countries, nor are they considered to be unethical.

1. Prohibition against the Bribery of Foreign Officials

In the United States, the Foreign Corrupt Practices Act (FCPA) in 1977 prohibits U.S. businesspersons from bribing foreign officials to secure advantageous contracts.

2. Bribery by Foreign Companies

The U.S. Department of Justice can use the FCPA to prosecute foreign companies suspected of bribing officials outside the United States.

3. Accounting Requirements

Accountants (and others) are subject to penalties for making false statements in records or accounts.

4. Penalties for Violations

Business firms may be fined up to \$2 million. Individuals can be fined up to \$100,000 (the firm cannot pay the fine) and imprisoned up to five years.

ENHANCING YOUR LECTURE—



9 BRIBERY AND THE FOREIGN CORRUPT PRACTICES ACT



Many countries have followed in the footsteps of the United States by passing their own anti-corruption laws, sometimes similar to our Foreign Corrupt Practices Act. But, other countries are often not as diligent in weeding out corruption of government officials, for instance.

MEXICO FACES A CORRUPTION ISSUE

Recently, Mexico passed an anti-corruption law that prevents hospital administrators from approving contracts. Medical device supplier Orthofix International NV, based in Texas, faced a problem after passage of the new law. It wanted to continue providing bone-repair products to Mexico. It therefore bribed regional government officials instead of hospital administrators. For years, Orthofix successfully paid over \$300,000 in bribes to Mexican officials to retain government health care contracts. Employees at Orthofix called these bribes “chocolates.” They generated almost \$8.7 million in revenues for the company

THE BRIBING PROCESS

Orthofix’s Mexican subsidiary, Promeca, regularly paid cash and gifts, such as vacation packages, televisions, and laptops, to hospital employees in order to secure sales contracts. These employees then submitted falsified receipts for imaginary expenses such as meals and new car tires. As the bribes became too large to hide in this manner, Promeca’s employees falsely attributed the payments to promotional and training expenses. After the passage of the anti-corruption law, Mexico formed a special national committee to approve medical contracts. Promeca employees then simply bribed committee members to ensure that they were awarded the contracts.

NO PREVENTION TRAINING OR COMPLIANCE POLICY

It turns out that Orthofix did not have Foreign Corrupt Practices Act prevention training or a compliance policy in place in Mexico. Orthofix did create codes of ethics and anti-bribery training materials, but they were only distributed in English. When Orthofix managers found out about Promeca’s over-budget expenses, they inquired, but initially did not do anything further.

THE U.S. GOVERNMENT INVESTIGATES

Well after Orthofix learned of the payments, it self-reported them to the Securities and Exchange Commission (SEC). After negotiations with the SEC, Orthofix agreed to terminate the Promeca executives who were engaged in bribing and to end Promeca’s operations. Orthofix required mandatory training for all employees and strengthened its auditing of company payments. In addition, the company paid over \$7 million in penalties.

CRITICAL THINKING

Because managers are potentially responsible for all actions of their foreign subsidiaries whether or not they knew of the illegal conduct, what actions should Orthofix's upper management have taken before this corruption scandal came to light? All anti-corruption prevention training materials and compliance policies should have been translated into Spanish and presented to all Promeca employees. Additionally, after the unusual expenses at Promeca were discovered, Orthofix's upper management should have immediately engaged into a thorough investigation rather than waiting.

TEACHING SUGGESTIONS

1. To emphasize the relation between law and ethics, emphasize their distinction by discussing the theory of civil disobedience. Ethics are created by moral values. Whether to obey the law is itself an ethical question. Some individuals may choose to ignore the law if their ethical principles conflict with it. ***If there is a conflict between a law and an ethic, should an individual disobey the law, or should an individual obey the law even if he or she thinks it would be unethical to do so? Is there a higher law than what society provides in a particular place at a particular time?***

2. Ethical standards are subjective. They are derived from personal religious beliefs or philosophical assumptions concerning the nature of goodness, fairness, rightness, or justice. Each of us decides what we believe in and how to act on those beliefs. Have students give examples of their own ethical standards and explain how they arrived at those standards.

3. There are a number of hypotheticals that could be used to introduce this chapter's subject matter. Have students imagine that they own a company at which there is an opening at a beginning level. There are two applicants—one, the students' personal friend and the other, a member of the opposite sex (or of a minority). The latter individual is more qualified for the job than the friend. Ask the students to suppose that in spite of whatever profit the most qualified person might generate, they would rather have their friend on the job. State that in this hypothetical, hiring the friend would violate the law against discrimination. ***Would the students hire the friend in violation of the law?***

Other hypotheticals involving employment might be used. ***For example, would students, as owners of a business, offer a prospective employee a lower salary if (1) the employee indicated during the interview that she expected a lower salary than they had been prepared to offer based on other companies' salaries for similar positions? (2) paying the lower salary would violate no law? (3) the position was unique within the company (so that there were not other employees with whom she could compare pay)?***

4. To introduce social responsibility, a hypothetical involving a violation of the law could be given, but a violation as to which there is no risk of being caught. For example, have students suppose that as businesspersons they will have an opportunity to make more money by meeting with competitors and fixing prices, conduct which is illegal. For this hypothetical, tell them that the authorities will not discover that the prices have been fixed. In fact, the price rise could be small—pennies per item—but the increases in net profit could be considerable. ***Is price-fixing fair? Ethical? Socially responsible? Does it make any difference what***

the extra profit is used for? If the students imagine that they need the money, would price-fixing be wrong? Would their answers be different if there was an even chance that they would be caught? Why?

5. It might be pointed out that in a capitalist system it is essential that accurate information be disseminated to avoid any wasting of assets. Partly for this reason, an independent check on an enterprise's management by auditors benefits everyone with an interest in the business.

6. Suggest that students apply the same type of analytical reasoning to ethical problems that they apply to considering and deciding legal issues.

Cyberlaw Link

Should ethical standards be adapted to deal with the new forms of social disruption made possible by the Internet (for example, data theft, hacking, virus implanting, and invasion of privacy)? What new ethical standards, if any, are needed to resolve problems online?

DISCUSSION QUESTIONS

1. ***How does a law come to be an expression of an ethical principle?*** A law is what society deems proper behavior. An ethical value is also an expression of what is considered appropriate conduct. When people wish to enforce or change an ethical value, they often politicize the issue, urging politicians to create or amend a law. When the law changes, it more effectively represents the ethic that served as the impetus for its change.

2. ***What are reasons for unethical business behavior?***

- Employers or owners who condone it.
- The belief that it won't be discovered.
- The corporate structure, which can insulate individuals from responsibility for their acts through its distance from the acts' consequences and the collectivity (impersonality?) of corporate decision making.
- Lack of clarity as to what ethical standards are appropriate and acceptable in the business context.

3. ***In negotiating a business deal, is "strategic misrepresentation" permissible?*** From a duty-based ethics viewpoint, in an absolute sense, it would be unethical not to disclose information on which the negotiator knows the other side might hinge its decisions. In contrast, a negotiator owes an ethical duty to negotiate in the best interests of whomever he or she is negotiating for. When one ethical duty conflicts with another, a decision has to be made as to which duty is more fundamental. Frequently, questions faced by businesspersons do not have clear-cut answers, but involve choices between arguably equally good alternatives.

It has been suggested that business is a game and deception is an important element of negotiation, just as poker is a game in which bluffing plays an important part. The better an individual is at deception, the more successful he or she will be at negotiation. Those who do not anticipate deceit are fooling themselves. One of the problems with this suggestion is that there is no stated point at which deception is no longer acceptable. By comparison, in poker, it is acceptable to attempt to confuse other players as to the cards you have been dealt but it is not acceptable to bribe the dealer to deal you better cards. Also, if deception were widely practiced, the expense of protecting against it would increase for business and society.

4. Why would a corporation prefer to be seen as ethical? Consumers may be less willing to buy products of companies that appear to be unethical. Investors may prefer to invest in a firm that is perceived as ethically responsible. Suppliers may prefer to do business with ethical firms. In other words, socially responsible activities can improve profits.

5. Does a company have a duty to act in socially or politically beneficial ways? There is no agreement as to whether a company has a duty to act in a beneficial way. In deciding whether to do so, a company should consider the appropriateness and feasibility of an activity, the extent to which it will help the company, and whether expected gains will justify expected costs. Management must be prepared to explain its decision to shareholders and the public.

6. How does a corporation's investment in a political or social agenda affect its duty to its shareholders? People invest in business to make a profit, and a company's shareholders may have such a variety of political and social views that the company's pursuing a particular political or social goal may be divisive. Diverting corporate funds reduces the amount available for dividend payments. Diverting other resources reduces what is available to produce goods and services for sale. Investors may also be less likely to invest in a company that engages in behavior seen as unethical out of fear of consumer hostility toward the company.

7. To whom might a corporation owe a duty? A corporation may owe a duty to its shareholders, its employees and their families, its customers, and society as a whole. **What must a corporation do if it finds itself subject to conflicting duties?** There is no law that says which of these duties comes first or how much weight should be given to each in the balance. When there is no conflict between duties, the question of how best to fulfill a single duty involves trade-offs. When these duties overlap, a balance must be struck. Determining which duty takes precedence involves difficult trade-offs.

8. Because business controls so much wealth and power, what duty does it arguably have to society? It has been argued that business owes a duty to society to use its wealth and power in beneficial ways—promoting human rights, striving for equal treatment of minorities in the workplace, acting to safeguard the environment, and eschewing profits from activities that society deems unethical. Generally, business has been responsive to social needs, donating to programs that benefit society.

9. Do businesses have an ethical duty to use enhanced security measures to protect confidential customer information? Why or why not? For example, if an employer allowed its employee to store customers' unencrypted personal information on a laptop outside of the office, would this violate any ethical duty? Yes, because the information has been entrusted to their care and the theft of such information is well known. Also, from an ethical standpoint, in terms of profit, customers may be less willing to do business with a firm that does not protect such information. No, so long as the firm that possesses the data does not itself misuse it, because any theft or other misuse that might occur would be an illegal and unethical act on the part of its perpetrator, not the possessor.

10. What is the difference between legal and ethical standards? How are legal standards affected by ethical standards? Legal standards are greatly affected by ethical standards, and there are areas common to both. Killing another human being, for example, is rarely sanctioned by law and is commonly prohibited by religious and secular beliefs. Legal and ethical standards are not the same, however. The law does not codify all ethical requirements. An action might be legal but unethical. Compliance with the law does not always equate with ethical behavior.

ACTIVITY AND RESEARCH ASSIGNMENTS

1. Suggest that students research the basis for their personal ethical standards. ***How well (or poorly) do these bases coincide with the law as they know it? Is there a code of human conduct so basic that everyone would agree to follow it?***
2. Have students research the conflict that seems to exist between the Judeo-Christian and Islamic ethics, between the Western and Arabic cultures. ***Is the apparent gap bridgeable? Do we in fact have a common ethics? Do our ethics at least derive from a common source?***
3. Ask students to discover exactly how a value can become a law. ***What does the lobbying process involve? Do your students believe that good customs actually do become law? What factors distinguish good from bad customs?***
4. Have students choose an employer and discover as much as they can about the people who work for the employer. ***What are the job categories and what percentages of each are held by women and minorities? How does the employer determine wages? How flexible is the employer's policy?***
5. Some business firms publish annual reports concerning their socially responsible activities. Critics of these reports call them advertising ploys. Suggest that students obtain and read one or more of the reports. ***What activities do these firms consider socially responsible? What influence might the reporting of these activities have on the firms' management? Are firms that issue these reports likely to increase these activities?***

EXPLANATION OF A SELECTED FOOTNOTE IN THE TEXT

Footnote 3: Johnson Construction Co. took a leaky truck for repair to Shaffer's Auto and Diesel Repair, LLC. Shaffer gave a verbal estimate of \$1,000 for the work, but after the repair invoiced Johnson for \$5,863.49. Johnson offered to pay the amount of the estimate plus the costs of parts and shipping, but no more. Shaffer refused to return the truck without payment in full, and began to add storage charges of \$50 a day plus 18 percent interest on the amount of the invoice. Johnson filed a suit in a Louisiana state court against Shaffer, alleging unfair trade practices. The court awarded Johnson \$3,500 in damages and \$750 in attorneys' fees, and awarded Shaffer \$1,000. Shaffer appealed.

In *Johnson Construction Co. v. Shaffer*, a state intermediate appellate court affirmed. Johnson's owner had testified that he agreed to the \$1,000 estimate but not more. A Shaffer mechanic corroborated this testimony. As for the storage charges, if Shaffer had simply billed Johnson for the amount of the estimate, the firm would have paid it and there would have been no need to store the truck. Shaffer's keeping it was holding it "hostage" in an effort to force an unauthorized payment. This was conversion.

Suppose that Shaffer had invoiced Johnson for only \$1,500. Would the outcome have been different? Even if the court had been convinced that Johnson had agreed to spend only \$1,000 on the third repair of his truck, the difference between the agreed-on price and the actual invoice price probably would not have seemed large enough to justify Johnson not paying the invoice. Consequently, had all of the other facts remained the same, the court probably would have arrived at a different conclusion.

Would it have been ethical for Shaffer's mechanic to lie to support his employer's case? Discuss. No, it would not have been ethical for the Shaffer mechanic to lie on his employer's behalf. Of course it would have

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been fraud. This would have been unethical and illegal. And there might have been a question from the legal perspective as to whether his employer directed the misconduct.