All of the following businesspersons have been in the news recently:

- Dennis Kozlowski (former chairman and chief executive officer of Tyco International).
- Mark H. Swartz (former chief financial officer of Tyco International).
- Jeffrey Skilling (former chief executive officer of Enron Corporation).
- Bernard Ebbers (former chief executive officer of WorldCom).

What do these individuals have in common? They are all in prison, and some may stay there until they die. They were all convicted of various crimes ranging from overseeing revenue exaggeration in order to increase stock prices to personal use of millions of dollars of public company funds. Not only did they break the law, but they also clearly violated even the minimum ethical principles that a civil society expects to be followed. Other officers and directors of the companies mentioned in the above list cost shareholders billions of dollars. In the case of those companies that had to enter bankruptcy, such as Enron Corporation, tens of thousands of employees lost their jobs.

Acting ethically in a business context is not child's play; it can mean billions of dollars—up or down—for corporations, shareholders, and employees. In the wake of the recent scandals, Congress attempted to prevent similar unethical business behavior in the future by passing stricter legislation in the form of the Sarbanes-Oxley Act of 2002, which will be explained in detail in Chapters 41 and 51. This act generally imposed more reporting requirements on corporations in an effort to deter unethical behavior and encourage accountability.

**SECTION 1**

**Business Ethics**

As you might imagine, business ethics is derived from the concept of ethics. Ethics can be defined as the study of what constitutes right or wrong behavior. It is a branch of philosophy focusing on morality and the way moral principles are derived. Ethics has to do with the fairness, justness, rightness, or wrongness of an action.

**What Is Business Ethics?**

Business ethics focuses on what is right and wrong behavior in the business world. It has to do with how businesses apply moral and ethical principles to situations that arise in the workplace. Because business decision makers must often address more complex ethical issues in the workplace than they face in their personal lives, business ethics is more complicated than personal ethics.

**Why Is Business Ethics Important?**

For an answer to the question, why is business ethics so important? reread the list at the beginning of this chapter. All of the individuals who are sitting behind bars could have avoided their fates. Had they engaged in ethical decision making throughout their business careers, they would never have followed their different paths to criminal behavior. The corporations, shareholders, and employees who suffered because of those individuals’ unethical and criminal behavior certainly paid a high price. Thus, an in-depth understanding of
business ethics is important to the long-run viability of any corporation today. It is also important to the well-being of individual officers and directors and to the firm’s employees. Finally, unethical corporate decision making can negatively affect suppliers, consumers, the community, and society as a whole.

At the end of every unit in this book, you will be exposed to a series of ethical issues in features called Focus on Ethics. In each of these unit-ending features, we expand on the concepts of business ethics that we present in this chapter.

**Common Reasons Why Ethical Problems Occur**

Not that many years ago, the popular painkiller Vioxx was recalled because its long-term use increased the risk of heart attack and stroke. Little by little, evidence surfaced that the drug’s maker, Merck & Company, knew about these dangers yet allowed Vioxx to remain on the market. Merck’s failure to recall the drug earlier could potentially have adversely affected the health of thousands of patients. Now Merck faces hundreds of lawsuits and years of litigation and millions of dollars in lawyers’ fees and settlements. In addition, Merck has undergone investigations by both Congress and the U.S. Department of Justice. How did a major corporation manage to make so many missteps? The answer is simply that certain officers and employees of Merck felt that it was not necessary to reveal the results of studies that might have decreased sales of Vioxx.

In other words, the common thread among the ethical problems that occur in business is the desire to increase sales (or not lose them), thereby increasing profits and, for the corporation, increasing market value. In most situations, though, ethically wrong behavior by a corporation turns out to be costly to everyone concerned. Just ask the shareholders of Merck (and, of course, Enron, WorldCom, and Tyco).

**Short-Run Profit Maximization**

Some people argue that a corporation’s only goal should be profit maximization, which will be reflected in a higher market value. When all firms strictly adhere to the goal of profit maximization, resources tend to flow to where they are most highly valued by society. Ultimately profit maximization, in theory, leads to the most efficient allocation of scarce resources.

Corporate executives and employees have to distinguish, though, between short-run and long-run profit maximization. In the short run, the employees of Merck & Company may have increased profits because of the continuing sales of Vioxx. In the long run, though, because of lawsuits, large settlements, and bad publicity, profits have suffered. Thus, business ethics is consistent only with long-run profit maximization.

**Determining Society’s Rules—The Role of Corporate Influence**

Another possible cause of bad business ethics has to do with corporations’ role in influencing the law. Corporations may use lobbyists to persuade government agencies not to institute new regulations that would increase the corporations’ costs and reduce their profits. Once regulatory rules are promulgated, corporations may undertake actions to reduce their impact. One way to do this is to make it known that members of regulatory agencies will always have jobs waiting for them when they leave the agencies. This revolving door, as it is commonly called, has existed as long as there have been regulatory agencies at the state and federal levels of government.

**The Importance of Ethical Leadership**

Talking about ethical business decision making is meaningless if management does not set standards. Furthermore, managers must apply the same standards to themselves as they do to the employees of the company.

**Attitude of Top Management**

One of the most important ways to create and maintain an ethical workplace is for top management to demonstrate its commitment to ethical decision making. A manager who is not totally committed to an ethical workplace rarely succeeds in creating one. Management’s behavior, more than anything else, sets the ethical tone of a firm. Employees take their cues from management. For example, an employee who observes a manager cheating on her expense account quickly learns that such behavior is acceptable.

Managers who set unrealistic production or sales goals increase the probability that employees will act unethically. If a sales quota can be met only through high-pressure, unethical sales tactics, employees will try to act “in the best interest of the company” and will continue to behave unethically.

A manager who looks the other way when she or he knows about an employee’s unethical behavior also sets an example—one indicating that ethical transgressions will be accepted. Managers have found that discharging even one employee for ethical reasons has a tremendous impact as a deterrent to unethical behavior in the workplace.
Behavior of Owners and Managers

Business owners and managers sometimes take more active roles in fostering unethical and illegal conduct. This may indicate to their co-owners, co-managers, employees, and others that unethical business behavior will be tolerated. The following case illustrates how business owners’ misbehavior can have negative consequences for themselves and their business. Not only can a court sanction the business owners and managers, but it can also issue an injunction that prevents them from engaging in similar patterns of conduct in the future.

**Baum v. Blue Moon Ventures, LLC**

**Extended Case 5.1**

*DeMOSS, Circuit Judge:*

Douglas Baum purports to run an asset recovery business. He researches various unclaimed funds, tries to locate the rightful owner, and then gets paid either with a finder’s fee or by taking an assignment [a right to payment of some or all of the funds]. Douglas Baum acts in concert with his brother, Brian Baum, and his father, Sheldon Baum ("the Baums").

In September 2002, the Baums [became involved in] a federal district court case *by recruiting investors—through misrepresentation—to sue a receiver [a court-appointed person who oversees a business firm’s affairs], the receiver’s attorney, other investors, and those investors’ attorneys. The district court determined that the Baums’ pleadings were ‘gratuitous, malicious attacks with legal propositions that were wholly disconnected from the facts of the defendants’ behavior.’ The district court admonished the Baums for wrongfully interfering in the case, wrongfully holding themselves out to be attorneys licensed to practice in Texas, lying to the parties and the court, and for generally abusing the judicial system. The district court stated:

This case is an example of guerilla warfare through litigation. The Baums brought this suit to satisfy their illusion of hidden funds or to extort deals for their other clients. These claims were fraudulent. Once instituted, the Baums maintained them with singular ineptitude. When asked to explain their case—or anything else—Brian and Sheldon Baum did not tell the truth.

The Baums have wasted the time and money of the defendants and the scarce resources that the taxpayers entrust to the judiciary. They have flouted the authority of this court—an authority they invoked. They have no concept of the purpose and function of the courts.

The district court sanctioned both Brian and Sheldon Baum to ten days in jail and ordered them to pay $100,000 in attorney’s fees to the defendants. The court also issued a permanent injunction against all three Baums [to prohibit them from filing claims related to the same case in Texas state courts without the permission of Judge Lynn Hughes, the district court judge].

In June 2005, the Baums entered an appearance in another bankruptcy case [a proceeding to ensure equitable treatment to creditors competing for a debtor’s assets]. Danny Hilal owned and operated several limited liability companies, including Appellee, Blue Moon Ventures, LLC. Blue Moon’s primary business was purchasing real property at foreclosure sales and leasing those properties to residential tenants.

Sheldon Baum claimed to be a creditor in the Hilal case, but he would not identify his claim. Brian Baum was again misleading the parties and the court as to being a licensed attorney in Texas, and Douglas Baum participated in the scheme by posting a fake notice [that the Internal Revenue Service might foreclose on Hilal’s property to collect unpaid taxes].

The bankruptcy court concluded that this was a continuation of a pattern of conduct identified by materially misleading to creditors and parties in interest in this case. The bankruptcy court forwarded a memo on the case to the district court that had imposed the sanctions on the Baums.

CASE CONTINUES
The [district] court conducted two three-hour hearings in which the Baums all testified, as well as counsel for the Appellees (collectively referred to as “Blue Moon”). The court concluded that the Baums had continued in their abusive practices, and thus a modification of the injunction was necessary. [The court expanded the injunction to include the filing of any claim in any federal or state court or agency in Texas.]

Douglas refused to agree to any modification of the injunction on the grounds that it would impede his business. Douglas Baum filed a timely notice of appeal [to the U.S. Court of Appeals for the Fifth Circuit].

Douglas Baum argues that the district court lacked jurisdiction to modify the pre-filing injunction. We disagree.

A district court has jurisdiction to impose a pre-filing injunction to deter vexatious filings. Federal courts have both the inherent power and the constitutional obligation to protect their jurisdiction from conduct that impairs their ability to carry out their functions. If such power did not exist, or if its exercise were somehow dependent upon the actions of another branch of government or upon the entitlement of a private party to injunctive relief, the independence and constitutional role of the courts would be endangered. Because the district court has jurisdiction to impose a pre-filing injunction to deter vexatious filings, it also has jurisdiction to modify an existing permanent injunction to accomplish the same goal.

Modification of an injunction is appropriate when the legal or factual circumstances justifying the injunction have changed.

Federal courts have the power to enjoin plaintiffs from future filings when those plaintiffs consistently abuse the court system and harass their opponents.

The district court could consider Baum’s conduct in the state court proceedings in determining whether his conduct before the bankruptcy court was undertaken in bad faith or for an improper motive. Limiting the injunction to any particular defendants did not stop Baum from repeating his pattern of abusive litigation practices; therefore, the district court did not abuse its discretion in determining that a broader injunction is necessary to protect both the court and future parties.

Baum argues that the district court abused its discretion in extending the injunction to prohibit Baum from filing any claims in state courts or agencies.

[A] district court’s pre-filing injunction may extend to filings in lower federal courts within the circuit that the issuing court is located, a district court’s pre-filing injunction may not extend to filings in any federal appellate court, and a district court’s pre-filing injunction may not extend to filings in any state court. Based on the facts of this case, we find that the district court abused its discretion in extending the pre-filing injunction to filings in state courts, state agencies, and federal bankruptcy courts, federal district courts, and federal agencies in the state of Texas without the express written permission of Judge Hughes.

QUESTIONS

1. Would there by any way in which the Baums could have operated their business ethically? Explain.

2. Are there situations in which a business owner’s conduct would be more reprehensible than the Baums’ behavior in this case? Explain.
Approaches to Ethical Reasoning

Each individual, when faced with a particular ethical dilemma, engages in ethical reasoning—that is, a reasoning process in which the individual examines the situation at hand in light of his or her moral convictions or ethical standards. Businesspersons do likewise when making decisions with ethical implications.

How do business decision makers decide whether a given action is the “right” one for their firms? What ethical standards should be applied? Broadly speaking, ethical reasoning relating to business traditionally has been characterized by two fundamental approaches. One approach defines ethical behavior in terms of duty, which also implies certain rights. The other approach determines what is ethical in terms of the consequences, or outcome, of any given action. We examine each of these approaches here.

In addition to the two basic ethical approaches, a few theories have been developed that specifically address the social responsibility of corporations. Because these theories also influence today’s business decision makers, we conclude this section with a short discussion of the different views of corporate social responsibility.

Duty-Based Ethics

Duty-based ethical standards often are derived from revealed truths, such as religious precepts. They can also be derived through philosophical reasoning.

Religious Ethical Standards In the Judeo-Christian tradition, which is the dominant religious tradition in the United States, the Ten Commandments of the Old Testament establish fundamental rules for moral action. Other religions have their own sources of revealed truth. Religious rules generally are absolute with respect to the behavior of their adherents. For example, the commandment “Thou shalt not steal” is an absolute mandate for a person who believes that the Ten Commandments reflect revealed truth. Even a benevolent motive for stealing (such as Robin Hood’s) cannot justify the act because the act itself is inherently immoral and thus wrong.

Kantian Ethics Duty-based ethical standards may also be derived solely from philosophical reasoning. The German philosopher Immanuel Kant (1724–1804), for example, identified some general guiding principles for moral behavior based on what he believed to be the fundamental nature of human beings. Kant believed that human beings are qualitatively different from other physical objects and are endowed with moral integrity and the capacity to reason and conduct their affairs rationally. Therefore, a person’s thoughts and actions should be respected. When human beings are treated merely as a means to an end, they are being treated as the equivalent of objects and are being denied their basic humanity.

A central theme in Kantian ethics is that individuals should evaluate their actions in light of the consequences that would follow if everyone in society acted in the same way. This categorical imperative can be applied to any action. For example, suppose that you are deciding whether to cheat on an examination. If you have adopted Kant’s categorical imperative, you will decide not to cheat because if everyone cheated, the examination (and the entire education system) would be meaningless.

The Principle of Rights Because a duty cannot exist without a corresponding right, duty-based ethical standards imply that human beings have basic rights. The principle that human beings have certain fundamental rights (to life, freedom, and the pursuit of happiness, for example) is deeply embedded in Western culture. As discussed in Chapter 1, the natural law tradition embraces the concept that certain actions (such as killing another person) are morally wrong because they are contrary to nature (the natural desire to continue living). Those who adhere to this principle of rights, or “rights theory,” believe that a key factor in determining whether a business decision is ethical is how that decision affects the rights of others. These others include the firm’s owners, its employees, the consumers of its products or services, its suppliers, the community in which it does business, and society as a whole.

A potential dilemma for those who support rights theory, however, is that they may disagree on which rights are most important. When considering all those affected by a business decision, for example, how much weight should be given to employees relative to shareholders, customers relative to the community, or employees relative to society as a whole?

In general, rights theorists believe that whichever right is stronger in a particular circumstance takes precedence. Suppose that a firm can either keep a plant open, saving the jobs of twelve workers, or shut the plant down and avoid contaminating a river with...
pollutants that would endanger the health of thousands of people. In this situation, a rights theorist can easily choose which group to favor. (Not all choices are so clear-cut, however.)

**Outcome-Based Ethics: Utilitarianism**

“The greatest good for the greatest number” is a paraphrase of the major premise of the utilitarian approach to ethics. Utilitarianism is a philosophical theory developed by Jeremy Bentham (1748–1832) and modified by John Stuart Mill (1806–1873)—both British philosophers. In contrast to duty-based ethics, utilitarianism is outcome oriented. It focuses on the consequences of an action, not on the nature of the action itself or on any set of preestablished moral values or religious beliefs.

Under a utilitarian model of ethics, an action is morally correct, or “right,” when, among the people it affects, it produces the greatest amount of good for the greatest number. When an action affects the majority adversely, it is morally wrong. Applying the utilitarian theory thus requires (1) a determination of which individuals will be affected by the action in question; (2) a cost-benefit analysis, which involves an assessment of the negative and positive effects of alternative actions on these individuals; and (3) a choice among alternative actions that will produce maximum societal utility (the greatest positive net benefits for the greatest number of individuals).

**Corporate Social Responsibility**

For many years, groups concerned with civil rights, employee safety and welfare, consumer protection, environmental preservation, and other causes have pressured corporate America to behave in a responsible manner with respect to these causes. Thus was born the concept of corporate social responsibility—the idea that those who run corporations can and should act ethically and be accountable to society for their actions. Just what constitutes corporate responsibility has been debated for some time, however, and there are a number of different theories today.

**Stakeholder Approach**

One view of corporate social responsibility stresses that corporations have a duty not just to shareholders, but also to other groups affected by corporate decisions (“stakeholders”). Under this approach, a corporation would consider the impact of its decision on the firm’s employees, customers, creditors, suppliers, and the community in which the corporation operates. The reasoning behind this “stakeholder view” is that in some circumstances, one or more of these other groups may have a greater stake in company decisions than the shareholders do. Although this may be true, it is often difficult to decide which group’s interests should receive greater weight if the interests conflict (see the discussion of conflicting rights on page 103).

**Corporate Citizenship**

Another theory of social responsibility argues that corporations should behave as good citizens by promoting goals that society deems worthwhile and taking positive steps toward solving social problems. The idea is that because business controls so much of the wealth and power of this country, business in turn has a responsibility to society to use that wealth and power in socially beneficial ways. Under a corporate citizenship view, companies are judged on how much they donate to social causes, as well as how they conduct their operations with respect to employment discrimination, human rights, environmental concerns, and similar issues.

In the following case, a corporation’s board of directors did not seem to doubt the priority of the firm’s responsibilities. Focused solely on the profits delivered into the hands of the shareholders, the board failed to check the actions of the firm’s chief executive officer (CEO) and, in fact, appeared to condone the CEO’s misconduct. If the board had applied a different set of priorities, the shareholders might have been in a better financial position, however. A regulatory agency soon found the situation “troubling” and imposed a restriction on the firm. The board protested. The protest reminded the court of “the old saw about the child who murders his parents and then asks for mercy because he is an orphan.”

**CASE 5.2**

Fog Cutter Capital Group, Inc. v. Securities and Exchange Commission


- **Background and Facts** The National Association of Securities Dealers (NASD) operates the Nasdaq, an electronic securities exchange, on which Fog Cutter Capital Group was listed.* Andrew

  a. Securities (stocks and bonds) can be bought and sold through national exchanges. Whether a security is listed on an exchange is subject to the discretion of the organization that operates it. The Securities and Exchange Commission oversees the securities exchanges.
Wiederhorn had founded Fog Cutter in 1997 to manage a restaurant chain and make other investments. With family members, Wiederhorn controlled more than 50 percent of Fog Cutter’s stock. The firm agreed that if Wiederhorn was terminated “for cause,” he was entitled only to his salary through the date of termination. If terminated “without cause,” he would be owed three times his $350,000 annual salary, three times his largest annual bonus from the previous three years, and any unpaid salary and bonus. “Cause” included the conviction of a felony. In 2001, Wiederhorn became the target of an investigation into the collapse of Capital Consultants, LLC. Fog Cutter then redefined “cause” in his termination agreement to cover only a felony involving Fog Cutter. In June 2004, Wiederhorn agreed to plead guilty to two felonies, serve eighteen months in prison, pay a $25,000 fine, and pay $2 million to Capital Consultants. The day before he entered his plea, Fog Cutter agreed that while he was in prison, he would keep his title, responsibilities, salary, bonuses, and other benefits. It also agreed to a $2 million “leave of absence payment.” In July, the NASD delisted Fog Cutter from the Nasdaq. Fog Cutter appealed this decision to the Securities and Exchange Commission (SEC), which dismissed the appeal. Fog Cutter petitioned the U.S. Court of Appeals for the District of Columbia Circuit for review.

**IN THE LANGUAGE OF THE COURT**

**RANDOLPH,** Circuit Judge.

* * * Fog Cutter made a deal with Wiederhorn that cost the company $4.75 million in a year in which it reported a $3.93 million net loss. We know as well that Fog Cutter handed Wiederhorn a $2 million bonus right before he went off to prison, a bonus stemming directly from the consequences of Wiederhorn’s criminal activity.

* * * Here there was ample evidence supporting the NASD’s grounds for taking action against Fog Cutter. Wiederhorn’s guilty plea, the leave-of-absence deal and its cost to the company, the Board’s determination that Wiederhorn should retain his positions with Fog Cutter, and the concern that Wiederhorn would continue to exert influence on company affairs even while he was in prison. The decision was in accordance with NASD rules giving the organization broad discretion to determine whether the public interest requires delisting securities in light of events at a company. That rule is obviously consistent with the [law], and NASD’s decision did not burden competition. [Emphasis added.]

Fog Cutter claims that it had to pay Wiederhorn and retain him because if it fired him in light of his guilty plea, it would have owed him $6 million. This scarcely speaks well for the company’s case. The potential obligation is a result of an amendment the Board granted Wiederhorn in 2003 while he was under investigation.* * * Before the amendment to Wiederhorn’s employment agreement in 2003, termination “for cause” included the conviction of any felony other than a traffic offense. In the 2003 amendment, the relevant provision allowed the Board to terminate Wiederhorn “for cause” upon conviction of a felony involving Fog Cutter. The Board had known about the investigation of Wiederhorn in connection with Capital Consultants for more than two years when it agreed to this amendment.

Fog Cutter thinks NASD’s action was “unfair.” But it was the company that bowed to Wiederhorn’s demand for an amendment to his employment agreement, knowing full well that it was dramatically increasing the cost of firing him. Now it argues that terminating Wiederhorn would have been too expensive. One is reminded of the old saw about the child who murders his parents and then asks for mercy because he is an orphan. The makeup of Fog Cutter’s Board was virtually unchanged between the time it amended the employment agreement and entered into the leave-of-absence agreement. It was, to say the least, not arbitrary or capricious for the Commission to find
Creating Ethical Codes of Conduct

One of the most effective ways to set a tone of ethical behavior within an organization is to create an ethical code of conduct. A well-written code of ethics explicitly states a company's ethical priorities and demonstrates the company's commitment to ethical behavior. The code should set forth guidelines for ethical conduct, establish procedures that employees can follow if they have questions or complaints, and inform employees why these ethics policies are important to the company. A well-written code might also provide appropriate examples to clarify what the company considers to be acceptable and unacceptable conduct.

Providing Ethics Training to Employees

For an ethical code to be effective, its provisions must be clearly communicated to employees. Most large companies have implemented ethics training programs in which management discusses with employees on a face-to-face basis the firm's policies and the importance of ethical conduct. Some firms hold periodic ethics seminars during which employees can openly discuss any ethical problems that they may be experiencing and learn how the firm's ethical policies apply to those specific problems. Smaller firms should also offer some form of ethics training to employees, because this is one factor that courts will consider if the firm is later accused of an ethics violation.

The Sarbanes-Oxley Act and Web-Based Reporting Systems

The Sarbanes-Oxley Act of 2002 requires that companies set up confidential systems so that employees and others can “raise red flags” about suspected illegal or unethical auditing and accounting practices. The act required publicly traded companies to have such systems in place by April 2003.

Some companies have created online reporting systems to accomplish this goal. In one such system, employees can click on an icon on their computers that anonymously links them with Ethicspoint, an organization based in Vancouver, Washington. Through Ethicspoint, employees can report suspicious accounting practices, sexual harassment, and other possibly unethical behavior. Ethicspoint, in turn, alerts management personnel or the audit committee at the designated company to the potential problem. Those who have used the system say that it is less inhibiting than calling a company’s toll-free number.

How the Law Influences Business Ethics

Although business ethics and the law are closely related, they are not always identical. Here we examine some situations in which what is legal and what is ethical may not be the same.

CASE 5.2 CONTINUED

that Wiederhorn exercised thorough control over the Board, and to find this troubling. We agree that the Board provided little or no check on Wiederhorn’s conduct, and that the Board’s actions only aggravated the concerns Wiederhorn’s conviction and imprisonment raised.

That Fog Cutter did not itself violate the [law] and that it disclosed the relevant events does not demonstrate any error in the delisting decision. The NASD’s rules state that it may apply criteria more stringent than the minimum [legal] standards for listing. Fog Cutter’s disclosure of its arrangements with Wiederhorn did not change the nature of those arrangements, which is what led the NASD to find that the company’s actions were contrary to the public interest and a threat to public confidence in the Nasdaq exchange.

• Decision and Remedy
  The U.S. Court of Appeals for the District of Columbia Circuit denied Fog Cutter’s petition for review of the SEC’s decision. The NASD was concerned with “the integrity and the public’s perception of the Nasdaq exchange” in light of Wiederhorn’s legal troubles and the Fog Cutter board’s acquiescence to his demands. The SEC “amply supported these concerns and was well within its authority to dismiss Fog Cutter’s” appeal.

• The Ethical Dimension
  Should more consideration have been given to the fact that Fog Cutter was not convicted of a violation of the law? Why or why not?

• The Global Dimension
  What does the decision in this case suggest to foreign investors who may be considering investments in securities listed on U.S. exchanges?

The Moral Minimum

Compliance with the law is normally regarded as the moral minimum—the minimum acceptable standard for ethical business behavior. In many corporate scandals, had most of the businesspersons involved simply followed the law, they would not have gotten into trouble. Note, though, that in the interest of preserving personal freedom, as well as for practical reasons, the law does not—and cannot—codify all ethical requirements. As they make business decisions, businesspersons must remember that just because an action is legal does not necessarily make it ethical. Look at Exhibit 5–1. Here, you see that there is an intersection between what is ethical and what is legal. Businesspersons should attempt to operate in the area where what is legal and what is ethical intersect.

Excessive Executive Pay

As just mentioned, business behavior that is legal may still be unethical. Consider executive pay. There is no law that specifies what public corporations can pay their officers. Consequently, “executive-pay scandals” do not have to do with executives breaking the law. Rather, such scandals have to do with the ethical underpinnings of executive-pay scales that can exceed millions of dollars. Such high pay for executives may appear unethical when their companies are not making very high profits (or are even suffering losses) and their share prices are falling.

Even this subject, though, does not lend itself to a black-and-white ethical analysis. As with many other things, there is a market for executives that operates according to supply and demand. Sometimes, corporate boards decide to offer executives very large compensation packages in order either to entice them to come to work for the company or to keep them from leaving for another corporation. There is no simple formula for determining the ethical level of compensation for a given executive in a given company. If a law were passed that limited executive compensation to, say, twenty times the salary of the lowest-paid worker in the company, there would be fewer individuals willing to undergo the stress and long hours associated with running major companies.

Determining the Legality of a Given Action

It may seem that determining the legality of a given action should be simple. Either something is legal or it is not. In fact, one of the major challenges businesspersons face is that the legality of a particular action is not always clear. In part, this is because there are so many laws regulating business that it is increasingly possible to violate one of them without realizing it. The law also contains numerous “gray areas,” making it difficult to predict with certainty how a court will apply a given law to a particular action.

Determining whether a planned action is legal thus requires that decision makers keep abreast of the law. Normally large business firms have attorneys on their staffs to assist them in making key decisions. Small firms must also seek legal advice before making important business decisions because the consequences of just one violation of a regulatory rule may be costly.

Ignorance of the law will not excuse a business owner or manager from liability for violating a statute or regulation. In one case, for example, the court imposed criminal fines, as well as imprisonment, on a company’s supervisory employee for violating a federal environmental act—even though the employee was completely unaware of what was required under the provisions of that act.2

The Law Cannot Control All Business Behavior

Congress, the regulatory agencies, and state and local governments do not have perfect knowledge. Often they only discover the negative impact of corporate activities after the fact. The same can be true of corporate executives. They do not always know the full impact of their actions. When asbestos was used for insulation, for example, the corporations that supplied it did not know that it was capable of causing a rare type of cancer.

At other times, though, the law is not ambiguous. Nevertheless, it may still be unable to control business behavior—at least initially.

**Breaking the Law—Backdating Stock Options**

Stock options are a device that potentially rewards hard work. Publicly held corporations offer

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2. United States v. Hanousek, 176 F.3d 1116 (9th Cir. 1999).
stock options to employees at the current price of the company's stock on the day that the options are granted. If at a later time the market price of the stock has gone up, an employee can exercise the stock options and reap the difference between the price of the options and the current market price.

In 2006, and 2007, it was revealed that a number of large corporations had backdated stock options. If stock options are granted and the price of the company's stock subsequently falls or does not rise very much, the value of the stock options is essentially zero. One way around this problem is to go back and change the date on which the stock options were granted to the employee. In other words, the date of the stock options is simply moved back to a day when the stock had a lower price than it has currently, thereby making the options valuable again.

For example, Apple, Inc., awarded its founder and chief executive, Steve Jobs, 7.5 million options in December 2001. According to the Securities and Exchange Commission (SEC), those options were subsequently backdated to October 19 of that year. The SEC further alleged that Apple's general counsel, Nancy Heinen, signed fictitious minutes stating that the board of directors had met and approved the grant on October 19. In actuality, the meeting never occurred.

As it turns out, backdated option grants are not illegal if companies follow accounting and SEC disclosure rules. As of the spring of 2007, 252 public companies had disclosed that they had undertaken internal investigations to discover if backdating had occurred without following proper procedures. The backdating scandal is another example of unethical behavior resulting in long-run profit reduction. The companies involved face more than 125 shareholder lawsuits and as many SEC investigations, plus fifty-eight Department of Justice investigations and even six criminal cases.

Misleading Regulators—The Case of OxyContin

In 1996, the pharmaceutical company Purdue Pharma, LP started marketing a “wonder” narcotic painkiller called OxyContin. This powerful, long-lasting drug provides pain relief for twelve hours. Just a few years after its introduction, Purdue Pharma’s annual sales of the drug reached $1 billion.

The company’s executives initially contended that OxyContin, because of its time-release formulation, posed no risk for serious abuse or addiction. Quickly, though, experienced drug abusers and even teenagers discovered that chewing on an OxyContin tablet or crushing one and snorting the powder produced a powerful high, comparable to that of heroin. By 2000, large parts of the United States were experiencing increases in addiction and crime related to OxyContin.

In reality, the company and three of its executives had fraudulently marketed OxyContin for over six years as a drug unlikely to lead to abuse. Internal company documents showed that even before OxyContin was marketed, executives recognized that if physicians knew that the drug could be abused and become addictive, they would be less likely to prescribe it. Consequently, the company simply kept the information secret.

On May 10, 2007, Purdue Pharma and three former executives pleaded guilty to criminal charges that they had misled regulators, patients, and physicians about OxyContin’s risks of addiction. Purdue Pharma agreed to pay $600 million in fines and other payments. The three ex-executives agreed to pay $34.5 million in fines. Once again, company executives engaged in unethical reasoning because they wanted to maximize profits in the short run, rather than engaging in behavior that would lead to profit maximization in the long run.

“Gray Areas” in the Law

In many situations, business firms can predict with a fair amount of certainty whether a given action is legal. For instance, firing an employee solely because of that person’s race or gender clearly violates federal laws prohibiting employment discrimination. In some situations, though, the legality of a particular action may be less clear.

For example, suppose that a firm decides to launch a new advertising campaign. How far can the firm go in making claims for its products or services? Federal and state laws prohibit firms from engaging in “deceptive advertising.” At the federal level, the test for deceptive advertising normally used by the Federal Trade Commission is whether an advertising claim would deceive a “reasonable consumer.” At what point, though, would a reasonable consumer be deceived by a particular ad?

In addition, many rules of law require a court to determine what is “foreseeable” or “reasonable” in a particular situation. Because a business has no way of
predicting how a specific court will decide these issues, decision makers need to proceed with caution and evaluate an action and its consequences from an ethical perspective. The same problem often occurs in cases involving the Internet because it is often unclear how a court will apply existing laws in the context of cyberspace. Generally, if a company can demonstrate that it acted in good faith and responsibly in the circumstances, it has a better chance of successfully defending its action in court or before an administrative law judge.

The following case shows that businesses and their customers have different expectations with respect to the standard of care regarding the handling of personal information. The case also illustrates that the legal standards in this area may be inconsistent and vague.

**Case 5.3 Guin v. Brazos Higher Education Service Corp.**

*United States District Court, District of Minnesota, 2006.* __ F.Supp.2d __.

**Background and Facts** Brazos Higher Education Service Corporation, which is based in Waco, Texas, makes and services student loans. Brazos issued a laptop computer to its employee John Wright, who worked from an office in his home in Silver Spring, Maryland, analyzing loan information. Wright used the laptop to store borrowers’ personal information. In September 2004, Wright’s home was burglarized and the laptop was stolen. Based on Federal Trade Commission (FTC) guidelines and California state law (which requires notice to all resident borrowers), Brazos sent a letter to all of its 550,000 customers. The letter stated that “some personal information associated with your student loan, including your name, address, Social Security number and loan balance, may have been inappropriately accessed by [a] third party.” The letter urged borrowers to place “a free 90-day security alert” on their credit bureau files and review FTC consumer assistance materials. Brazos set up a call center to answer further questions and track any reports of identity theft. Stacy Guin, a Brazos customer, filed a suit in a federal district court against Brazos, alleging negligence. Brazos filed a motion for summary judgment.

**IN THE LANGUAGE OF THE COURT**

**KYLE, J. [Judge]**

* * * [N]egligence is the failure to exercise due or reasonable care. In order to prevail on a claim for negligence, a plaintiff must prove [among other things] the existence of a duty of care [and] a breach of that duty. * * * * * [Emphasis added.]

Guin argues that the Gramm-Leach-Bliley Act (the “GLB Act”) establishes a statutory-based duty for Brazos to protect the security and confidentiality of customers' nonpublic personal information. * * * * * Brazos concedes that the GLB Act applies to these circumstances and establishes a duty of care. The GLB Act was created “to protect against unauthorized access to or use of such records which could result in substantial harm or inconvenience to any customer [of a financial institution].” Under the GLB Act, a financial institution must comply with several objectives, including:

- Develop, implement, and maintain a comprehensive written information security program that is written in one or more readily accessible parts and contains administrative, technical, and physical safeguards that are appropriate to your size and complexity, the nature and scope of your activities, and the sensitivity of any customer information at issue.

Guin argues that Brazos breached the duty imposed by the GLB Act by (1) “providing Wright with [personal information] that he did not need for the task at hand,” (2) “permitting Wright to continue keeping [personal information] in an unattended, insecure personal residence,” and (3) “allowing Wright to keep [personal information] on his laptop unencrypted.” * * * * *

The Court concludes that Guin has not presented sufficient evidence from which a fact finder could determine that Brazos failed to comply with the GLB Act. In September 2004, when Wright’s home was burglarized and the laptop was stolen, Brazos had written security policies, current risk...
Making Ethical Business Decisions

As Dean Krehmeyer, executive director of the Business Roundtable’s Institute for Corporate Ethics, once said, “Evidence strongly suggests being ethical—doing the right thing—pays.” Instilling ethical business decision making into the fabric of a business organization is no small task, even if ethics “pays.” The job is to get people to understand that they have to think more broadly about how their decisions will affect employees, shareholders, customers, and even the community. Great companies, such as Enron and the accounting firm Arthur Andersen, were brought down by the unethical behavior of a few. A two-hundred-year-old British investment banking firm, Barings Bank, was destroyed by the actions of one employee and a few of his friends. Clearly, ensuring that all employees get on the ethical business decision-making “bandwagon” is crucial in today’s fast-paced world.

The George S. May International Company has provided six basic guidelines to help corporate employees judge their actions. Each employee—no matter what his or her level in the organization—should evaluate his or her actions using the following six guidelines:

1. **The law.** Is the action you are considering legal? If you do not know the laws governing the action, then find out. Ignorance of the law is no excuse.

2. **Rules and procedures.** Are you following the internal rules and procedures that have already been laid out by your company? They have been developed to avoid problems. Is what you are planning to do consistent with your company's policies and procedures? If not, stop.

3. **Values.** Laws and internal company policies reinforce society’s values. You might wish to ask yourself whether you are attempting to find a loophole in the law or in your company’s policies. Next, you have to ask yourself whether you are following the “spirit” of the law as well as the letter of the law or the internal policy.

4. **Conscience.** If you have any feeling of guilt, let your conscience be your guide. Alternatively, ask yourself whether you would be happy to be interviewed by a national news magazine about the actions you are going to take.

5. **Promises.** Every business organization is based on trust. Your customers believe that your company will do what it is supposed to do. The same is true for your suppliers and employees. Will your actions live up to the commitments you have made to others, both inside the business and outside?

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**CASE 5.3 CONTINUED**

assessment reports, and proper safeguards for its customers’ personal information as required by the GLB Act. Brazos authorized Wright to have access to customers’ personal information because Wright needed the information to analyze loan portfolios. Thus, his access to the personal information was within “the nature and scope of [Brazos’s] activities.” Furthermore, the GLB Act does not prohibit someone from working with sensitive data on a laptop computer in a home office. Despite Guin’s persistent argument that any nonpublic personal information stored on a laptop computer should be encrypted, the GLB Act does not contain any such requirement. Accordingly, Guin has not presented any evidence showing that Brazos violated the GLB Act requirements.

- **Decision and Remedy** The court granted the defendant’s motion for summary judgment and dismissed the case. Brazos may have owed Guin a duty of care under the GLB Act, but neither Brazos nor Wright breached that duty. Wright had followed Brazos’s written security procedures, which was all that the GLB Act required.

- **What If the Facts Were Different?** Suppose that Wright had not been a financial analyst and his duties for Brazos had not included reviewing confidential loan data. How might the opinion of the court have been different?

- **The Ethical Dimension** Do businesses have an ethical duty to use enhanced security measures to protect confidential customer information? Why or why not? Does the fact that Brazos allowed its employees to store customers’ unencrypted personal information on a laptop outside the office violate any ethical duty?
6. **Heroes.** We all have heroes who are role models for us. Is what you are planning on doing an action that your hero would take? If not, how would your hero act? That is how you should be acting.

### Business Ethics on a Global Level

Given the various cultures and religions throughout the world, conflicts in ethics frequently arise between foreign and U.S. businesspersons. For example, in certain countries the consumption of alcohol and specific foods is forbidden for religious reasons. Under such circumstances, it would be thoughtless and imprudent for a U.S. businessperson to invite a local business contact out for a drink.

The role played by women in other countries may also present some difficult ethical problems for firms doing business internationally. Equal employment opportunity is a fundamental public policy in the United States, and Title VII of the Civil Rights Act of 1964 prohibits discrimination against women in the employment context (see Chapter 34). Some other countries, however, offer little protection for women against gender discrimination in the workplace, including sexual harassment.

We look here at how the employment practices that affect workers in other countries, particularly developing countries, have created some especially difficult ethical problems for U.S. sellers of goods manufactured in foreign nations. We also examine some of the ethical ramifications of laws prohibiting bribery and the expansion of ethics programs in the global community.

### Monitoring the Employment Practices of Foreign Suppliers

Many U.S. businesses now contract with companies in developing nations to produce goods, such as shoes and clothing, because the wage rates in those nations are significantly lower than those in the United States. Yet what if a foreign company hires women and children at below-minimum-wage rates, for example, or requires its employees to work long hours in a workplace full of health hazards? What if the company’s supervisors routinely engage in workplace conduct that is offensive to women?

Given today’s global communications network, few companies can assume that their actions in other nations will go unnoticed by “corporate watch” groups that discover and publicize unethical corporate behavior. As a result, U.S. businesses today usually take steps to avoid such adverse publicity—either by refusing to deal with certain suppliers or by arranging to monitor their suppliers’ workplaces to make sure that the employees are not being mistreated.

### The Foreign Corrupt Practices Act

Another ethical problem in international business dealings has to do with the legitimacy of certain side payments to government officials. In the United States, the majority of contracts are formed within the private sector. In many foreign countries, however, government officials make the decisions on most major construction and manufacturing contracts because of extensive government regulation and control over trade and industry. Side payments to government officials in exchange for favorable business contracts are not unusual in such countries, nor are they considered to be unethical. In the past, U.S. corporations doing business in these nations largely followed the dictum, “When in Rome, do as the Romans do.”

In the 1970s, however, the U.S. press uncovered a number of business scandals involving large side payments by U.S. corporations to foreign representatives for the purpose of securing advantageous international trade contracts. In response to this unethical behavior, in 1977 Congress passed the Foreign Corrupt Practices Act (FCPA), which prohibits U.S. businesspersons from bribing foreign officials to secure beneficial contracts. (For a discussion of how a German corporation ran afoul of Germany’s anti-bribery laws, see this chapter’s Insight into the Global Environment feature on the next page.)

### Prohibition against the Bribery of Foreign Officials

The first part of the FCPA applies to all U.S. companies and their directors, officers, shareholders, employees, and agents. This part prohibits the bribery of most officials of foreign governments if the purpose of the payment is to get the official to act in his or her official capacity to provide business opportunities.

The FCPA does not prohibit payment of substantial sums to minor officials whose duties are ministerial. These payments are often referred to as “grease,” or facilitating payments. They are meant to accelerate the performance of administrative services that might otherwise be carried out at a slow pace. Thus, for example,
Whether you call it immoral, unethical, illegal, or a breach of trust, bribery by any name is wrong. In recent years, officers and managing directors at several major German corporations have been investigated, arrested, and fined for bribery. One German firm that has faced numerous charges is Siemens, a venerable corporation that was founded in 1847. Siemens built the first long-distance telegraph line in Europe from Berlin to Frankfurt in 1849. Today, the company, which its almost 500,000 workers like to call the House of Siemens, has operations in communications, radar, traffic control, and cell phones.

**Corruption Charges Are Not New**

When global competition intensified in the 1980s and 1990s, Siemens began to face fierce competition from multinational giants such as General Electric. To maintain the company’s cash flow and sales dominance, some of Siemens managers started bribing potential clients—usually government agencies—to generate new business. In the early 1990s, the German government investigated Siemens’s activities and convicted nine of the company’s managers on bribery charges. The judge in the case wondered why the managers kept referring to the company as the “House of Siemens”—a name that, in the judge’s view, implies “that the firm rises above the muck of ordinary business; it conveys a sense of moral exemption and entitlement.” Of course, part of Siemens’s problem may have been the somewhat ambiguous approach to bribery taken by German law. Bribes paid to foreign officials were tax deductible in Germany until 1999.

**Unethical Actions Continue**

Apparently, Siemens did not learn its lesson, for complaints about its behavior continued. In the early 2000s, Swiss authorities began an investigation that continued for a year and a half. The allegations of corruption did not trouble Heinrich von Pierer, Siemens’s chair, however, or spur him to look into his managers’ behavior. Instead, he stated simply, “I’m aware that our organization is hard to understand for outsiders. The job of board members is primarily strategic. Going over the books is the responsibility of others.” Several years later, the company finally disclosed that about $600 million in “suspicious transactions” (read “bribes”) had been discovered.

By 2007, von Pierer had resigned, and the chief executive officer decided not to ask for a new contract. In the meantime, a German court had convicted two former Siemens executives of bribery and fined the company about $50 million.

Once again, ambiguities in German law entered the case. One former Siemens executive told the court that he did indeed authorize millions of dollars of bribes to win contracts from an Italian electric company. He insisted, though, that he did not break any laws and that the payments were not illegal because German law only forbids payments to “civil servants.” The executive contended that the payments he made to the Italian company’s managers were made to representatives of a private-sector company, not to “civil servants.” German prosecutors had to admit that the legal definition of what constitutes a civil servant allows room for interpretation.

**Bribing the Union**

Siemens executives may not have restricted their activities to bribing “civil servants” or private-sector managers. One Siemens executive, Johannes Feldmayer, has been arrested on a special type of bribery charge. He has been accused of bribing the head of a workers’ organization, a type of independent labor union. Apparently, Siemens wanted a counterweight to IG Metall, the most powerful German union, and Feldmayer allegedly oversaw the transfer of some $45 million to the independent union to facilitate this. Earlier, another major German corporation, Volkswagen (VW), faced similar charges of making illegal payments to the head of its workers council. Peter Harz, formerly VW’s head of labor relations, pleaded guilty to the charges and paid a fine of about $750,000.

**CRITICAL THINKING**

**INSIGHT INTO CULTURE**

Clearly, the corporate culture at Siemens, at least in the last few decades, did not distinguish among actions that were both ethical and legal, actions that were unethical but perhaps legal, and actions that were both unethical and illegal. What could top management at that company have done to instill a different corporate culture that would have resulted in a different outcome?
if a firm makes a payment to a minor official to speed up an import licensing process, the firm has not violated the FCPA. Generally, the act, as amended, permits payments to foreign officials if such payments are lawful within the foreign country. The act also does not prohibit payments to private foreign companies or other third parties unless the U.S. firm knows that the payments will be passed on to a foreign government in violation of the FCPA.

**Accounting Requirements** In the past, bribes were often concealed in corporate financial records. Thus, the second part of the FCPA is directed toward accountants. All companies must keep detailed records that “accurately and fairly” reflect their financial activities. In addition, all companies must have accounting systems that provide “reasonable assurance” that all transactions entered into by the companies are accounted for and legal. These requirements assist in detecting illegal bribes. The FCPA further prohibits any person from making false statements to accountants or false entries in any record or account.

**Penalties for Violations** In 1988, the FCPA was amended to provide that business firms that violate the act may be fined up to $2 million. Individual officers or directors who violate the FCPA may be fined up to $100,000 (the fine cannot be paid by the company) and may be imprisoned for up to five years.

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**REVIEWING Ethics and Business Decision Making**

Isabel Arnett was promoted to chief executive officer (CEO) of Tamik, Inc., a pharmaceutical company that manufactures a vaccine called Kafluk, which supposedly provides some defense against bird flu. The company began marketing Kafluk throughout Asia. After numerous media reports that bird flu could soon become a worldwide epidemic, the demand for Kafluk increased, sales soared, and Tamik earned record profits. Tamik’s CEO, Arnett, then began receiving disturbing reports from Southeast Asia that in some patients, Kafluk had caused psychiatric disturbances, including severe hallucinations, and heart and lung problems. Arnett was informed that six children in Japan had committed suicide by jumping out of windows after receiving the vaccine. To cover up the story and prevent negative publicity, Arnett instructed Tamik’s partners in Asia to offer cash to the Japanese families whose children had died in exchange for their silence. Arnett also refused to authorize additional research within the company to study the potential side effects of Kafluk. Using the information presented in the chapter, answer the following questions.

1. This scenario illustrates one of the main reasons why ethical problems occur in business. What is that reason?
2. Would a person who adheres to the principle of rights consider it ethical for Arnett not to disclose potential safety concerns and to refuse to perform additional research on Kafluk? Why or why not?
3. If Kafluk prevented fifty Asian people who were infected with bird flu from dying, would Arnett’s conduct in this situation be ethical under a utilitarian model of ethics? Why or why not?
4. Did Tamik or Arnett violate the Foreign Corrupt Practices Act in this scenario? Why or why not?

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**TERMS AND CONCEPTS**

- business ethics 99
- categorical imperative 103
- corporate social responsibility 104
- cost-benefit analysis 104
- ethical reasoning 103
- ethics 99
- moral minimum 107
- principle of rights 103
- utilitarianism 104
5-1. Some business ethicists maintain that whereas personal ethics has to do with “right” or “wrong” behavior, business ethics is concerned with “appropriate” behavior. In other words, ethical behavior in business has less to do with moral principles than with what society deems to be appropriate behavior in the business context. Do you agree with this distinction? Do personal and business ethics ever overlap? Should personal ethics play any role in business ethical decision making?

5-2. QUESTION WITH SAMPLE ANSWER

If a firm engages in “ethical” behavior solely for the purpose of gaining profits from the goodwill it generates, the “ethical” behavior is essentially a means toward a self-serving end (profits and the accumulation of wealth). In this situation, is the firm acting unethically in any way? Should motive or conduct carry greater weight on the ethical scales in this situation?

- For a sample answer to Question 5-2, go to Appendix I at the end of this text.

5-3. Susan Whitehead serves on the city planning commission. The city is planning to build a new subway system, and Susan’s brother-in-law, Jerry, who owns the Custom Transportation Co., has submitted the lowest bid for the system. Susan knows that Jerry could complete the job for the estimated amount, but she also knows that once Jerry finishes this job, he will probably sell his company and retire. Susan is concerned that Custom Transportation’s subsequent management might not be as easy to work with if revisions need to be made on the subway system after its completion. She is torn as to whether she should tell the city about the potential changes in Custom Transportation’s management. If the city knew about the instability of Custom Transportation, it might prefer to give the contract to one of Jerry’s competitors, whose bid was only slightly higher than Jerry’s. Does Susan have an ethical obligation to disclose the information about Jerry to the city planning commission? How would you apply duty-based ethical standards to this question? What might be the outcome of a utilitarian analysis? Discuss fully.

5-4. Assume that you are a high-level manager for a shoe manufacturer. You know that your firm could increase its profit margin by producing shoes in Indonesia, where you could hire women for $40 a month to assemble them. You also know, however, that human rights advocates recently accused a competing shoe manufacturer of engaging in exploitative labor practices because the manufacturer sold shoes made by Indonesian women working for similarly low wages. You personally do not believe that paying $40 a month to Indonesian women is unethical because you know that in their impoverished country, $40 a month is a better-than-average wage rate. Assuming that the decision is yours to make, should you have the shoes manufactured in Indonesia and make higher profits for your company? Or should you avoid the risk of negative publicity and the consequences of that publicity for the firm’s reputation and subsequent profits? Are there other alternatives? Discuss fully.

5-5. Shokun Steel Co. owns many steel plants. One of its plants is much older than the others. Equipment at the old plant is outdated and inefficient, and the costs of production at that plant are now twice as high as at any of Shokun’s other plants. Shokun cannot increase the price of its steel because of competition, both domestic and international. The plant employs more than a thousand workers; it is located in Twin Firs, Pennsylvania, which has a population of about forty-five thousand. Shokun is contemplating whether to close the plant. What factors should the firm consider in making its decision? Will the firm violate any ethical duties if it closes the plant? Analyze these questions from the two basic perspectives on ethical reasoning discussed in this chapter.

5-6. CASE PROBLEM WITH SAMPLE ANSWER

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 $121.1 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)]

- To view a sample answer for Problem 5-6, go to this book’s Web site at academic.cengage.com/blaw/clarkson, select “Chapter 5,” and click on “Case Problem with Sample Answer.”

5-7. 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)]

5-8. 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)]

5-9. Ethical Conduct. Ernest Price suffered from sickle-cell anemia. In 1997, Price asked Dr. Ann Houston, his physician, to prescribe OxyContin, a strong narcotic, for the pain. Over the next several years, Price saw at least ten different physicians at ten different clinics in two cities, and used seven pharmacies in three cities, to obtain and fill simultaneous prescriptions for OxyContin. In March 2001, when Houston learned of these activities, she refused to write more prescriptions for Price. As other physicians became aware of Price’s actions, they also stopped writing his prescriptions. Price filed a suit in a Mississippi state court against Purdue Pharma Co. and other producers and distributors of OxyContin, as well as his physicians and the pharmacies that had filled the prescriptions. Price alleged negligence, among other things, claiming that OxyContin’s addictive nature caused him injury and that this was the defendants’ fault. The defendants argued that Price’s claim should be dismissed because it arose from his own wrongdoing. Who should be held legally liable? Should any of the parties be considered ethically responsible? Why or why not? [Price v. Purdue Pharma Co., 320 So. 2d 479 (Miss. 2006)]

5-10. Ethical Leadership. In 1999, Andrew Fastow, chief financial officer of Enron Corp., asked Merrill Lynch, an investment firm, to participate in a bogus sale of three barges so that Enron could record earnings of $12.5 million from the sale. Through a third entity, Fastow bought the barges back within six months and paid Merrill for its participation. Five Merrill employees were convicted of conspiracy to commit wire fraud, in part, on an “honest services” theory. Under this theory, an employee deprives his or her employer of “honest services” when the employee promotes his or her own interests, rather than the interests of the employer. Four of the employees appealed to the U.S. Court of Appeals for the Fifth Circuit, arguing that this charge did not apply to the conduct in which they engaged. The court agreed, reasoning that the barge deal was conducted to benefit Enron, not to enrich the Merrill employees at Enron’s expense. Meanwhile, Kevin Howard, chief financial officer of Enron Broadband Services (EBS), engaged in “Project Braveheart,” which enabled EBS to show earnings of $111 million in 2000 and 2001. Braveheart involved the sale of an interest in the future revenue of a video-on-demand venture to nCube, a small technology firm, which was paid for its help when EBS bought the interest back. Howard was convicted of wire fraud, in part, on the “honest services” theory. He filed a motion to vacate his conviction on the same basis that the Merrill employees had argued. Did Howard act unethically? Explain. Should the court grant his motion? Discuss. [United States v. Howard, 471 F. Supp. 2d 772 (S.D. Tex. 2007)]

5-11. A QUESTION OF ETHICS

Steven Soderbergh is the Academy Award–winning director of Erin Brockovich, Traffic, and many other films. CleanFlicks, LLC, filed a suit in a federal district court against Soderbergh, fifteen other directors, and the Directors Guild of America. The plaintiff asked the court to rule that it had the right to sell DVDs of the defendants’ films altered without the defendants’ consent to delete scenes of “sex, nudity, profanity, and gory violence.” CleanFlicks sold or rented the edited DVDs under the slogan “It’s About Choice” to consumers, sometimes indirectly through retailers. It would not sell to retailers that made unauthorized copies of the edited films. The defendants, with DreamWorks LLC and seven other movie studios that own the copyrights to the films, filed a counterclaim against CleanFlicks and others engaged in the same business, alleging copyright infringement. Those filing the counterclaim asked the court to enjoin CleanFlicks and the others from making and marketing altered versions of the films. [CleanFlicks of Colorado, LLC v. Soderbergh, 433 F. Supp. 2d 1236 (D. Colo. 2006)]

(a) Movie studios often edit their films to conform to content and other standards and sell the edited ver-
sions to network television and other commercial buyers. In this case, however, the studios objected when CleanFlicks edited the films and sold the altered versions directly to consumers. Similarly, CleanFlicks made unauthorized copies of the studios’ DVDs to edit the films, but objected to others’ making unauthorized copies of the altered versions. Is there anything unethical about these apparently contradictory positions? Why or why not?

(b) CleanFlicks and its competitors asserted, among other things, that they were making “fair use” of the studios’ copyrighted works. They argued that by their actions “they are criticizing the objectionable content commonly found in current movies and that they are providing more socially acceptable alternatives to enable families to view the films together, without exposing children to the presumed harmful effects emanating from the objectionable content.” If you were the judge, how would you view this argument? Is a court the appropriate forum for making determinations of public or social policy? Explain.

5–12. VIDEO QUESTION
Go to this text’s Web site at academic.cengage.com/blaw/clarkson and select “Chapter 5.” Click on “Video Questions” and view the video titled Ethics: Business Ethics an Oxymoron? Then answer the following questions.

(a) According to the instructor in the video, what is the primary reason that businesses act ethically?
(b) Which of the two approaches to ethical reasoning that were discussed in the chapter seems to have had more influence on the instructor in the discussion of how business activities are related to societies? Explain your answer.
(c) The instructor asserts that “[i]n the end, it is the unethical behavior that becomes costly, and conversely ethical behavior creates its own competitive advantage.” Do you agree with this statement? Why or why not?

For updated links to resources available on the Web, as well as a variety of other materials, visit this text’s Web site at academic.cengage.com/blaw/clarkson

West’s Legal Studies in Business offers an in-depth “Inside Look” at the Enron debacle at insidelook.westbuslaw.com

You can find articles on issues relating to shareholders and corporate accountability at the Corporate Governance Web site. Go to www.corpgov.net

For an example of an online group that focuses on corporate activities from the perspective of corporate social responsibility, go to www.corpwatch.org

Global Exchange offers information on global business activities, including some of the ethical issues stemming from those activities, at www.globalexchange.org

Legal Research Exercises on the Web
Go to academic.cengage.com/blaw/clarkson, the Web site that accompanies this text. Select “Chapter 5” and click on “Internet Exercises.” There you will find the following Internet research exercises that you can perform to learn more about the topics covered in this chapter.

Internet Exercises 5–1: Legal Perspective
Ethics in Business

Internet Exercises 5–2: Management Perspective
Environmental Self-Audits
In Chapter 5, we examined the importance of ethical standards in the business context. We also offered suggestions on how business decision makers can create an ethical workplace. Certainly, it is not wrong for a businessperson to try to increase his or her firm’s profits. But there are limits, both ethical and legal, to how far businesspersons can go. In preparing for a career in business, you will find that a background in business ethics and a commitment to ethical behavior are just as important as a knowledge of the specific laws that are covered in this text. Of course, no textbook can give an answer to each and every ethical question that arises in the business environment. Nor can it anticipate the types of ethical questions that will arise in the future, as technology and globalization continue to transform the workplace and business relationships.

The most we can do is examine the types of ethical issues that businesspersons have faced in the past and that they are facing today. In the Focus on Ethics sections in this book, we provide examples of specific ethical issues that have arisen in various areas of business activity.

In this initial Focus on Ethics feature, we look first at the relationship between business ethics and business law. We then examine various obstacles to ethical behavior in the business context. We conclude the feature by exploring the parameters of corporate social responsibility through a discussion of whether corporations have an ethical duty to the community or society at large.

Business Ethics and Business Law

Business ethics and business law are closely intertwined because ultimately the law rests on social beliefs about right and wrong behavior in the business world. Thus, businesspersons, by complying with the law, are acting ethically. Mere legal compliance (the “moral minimum” in terms of business ethics), however, is often not enough. This is because the law does not—and cannot—provide the answers for all ethical questions.

In the business world, numerous actions may be unethical but not necessarily illegal. Consider an example. Suppose that a pharmaceutical company is banned from marketing a particular drug in the United States because of the drug’s possible adverse side effects. Yet no law prohibits the company from selling the drug in foreign markets—even though some consumers in those markets may suffer serious health problems as a result of using the drug. At issue here is not whether it would be legal to market the drug in other countries but whether it would be ethical to do so. In other words, the law has its limits—it cannot make all ethical decisions for us. Rather, the law assumes that those in business will behave ethically in their day-to-day dealings. If they do not, the courts will not come to their assistance.

Obstacles to Ethical Business Behavior

People sometimes behave unethically in the business context, just as they do in their private lives. Some businesspersons knowingly engage in unethical behavior because they think that they can “get away with it”—that no one will ever learn of their unethical actions. Examples of this kind of unethical behavior include padding expense accounts, casting doubts on the integrity of a rival co-worker to gain a job promotion, and stealing company supplies or equipment. Obviously, these acts are unethical, and some of them are illegal as well. In some situations, however, businesspersons who would choose to act ethically may be deterred from doing so because of situational circumstances or external pressures.

Ethics and the Corporate Environment

Individuals in their personal lives normally are free to decide ethical issues as they wish and to follow through on those decisions. In the business world, and particularly in the corporate environment, rarely is such a decision made by one person. If you are an officer or a manager of a large company, for example, you will find that the decision as to what is right or wrong for the company is not totally yours to make. Your input may weigh in the decision, but ultimately a corporate decision is a collective undertaking.

Additionally, collective decision making, because it places emphasis on consensus and unity of opinion, tends to hinder individual ethical assertiveness. For example, suppose that a director has ethical concerns about a planned corporate venture that promises to be highly profitable. If the other directors have no such misgivings, the director who does may be swayed by the others’ enthusiasm for the project and downplay her or his own criticisms.

Furthermore, just as no one person makes a collective decision, so no one person (normally) is held accountable for the decision. The corporate
enterprise thus tends to shield corporate personnel from both individual exposure to the consequences of their decisions (such as direct experience with someone who suffers harm from a corporate product) and personal accountability for those decisions.

**Ethics and Management** Much unethical business behavior occurs simply because management does not always make clear what ethical standards and behaviors are expected of the firm’s employees. Although most firms now issue ethical policies or codes of conduct, these policies and codes are not always effective in creating an ethical workplace. At times, this is because the firm’s ethical policies are not communicated clearly to employees or do not bear on the real ethical issues confronting decision makers. Additionally, particularly in a large corporation, unethical behavior in one corporate department may simply escape the attention of the officers in control of the corporation or those responsible for implementing and monitoring the company’s ethics program.

Unethical behavior may also occur when corporate management, by its own conduct, indicates that ethical considerations take a back seat. If management makes no attempt to deter unethical behavior—through reprimands or employment terminations, for example—it will be obvious to employees that management is not at all that serious about ethics. Likewise, if a company gives promotions or salary increases to those who clearly use unethical tactics to increase the firm’s profits, then employees who do not resort to such tactics will be at a disadvantage. An employee in this situation may decide that because “everyone else does it,” he or she might as well do it, too.

Of course, an even stronger encouragement to unethical behavior occurs when employers engage in blatantly unethical or illegal conduct and expect their employees to do so as well. An employee in this situation faces two options, neither of which is satisfactory: participate in the conduct or “blow the whistle” on (inform authorities of) the employer’s actions—and, of course, risk being fired. (See Chapter 33 for a more detailed discussion of this ethical dilemma and its consequences for employees.)

**Corporate Social Responsibility**

As discussed in Chapter 5, just what constitutes corporate social responsibility has been debated for some time. In particular, questions arise concerning a corporation’s ethical obligations to its community and to society as a whole.

**A Corporation’s Duty to the Community** In some circumstances, the community in which a business enterprise is located is greatly affected by corporate decisions and therefore may be considered a stakeholder. Assume, for example, that a company employs two thousand workers at one of its plants. If the company decides that it would be profitable to close the plant, the employees—and the community—would suffer as a result. To be considered ethical in that situation (and, in some circumstances, to comply with laws governing plant shutdowns), a corporation must take both employees’ needs and community needs into consideration when making such a decision.

Another ethical question sometimes arises when a firm moves into a community. Does the company have an obligation to evaluate first how its presence will affect that community (even though the community is not a stakeholder yet)? This question has surfaced in regard to the expansion of Wal-Mart Stores, Inc., into smaller communities. Generally, most people in such communities welcome the lower prices and wider array of goods that Wal-Mart offers relative to other, smaller stores in the area. A vocal minority of people in some communities, however, claim that smaller stores often find it impossible to compete with Wal-Mart’s prices and thus are forced to go out of business. Many of these smaller stores have existed for years and, according to Wal-Mart’s critics, enhance the quality of community life. These critics claim that it is unethical of Wal-Mart to disregard a town’s interest in the quality and character of its community life.

In addition to expanding, Wal-Mart has been consolidating some of its smaller stores into large “superstores.” As it consolidates, Wal-Mart is closing stores in some of the very towns in which it drove its smaller competitors out of business. This development raises yet another ethical question: Does a store such as Wal-Mart have an obligation to continue operations in a community once it has driven its competitors out of business?

**A Corporation’s Duty to Society** Perhaps the most disputed area of corporate social responsibility is the nature of a corporation’s duty to society at large. Those who contend that corporations should first and foremost attend to the goal of profit maximization would argue that it is by generating profits that a firm can best contribute to society. Society benefits by profit-making activities because
profits can only be realized when a firm markets products or services that are desired by society. These products and services enhance the standard of living, and the profits accumulated by successful business firms generate national wealth. Our laws and court decisions promoting trade and commerce reflect the public policy that the fruits of commerce (wealth) are desirable and good. Because our society values wealth as an ethical goal, corporations, by contributing to that wealth, automatically are acting ethically.

Those arguing for profit maximization as a corporate goal also point out that it would be inappropriate to use the power of the corporate business world to further society’s goals by promoting social causes. Determinations as to what exactly is in society’s best interest involve questions that are essentially political, and therefore the public, through the political process, should have a say in making those determinations. Thus, the legislature—not the corporate boardroom—is the appropriate forum for such decisions.

Critics of the profit-maximization view believe that corporations should become actively engaged in seeking and furthering solutions to social problems. Because so much of the wealth and power of this country is controlled by business, business in turn has a responsibility to society to use that wealth and power in socially beneficial ways. Corporations should therefore promote human rights, strive for equal treatment of minorities and women in the workplace, take steps to preserve the environment, and generally not profit from activities that society has deemed unethical. The critics also point out that it is ethically irresponsible to leave decisions concerning social welfare up to the government, because many social needs are not being met sufficiently through the political process.

It Pays to Be Ethical

Most corporations today have learned that it pays to be ethically responsible—even if this means less profit in the short run (and it often does). Today’s corporations are subject to more intensive scrutiny—by both government agencies and the public—than corporations of the past. “Corporate watch” groups monitor the activities of U.S. corporations, including activities conducted in foreign countries. Through the Internet, complaints about a corporation’s practices can easily be disseminated to a worldwide audience. Similarly, dissatisfied customers and employees can voice their complaints about corporate policies, products, or services in Internet chat rooms and other online forums. Thus, if a corporation fails to conduct its operations ethically or to respond quickly to an ethical crisis, its goodwill and reputation (and future profits) will likely suffer as a result.

There are other reasons as well for a corporation to behave ethically. For example, companies that demonstrate a commitment to ethical behavior—by implementing ethical programs, complying with environmental regulations, and promptly investigating product complaints, for example—often receive more lenient treatment from government agencies and the courts. Additionally, investors may shy away from a corporation’s stock if the corporation is perceived to be socially irresponsible. Finally, unethical (and/or illegal) corporate behavior may result in government action, such as new laws imposing further requirements on corporate entities.

DISCUSSION QUESTIONS

1. What might be some other deterrents to ethical behavior in the business context, besides those discussed in this Focus on Ethics feature?

2. Can you think of a situation in which a business firm may be acting ethically but not in a socially responsible manner? Explain.

3. Why are consumers and the public generally more concerned with ethical and socially responsible business behavior today than they were, say, fifty years ago?

4. Suppose that an automobile manufacturing company has to choose between two alternatives: contributing $1 million annually to the United Way or reinvesting the $1 million in the company. In terms of ethics and social responsibility, which is the better choice?

5. Have Internet chat rooms and online forums affected corporate decision makers’ willingness to consider the community and public interest when making choices? Are corporate decision makers more apt to make ethical choices in the cyber age? Explain.