# ***Business Ethics 9th edition Jennings Solutions Manual***

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# UNIT TWO – SOLVING ETHICAL DILEMMAS AND PERSONAL INTROSPECTION

## *SECTION 2A – BUSINESS AND ETHICS: HOW DO THEY WORK TOGETHER?*

Use ***PowerPoint Slide 58***.

## READING 2.1 – WHAT'S DIFFERENT ABOUT BUSINESS ETHICS?

A. The Application of Moral Standards to Business Dilemmas

B. Moral Standards are Canons of Behavior that are Neither Legislated nor Changed by Legislation

  1. Conflicts between law and moral issues: child labor

  2. Moral accountability for business conduct

C. Some Firms Adopt Just the Law as Their Standard for Ethics

D. Ethics Asks that We Go Beyond the Minimum Requirements of the Law

E. Businesses Have Organizational Factors in Addition to Individual Decisions

**Answers and Key Discussion Items**

1. *As you did in Unit 1, think of something that you did at work in the past year that may have been motivated by the economic pressures at work, but it still bothers you. For example, one manager wrote, "I disagreed with a performance evaluation of an employee, but I didn't speak up." Another wrote, "I let someone else take the blame for something I did." Fit these actions and your own example into one of the categories of ethical dilemmas in Unit 1. Then think through the reasons that you and these managers did something that later bothered you.* Use ***PowerPoint Slides 6 - 9*** for examples of categories for classification and the types of issues that are occurring in the workplace. Notice how those who offered these examples to me (anonymously) understood that they were involved in an ethical issue, but did it anyway. And, the result is, they continue to think back on it. Students will explore the psychology behind these decisions – pressures and psychology.

2. *Now think of something you did in your personal life in the past year that still bothers you. For example, one student wrote, "I lied to relatives on the phone so that they wouldn't come and visit." Another wrote, "I accepted cable I had not paid for," or " I didn't tell my wife about a bonus I received." Again, think through the categories that apply as well as the reasons for doing these things.* These examples illustrate the desire to avoid pain (bad relatives!) or avoid cost – these examples are on the slides along with others. We are always trying to avoid something when we cross these lines, even though we see the possible harms and then continue to feel guilty about it.

3. *As you think through your bothersome business and personal actions, decide whether ethics in our personal lives and business lives are really different.* Students should discuss that business ethics issues are often made to seem more complex in an effort to rationalize through the complexity or through an overarching rationalization that "Business is different." Issues are the same and motivation to avoid pain is there, but the underlying categories of honesty, false impression, etc., are still there.

## READING 2.2 – THE ETHICS OF RESPONSIBILITY

**Peter Drucker**

Use ***PowerPoint Slide 59*** – Drucker elaborates on his ethics position here.

**Answers and Key Discussion Items**

1. *Does Dr. Drucker believe personal ethics and business ethics can be separated?* Dr. Drucker believes that ethics are ethics, whether in business or as an individual. The problem is that people don't change simply because they become vice president. They simply continue doing all the things they do personally. If they lie and cheat in their personal lives, they will lie and steal in their business lives. Stiff punishments serve in personal and business lives to deter unwanted behaviors.

2. *What is the Drucker test for ethics for business managers?* Dr. Drucker's test for ethics is "above all do no harm" (*primum non nocere).* He also believes that where much is given (as with business executives) we have a right to expect more – higher standards of behavior (as with the Eton graduate).

## READING 2.3 – IS BUSINESS BLUFFING ETHICAL?

**Albert Z. Carr**

This piece generally finds students with strong feelings, both ways, about Mr. Carr's theories and approach to ethics. Encourage them, once again, to begin thinking about their values and whether they would be comfortable with Mr. Carr's approach. Use ***PowerPoint Slides 60 and 61*** to discuss some questions based on the Carr article.

**Answers and Key Discussion Items**

1. *Do you agree or disagree with Carr's premise?* Have the students discuss the implications of lying during business negotiations in order to answer this question and offer their views on Carr's premise that we are all bluffing in business and so lying is acceptable. For example, what if you relied on a seller's representation that his price was the lowest and he guaranteed that price as lowest. To save yourself some time in checking around, you rely on the seller's representation. Soon you discover another seller with the same product at a lower price. What are the implications for your relationship with that seller? What is the level of trust you have with the seller? Would you continue to do business with that seller?

   Also have the students discuss the implications of not knowing what is just a bluff and therefore part of the big business game and what goes too far. How do we know where to draw the line on what is part of the game and what is fraud?

   Have the students note that even Friedman believes fraud must not be part of business in order for the free market to function effectively. Does Carr introduce fraud into the marketplace as an acceptable part of business?

2. *Does everyone operate at the same level of bluffing?* Review with the students the difficulties in having individuals decide what is acceptable vs. unacceptable bluffing. What is bluffing and what is misrepresentation? If bluffing is acceptable, what will happen to legal standards misrepresentation and fraud?

3. *How is the phrase "Sound ethics is good business" characterized?* Carr characterizes the statement

as “self-serving calculation in disguise”. He explains that the goal is to make more money and the statement just gives a surface explanation for what is really a strong drive for success.

**Compare & Contrast**

*Carr notes that espionage has become so common that it is no longer considered an ethical issue, but an effective means of competition. Compare this comment with the list of rationalizations and apply them to the statement. What are the key differences in the two scholars' views on ethics in business? Then compare Dr. Drucker's simple means of analysis with Carr's views. Can Dr. Drucker's views help in Carr's complex situations?* Carr, with his analysis of espionage relies on the measure of “Everybody does it.” Use ***PowerPoint Slide 61*** again and discuss with the students the NFL issue involving the Patriots and their conduct. “I think all the teams do that. That's been going on forever.” Even though all the teams “were doing it,” “it” was still misconduct and the public reacted strongly to the conduct.

Drucker feels that there are absolutes in business ethics and that businesses have choices despite the pressures. Carr feels that people must succumb to pressures in business or they will never survive. Novak also rises above the either/or conundrum that Carr uses (either we bluff or we will not be successful) and calls businesses to a higher order that is not mutually exclusive with success. Carr feels you have to leave personal principles and feelings out of business. Carr proposes a sort of amoral technician mentality for business.

Dr. Drucker demands a higher standard as well – we should not hurt anyone. Carr feels that sometimes we have to hurt people if we are to stay in business. Carr advocates a sort of detached approach to business whereas Drucker asks that we have the same ethics in business as we do in our personal lives. Drucker demands more caring and feeling as a way to ensure that business survives and thrives. Carr deals with his perception of the reality of doing business – do or die.

## ***SECTION 2B – WHAT GETS IN THE WAY OF ETHICAL DECISIONS IN BUSINESS?***

Use ***PowerPoint Slide 62.***

### READING 2.4 – HOW LEADERS LOSE THEIR WAY: THE BATHSHEBA SYNDROME AND WHAT PRICE HUBRIS?

Use ***PowerPoint Slides 63 - 65***.

**Answers and Key Discussion Items**

1. *What would the role of adherence to your credo play in preventing you from losing your way?* The credo keeps you grounded. Andersen's credo was that he would never certify statements that were not accurate and yet the firm lost its way by being willing to sign off on Enron because they were willing to do so in order to keep the consulting train going. Also, the credo is a self-imposed set of rules that keeps leaders from ignoring the rules. They are willing to comply with their own rules even if they perceive others' rules to be not very important or valuable to their leadership.

2. *Looking at the list of how leaders lose their way, develop a list of actions that would stop these problems from taking hold.* Things that would help – get feedback from front-line employees and allow it to be anonymous so that employees can speak candidly. A focus on things outside of work can distract from the materialism that consumes leaders who do not keep values with them. They should also work on developing leaders within the organization in order to keep the purpose of leadership clear. Leaders should also think back to the last time they admitted they made a mistake in order to

get around invincibility. They could do the exercise with speeding from Unit One – are there areas in their business lives in which they have shifted the norm but are really pushing the envelope in terms of legality.

3. *Give examples of how leaders lost their way. David's weakness was using his power to commit adultery. Has this been a downfall for any leaders of this era? Do some leaders have too much focus on material things and amassing a fortune or "stuff"? Be sure to look for examples as you study the cases in the remaining units of this book.* Adultery is a common downfall for leaders. For example, General David Petreaus ended his career following an affair with a younger woman. President Bill Clinton was impeached following his affair with a young White House intern. Two generals were removed from office in 2016 for ongoing affairs.

   The pursuit of wealth and material goods was part of the culture at Enron. The Rigas family, in the words of a prosecutor in the case, used their company, Adelphia, as a personal "piggy bank." Kayne West experienced financial difficulties despite a $50-million fortune because of his desire for more.

**Compare & Contrast**

*William Wilberforce was a member of the British Parliament who is credited with obtaining passage of the Slavery Abolition Act of 1833 in England. Mr. Wilberforce has been identified by historians for his persistent leadership in seeing the act to passage. Mr. Wilberforce was also a philanthropist and a founder of the Society for the Prevention of Cruelty to Animals. Mr. Wilberforce died just three days after the Abolition Act was passed. What distinguishing characteristics do you see in Mr. Wilberforce that are different from the characteristics that indicate a leader is losing his or her way?* There are some obvious differences. Mr. Wilberforce's grounding came from his involvement in things other than just Parliament. That power was not the end-all to his existence. He had a purpose for his position and political power – he had a moral goal that he wanted to accomplish and he pursued that, not political power. Indeed, his career shows that he was willing to give up the trappings if he could accomplish his goal. Those around him knew him as principled and were willing to work with him because they also understood the purpose of his leadership.

## READING 2.5 – MORAL RELATIVISM AND THE EITHER/OR CONUNDRUM

Use ***PowerPoint Slide 66.***

Discuss with the students the dangers of framing an issue by "Either I do this or ________________________" with the "or" spelling out some awful fate.

**Answers and Key Discussion Items**

1. *Describe a time when you have fallen into an either/or trap.* Students often fall into, "Either I get the homework from someone else or my grade is ruined." "Either I get this job interview or my life is over." "Either I get this GPA or I can't get into law school." We define the issue in such a way that we get the answer we want because we have predicted the outcome, regardless of whether it will actually come to pass.

2. *In 2009, Ikea discovered that the Russian executive it had hired to manage its generator contracts was accepting kickbacks from the companies that wanted to do business with Ikea. What lessons should Ikea and other companies learn from this experience?* One of the lessons from Ikea's experience is that there are some countries in which you do business that the corruption is so rampant that you have to face the reality that doing business there will be a constant battle with the government as well as with employees who can be led astray by the atmosphere of corruption.

## READING 2.6 – *P = ƒ(x)* THE PROBABILITY OF AN ETHICAL OUTCOME IS A FUNCTION OF THE AMOUNT OF MONEY INVOLVED: PRESSURE

Use ***PowerPoint Slide 67***.

Discuss the research that shows a company's vulnerability to ethical missteps if the company has been on an earnings roll.

High aspirations, high expectations, and prominence are indicators of illegality.

Discuss the U-Haul truck and the eaves example.

**Answers and Key Discussion Items**

1. *Think of an example of a situation in which you resisted pressure to act unethically.* You could draw on the example of J.P. Hayes from Unit One – Use ***PowerPoint Slide 21***. John Adams, second U.S. president noted, "When conscience claps, let the world hiss." Other examples include pointing out damage on a rental car. Telling a clerk that you have been given too much change. Pointing out to the hotel desk clerk that you were not billed for your extra charges on your bill. Disclosing on a mortgage application when you are about to experience a salary reduction at work.

2. *Refer to the Goldman case in Case 2.10 and make a list of the pressures Tourre felt.* Tourre felt the pressure of his salary/compensation. He was paid $2,000,0000 per year so he was unwilling to rock the boat. He had been designated to handle an important client and a large offering – he needed to be a client pleaser. If Tourre did not perform up to expectations, then the firm might not advance him to partner. He was trying to attain a partnership.

3. *How could your credo help in resisting pressure?* Your credo helps you determine in advance what you would or would not do in a particular situation. Because you have thought about it in advance, you are not as vulnerable when the pressure hits. You are better able to resist the pressure because you have already thought through all the potential risks and that it is "so not worth it."

## CASE 2.7 – BP AND THE DEEPWATER HORIZON EXPLOSION: SAFETY FIRST

Use ***PowerPoint Slides 68 - 75.***

**Legal Issues**

A company is liable for damages and injuries caused by its failure to live up to a reasonable and prudent person standard. BP had not performed safety and inspection processes that were standard in the industry for the pipeline and the refinery. The result is negligence exposure on those events. However, the refinery is a workers' compensation issue, so the payments there will be limited to the scheduled amounts under the state system unless there is an exception for gross negligence. The Oil Spill Act covers BP's damages on the Prudhoe Bay pipe bursting and Deepwater Horizon. BP will be responsible for the cost of clean-up, but there is also the negligence liability under state law. In the Exxon case, Exxon was held liable to fishers, hunters, and others whose livelihoods were affected by the Valdez spill. BP has already starting paying these groups with the $20-billion fund. In short, there is tremendous liability exposure for BP here from state and federal laws, both statutory and through negligence standards. The classic confrontation of values occurred here in the ethical realm: safety vs. margins; inspections vs. cost savings. Conflicting values and which wins out? Again, the focus on the immediate costs was misguided because the executives failed to factor in the "what if" costs of cutting back on maintenance on the pipeline and at the refinery.

**Answers and Key Discussion Items**

1. *Discuss the ethical, negligence, and environmental issues you see in this case.* Legal issues are the compliance with OSHA safety standards, liability for spills, explosions, injuries. Negligence includes how the refinery and the pipelines and rigs were operated, whether they met statutory and industry standards. The environmental issues are the same as those for Exxon but with industry implications as the moratorium shut down all Gulf drilling.

2. *BP had rented the rig from Transocean for $500,000 per day. Transocean had been recognized by the U.S. government for its safety record. Can companies distance themselves from liability and responsibility through the use of contractors? What are the risks of using third-party contractors?* One of the provisions of codes of ethics in U.S. and international operations is taking responsibility for the conduct of contractors and not using them in an arm's length way so as to distance yourself from liability and issues. It does not work – those whose name and employees are on the operation are held responsible by the public, not the contractors. There are lessons to be learned here on carefully screening contractors.

3. *Discuss how BP got into the position in which it found itself in late 2006, and what might have prevented the spill, the financial fallout, and the loss of reputation. Be sure to factor in the financial implications of any decision made during the period from 2001 to 2006.* The conduct of BP is a classic situation in which a company focused only on the immediate costs of maintenance without taking into account the long-term implications of their failure to perform the maintenance that was costly in terms of margins but that, over the long term, would have saved them the pipeline break and possibly prevented the explosion. Both of those events were costly in terms of BP's share price as well as in the company's reputation.

   The conduct of the traders in controlling the market presented significant antitrust issues and violations of those U.S. laws.

4. *What was the impact of the emphasis on cost cutting on BP's culture? What was the impact on the company's performance?* The pressure that the company was feeling was that when oil prices were low, it had to get as much oil out there as possible to sell it to keep money coming in – no time for maintenance. When oil prices were high, it had to keep as much oil flowing as possible and even if the pipes were partially blocked, the price was so high that it was worth it to keep the oil flowing, even at a 25% rate. The following is a summary of the issues.

   - Why do people and companies make decisions, which, in hindsight, seem to be based on voids in reasoning and analysis? (drivers)
   - What were the consequences of the decision? (in cases not yet resolved, you must anticipate the consequences)
   - What are the fixes? (we are just now beginning that segment of the course)

5. *Evaluate the social responsibility positions of BP in light of the refinery explosion and the pipeline issue. What can companies learn from the BP experience?*

   Why and What They Missed (numbers issues)

   - Difficult to make pipeline maintenance worth it because when oil prices are down, expense really hurts margins; when oil prices are up, maintenance shuts off high-revenue periods and BP's margins were the worst in the industry
   - $20 per barrel and 11,000 barrels per day
   - Double whammy – for every safety/maintenance problem you solve, costs go up and revenues go down simultaneously
   - Flow was reduced to 25% – need to compute into the maintenance decisions the loss of flow and

whether there would be an economic trade-off in shutting down

- Not using industry standard for pipeline maintenance (Jack-in-the-Box risk); smart-pigging (5 yrs. 1998) (1992 no cleaning) vs. coupons
- Pipes are old (didn't expect oil fields to produce for more than 25 years so (installed in 1977), again, maintenance seemed silly for many years)
- Risk – accident rate was very low; long stretch with no events, but emotion moves public, not actual data (from 250 to 50 from 1995 to 2005); Kinder Morgan guy is right – it is safe; but data do not move cycle
- Noise was low (emotion) so long as oil prices low
- Margins at BP are 21.99 compared to 29.25 and 45.56 for competitors and 33.23 for industry; operating at 11.84 vs. 12.87; 17.43 for competitors and 18.54 for industry; EPS is at industry; PE better than competitors and industry
- Cash flow was cooking with gas (propane?) – up from 16 to 26 over two years (2003 to 2005); not a question of not having the funds for maintenance; BP made other choices on cash use (!)

<u>Issues Evolving (noise)</u>

- Should not have been "shocked, shocked" that there were problems with the pipeline
- Employee raised issue (retaliatory conduct with transfer)
- Consultant raised issue
- Hamel (complete with Hollywood connections (Spacek) and the emotion of little guy vs. big oil company and his having the trust of workers) raised issue
- Caribou accident
- Environmental groups raising corruption issue prior to caribou accident
- Alaskan officials meeting
- 1999 New Mexico accident
- Hazardous waste dump ($6.5 million plus reputation damage)
- Massey, head of board's environmental committee, writes memo on pipes

<u>Culture (why noise, apart from economics, was ignored)</u>

- Pressure from company: cost-cutting culture
- Personal pressure: salaries of workers – wanted to keep it going
- Retaliatory fits here, too
- Green company
- Halo of SR: alternative fuels investments
- Has partnership with Indiana on refinery
- Enlightened self-interest
- Sense of invincibility because of accolades (failure to meet with Alaskan officials)
- "S_____ happens" may not be the best response to the spill
- Number of institutional investors fairly low
- Propane price-fixing issue through control of supply – not done yet – more fall-out coming

<u>Consequences (also shows what they missed)</u>

- Analyst downgrades
- Market cap – share prices goes from $76.85 (year high) to $65.81 – double-digit drop – about a 15% drop in a year of record oil prices
- Capital costs increase
- Maintenance costs way up: $50 million plus 11,000 barrels per day @ $60 per barrel is $20,000,000 (July '06 – near $80) and current price is hovering at $61 - 62
- Revenues interrupted
- PR costs (BP was a big brand identity)
- Credibility lost – future in terms of ANWR

- Chief inspector took Fifth Amendment – does not bode well
- Grand jury investigations in Alaska
- Additional pipeline and maintenance regulations likely
- $6 billion plus $1 billion more in safety expenditures

In the parlance of the youth, what BP did to save maintenance costs to increase margins was "so not worth it". By this time in the course the students should be spotting a continuous theme that ethics and making money are not opposite goals – it is possible to have the two work in tandem. Indeed, when the ethical issues are not considered the result is often tremendous costs well beyond any savings achieved through the short-cuts.

The following is a memo, written at an executive level, that provides insights for the students and managers:

Why The Prudhoe Bay Spill Occurred

The operation of an oil pipeline presents unusual challenges vis-à-vis maintenance levels. When oil prices are down, extensive maintenance affects margins, with the resulting impact on profits and share price. When oil prices spike, as they did in 2006, shutting down pipelines for maintenance means both an increase in costs and a decrease in revenues. For every safety/maintenance problem that is addressed or resolved, costs increase as revenues decline. BP faced additional pressure on pipeline maintenance decisions because both its gross and operating margins were well below industry and competitor levels (33.23 vs. 21.99 and 18.54 vs. 11.84 respectively for BP vs. industry). Further, BP and other industry members could boast of a period of great progress in safety. The annual accident rate had declined from 250 in 1995 to 50 in 2005. The safety record produced a halo effect for the industry, an immunity from scrutiny with a resulting pass on the need for maintenance. Even a 1999 fatal accident at a BP facility in New Mexico did not evoke reaction or publicity.

Because of favorable circumstances and financial pressures, BP had not cleaned the Prudhoe Bay pipe systems since 1992. BP did not employ the industry standard of smart-pigging, relying rather on the less reliable coupon method. Pipeline experts agree that smart-pigging should be done at least every 5 years and is the only reliable method for detecting corrosion. BP had not done this ultrasound method since 1998. The maintenance deferrals were also justified by BP managers and employees because when the 1977 pipeline was built the estimated life of the Prudhoe Bay fields was 25 years. This anticipated failure of the oil source made maintenance seem cost ineffective, particularly as the end of the anticipated life span approached. By the time of the 2006 spill, the flow in the pipes had been reduced to 25%. With oil reaching $80 per barrel, the earlier cost/benefit analysis and maintenance deferral made even more economic sense. If the 11,000-barrel-per-day flow is combined with the $80 per barrel price during the 2006 pre-Prudhoe Bay accident, the company earned over $25,000,000 per month from the pipeline production, a figure that outweighs the fines from the spill. Further, the continuing flow, even at reduced levels, allowed the company to maintain its enviable cash position, EPS (at the industry average), and dividends.

What the Financial Analysis of Maintenance Deferral Missed

Because of the double-digit drop in BP's share price and resulting effect on capitalization, BP has been downgraded by analysts. BP faces an increased cost of capital even as it is forced to spend $50,000,000 for Prudhoe Bay repairs with a loss of about $20,000,000 in revenues (assuming a flow of 11,000 barrels, and a price @ $60 per barrel). BP has announced, in reaction to public, NGO, and regulatory noise, an additional $7 billion in refinery and pipeline safety upgrades and repairs. Additional regulations and resulting compliance with new standards will add more costs. The damage to BP's reputation and its brand reputation as a green company because of the spill and the subsequent events, such as its chief inspector taking the Fifth in his testimony, will have an impact on legislative and regulatory actions that affect BP. The award of ANWR rights, an increasingly likely scenario, could be tied to grantees' safety and environmental records, a system that would find BP beginning with a deficit.

Why BP Employees and Managers Ignored Signals of Flaws in Maintenance Analysis

The Prudhoe Bay spill should not have been a surprise. Nor is the spill explained as an unfortunate event at a good company. Over time, questions about BP's safety management and pipelines were emerging. There was the 1999 accident in New Mexico that raised flags about safety processes. In the 2003-2006 period there were several events that, if grouped and analyzed, provided a signal of the need for greater maintenance at the Prudhoe Bay pipeline. An employee, who was transferred as a result, expressed concerns about the pipeline and maintenance, as did an industry consultant. The failure of BP managers to meet with Alaskan officials regarding their concerns about pipeline safety (in conjunction with approval of the Arco merger) evidenced an insensitivity to evolving issues that resulted in increased scrutiny and activism by environmental groups, activity that became mainstream common knowledge with the spill that harmed the caribou. Just the presence of union activist Chuck Hamel (and the star power he brings through actress Sissy Spacek) was a foreshadowing of the public scrutiny BP is now experiencing. Finally, the memo and concerns of Mr. Massey, BP's board's head of its environmental committee, about the pipeline was a turning point the company missed. That memo will be used extensively in the litigation on the Prudhoe Bay spill.

The BP Culture Role in the Maintenance Analysis

Both employee interviews and press coverage indicate that BP had a "cost-cutting" culture. The quotations on cost reductions (despite the ongoing budget increases for Prudhoe maintenance) contribute to current public relations setbacks and are being used in litigation, regulatory proceedings, and, most likely, the ongoing grand jury investigation in Alaska. Generous salaries of pipeline workers, along with the transfer of a worker who raised concerns about the pipelines, served to ensure a culture of silence, something that now damages BP's reputation even further. BP enjoyed the support of environmental NGOs because of its substantial investment in alternative fuels but, as a result, it is now a target, subject to greater scrutiny and denunciation because of a perceived betrayal of trust. The BP investigations of Greenpeace and the Body Shop, along with cessation of political activities, have left BP isolated. The legal problems of the "market squeeze" by BP's propane dealers and the resulting price-fixing and stock trade investigations add to the credibility challenges, despite BP's pledge of $7 billion in safety and maintenance upgrades.

6. *What do you see happening with regulation in offshore drilling and the refinery and drilling portions of the oil and gas business?* There will be more regulation of both pipelines and refineries as well as additional inspections by government regulators. As discussed in the cycle reading, if we make good choices when there is no regulation, we can operate without additional regulation and costs. If we push the envelope in areas in which there is no regulation, the regulation comes, along with its additional costs.

7. *When does OSHA assess criminal penalties? When does the Clean Air Act require criminal penalties? Wouldn't workers' compensations cover the employees for the deaths and injuries? Why is there civil litigation?* OSHA is able to assess criminal sanctions only when the conduct is a repeat violation and/or company officials had been warned about the issues and took no action to remedy them or did not follow up with subordinates to be sure that they had been remedied. The penalties under the Clean Air Act are similarly assessed – when the company and its officials knew and continued the behavior or knew and took no action to fix the behaviors. Worker's compensation does generally cover these kinds of injuries. However, there are exceptions for criminal conduct and the fines show that there had been criminal neglect in these situations.

8. *The judge's opinion on the moratorium contained this discussion of the government's use of a report by experts on offshore drilling:*

> *Much to the government's discomfort and this Court's uneasiness, the Summary also states that "the recommendations contained in this report have been peer-reviewed by seven experts identified by the National Academy of Engineering." As the plaintiffs, and the experts*

> *themselves, pointedly observe, this statement was misleading. The experts charge it was a "misrepresentation." It was factually incorrect. Although the experts agreed with the safety recommendations contained in the body of the main Report, five of the National Academy experts and three of the other experts have publicly stated that they "do not agree with the six month blanket moratorium" on floating drilling. They envisioned a more limited kind of moratorium, but a blanket moratorium was added after their final review, they complain, and was never agreed to by them. A factor that might cause some apprehension about the probity of the process that led to the Report. The draft reviewed by the experts, for example, recommended a six-month moratorium on exploratory wells deeper than 1000 feet (not 500 feet) to allow for implementation of suggested safety measures. The Report makes no effort to explicitly justify the moratorium: it does not discuss any irreparable harm that would warrant a suspension of operations, it does not explain how long it would take to implement the recommended safety measures. The Report does generalize that "[w]hile technological progress has enabled the pursuit of deeper oil and gas deposits in deeper water, the risks associated with operating in water depths in excess of 1,000 feet are significantly more complex than in shallow water."*

*Evaluate the ethics of the Secretary of Interior regarding the representations of what the experts concluded.* Changing a report without the knowledge of its signatories is giving a false impression. This action, perhaps more than substance, contributed to the court's ruling against the Secretary. The Secretary engaged in the classic behavior of ends justifying the means. He was so committed to preventing an oil spill in the future that he was willing to misrepresent for what he felt was a greater cause. However, ethical analysis is not based on emotion. It is based on anticipating impact on others, both now and in the future and what if everyone behaved as you are?

9. *Evaluate Mr. Hayward's parting statement and his views on accountability.* Mr. Hayward offers an important lesson for all of us who are in business – we ultimately carry the accountability for these kinds of events, even when the law exonerates us or the company takes responsibility – "It happened on my watch" is a good overarching theme for thinking about ethical choices, even those that are a simple confrontation between safety and cost-cutting.

## CASE 2.8 – VALEANT: THE COMPANY WITH A NEW PHARMACEUTICAL MODEL AND DIFFERENT ACCOUNTING

Use ***PowerPoint Slide 76.***

**Answers and Key Discussion Items**

1. *List the ethical issues that you see in the case. Be sure to list them by the categories of ethical dilemmas that you studied in Unit 1.* It is not clear that Valeant was saying things that they knew were not true, but they were giving a false impression on their accounting and the role of Philidor. Information was hidden about the nature of investigations and subpoenas and its interest in Philidor. A great deal of financial information was withheld within the context of the mergers and acquisition growth model. The marketing and payment processes may have taken unfair advantage of both patients and insurers. Possibly violating the rules – with respect to the GAAP issues. It may have been a conflict of interest for Valeant to have the Philidor relationships and certainly one to not disclose its interest in that firm and option for acquisition. Balancing ethical dilemmas is another – there is a responsibility for the company to make a profit, but there are also questions about the pricing for the drugs that they were selling, which, in some cases, were life-saving.

2. *What issues did Valeant miss in its decisions on accounting practices and pricing of its drugs?* The issues that Valeant missed were related to trust in the market. The company was too clever by half in its accounting policies – they were able to make the numbers look great, but were hiding behind those great numbers the reality of where they really were in terms of financial performance.

3. *Why is transparency an issue for publicly traded companies? What credo ideas do you learn from this case?* Transparency is an issue because trust is at the heart of markets – people invest fundamentally because they trust. Once burned, investors turn away – the sell-off of the stock is an indication of what the lack of transparency can do. Some credo ideas: I will always present a full, fair, and accurate disclosure in my financial reports. When I have information that could affect the stock value, I will always comply with disclosure requirements and public disclosure. I would never withhold information from shareholders and the markets.

4. *In this case, the health of the CEO was an issue, and its disclosure was tricky for the company because the company had been through some rough waters in terms of its accounting and business model. See text for the table reflecting disclosures that have been made in the past when CEOs have been ill. PR experts say that when a high ranking executive leaves a company, there are two standard phrases used: "spending more time with family" and "pursuing other interests." However, neither phrase proves to be true and indeed may be a temporary face-saving measure for an executive or company in trouble. For example, Jeffrey Skilling, the now-convicted former CEO of Enron, left the company just months before its collapse with the first phrase of "spending more time with his family." The termination agreements are required by regulators and must give a reason, but one PR expert notes, "Who are they kidding?" After viewing examples and consequences in the table, discuss what ethical categories apply and why proper handling of these issues is so important to companies.* Use ***PowerPoint Slides 77 – 84***. There is a balancing of issues – privacy of the leaders on their medical conditions with the importance of their role in the company and the impact their absence would have – whether temporary or permanent (Apple). There are the issues of false impression, withholding information and disclosing information. There are also regs to consider – the SEC requires that companies announce material information and there is no doubt that the information about their health is material. DImon and Blankfein appear to have been the most transparent about their treatment, conditions, and tests.

## SECTION 2C – RESOLVING ETHICAL DILEMMAS IN BUSINESS

Use ***PowerPoint Slide 85****.*

### READING 2.9 – FRAMING ISSUES CAREFULLY: A STRUCTURED APPROACH FOR SOLVING ETHICAL DILEMMAS AND TRYING OUT YOUR ETHICAL SKILLS ON AN EXAMPLE

Use ***PowerPoint Slide 86*** – "Steps in Ethical Analysis."

1. Do your numbers – figure out costs of doing something and not doing something – including longer term impacts. Be sure to consider the impact on those not specifically mentioned in the case. For example, product safety issues don't involve just engineers' careers and company profits, shareholders, customers, customers' families and even communities supported by the business are affected by a business decision on what to do about a product and its safety issue.

2. Recall the categories and apply the categories to be sure you have spotted the issues.

3. Apply all the questions to see what you might have missed in analyzing.

4. Check for those warm language labels and rationalizations that may find you overlooking an issue as you find comfort in avoiding real analysis.

5. Be sure to consider other cases you have or will study and whether those historical precedents might be of help in analyzing your present situation and dilemma.

6. Bring in other areas of business to be sure you are looking at the ethical issue fully. For example, consider any strategic advantages in your decision. Be sure to apply economic principles to proposed actions. Think through the organizational behavior implications of your decision. In other words, integrate what you know about business as you analyze from an ethical perspective.

7. Watch the framing of the issue. Make sure that you are zeroing in on the issue itself and not what you see as consequences for public disclosure of the issue.

**Answers and Key Discussion Items**

*Review these examples side by side. Make a list of your answers to the components of analysis discussed in this reading.*

| | |
|---|---|
| *Example 1—The Bakery*<br><br>*"When working at a bakery, I was asked to repackage the old bread/cake and make it look nice and sell that first to the customers."* | *Example 2—The Real Estate Financing Deal*<br><br>*"I was asked to 'fudge' information and a bid value for a private equity firm that I interned for. When creating the investment teaser and memoranda for the investors, I listed the analyst's experience in real estate that was longer than what they actually had. And I worked backwards from a final bid value of £90 M rather than reach an intrinsic value from assumptions because 'that's the number we need to get past the first round.'"* |
| | |
| Withholding information | Withholding information |
| False impression | False impression |
| Saying things you know are not true | Saying things you know are not true |
| Taking unfair advantage | Taking unfair advantage |
| Hiding information | Hiding information |
| Condoning unethical actions | |
| Costs customer money | Could cost customer more money |
| | Sophisticated investor |
| When they find out, loss of trust | When they find out, loss of trust; possible securities law violations |
| Impact on reputation | Impact on reputation |

## CASE 2.10 – WHAT WAS UP WITH WALL STREET? THE GOLDMAN STANDARD AND SHADES OF GRAY

Use ***PowerPoint Slides 87 - 117***.

**Legal Issues**

Sophisticated investor: Goldman used the area of sophisticated investor – the definition to escape full disclosure to its client. Their offerings were made to "sophisticated investors" and Goldman did not disclose the full extent of its position in the investment or market. The Dodd-Frank Wall Street Reform Act has clarified the definition of "sophisticated investor" so that firms are less able to withhold information from investors.

Analysts and two opinions: Goldman did not follow the rules on consistency between the analysts' internal discussions and communications and external recommendations as the SEC rules require because it referred to a certain group as strategists. If they were not analysts in name then the rules did not apply to them.

Auction rate securities: Interestingly, on the auction rate securities issue, it took state law to result in a settlement of these issues. The SEC struggled with applying laws and regs to this practice of bidding up the price and then not buying. The nondisclosure to clients was that Goldman was bidding on the securities, but Goldman's and others' position was that there are always investment houses bidding in such auctions.

IPO allocation and structure of the market: The IPO structure was also eventually settled, but for relatively small fines with new rules on IPO allocations and agreements between clients on second-wave arrangements to buy more.

IPO profitability changes prior to IPO: The change in the profitability standard to one quarter was an interesting legal issue because the information on these dot-coms was always disclosed – the financials were there for investors to see. However, Goldman did not disclose its gradual drift from three years of profit to one year to one quarter. Investors assumed the vetting that had existed in the past.

Partnership to corporation structure: The change at Goldman from partnership structure, where the principals put everything they owned on the line, to corporation, by which they were shielded from liability, was one that allowed for greater risk with little downside for the principals. The new legal structure with limited liability resulted in the riskier strategies that the firm took.

**Answers and Key Discussion Items**

1. *Go back through the case and make a list of each action or practice that could be called a gray area.* See the legal issues listed above under "Legal Issues" and discuss how Goldman fell into the gray. Also discuss how folks were misled.

2. *Evaluate each of the actions or practices, using ethical analysis models other than the question, "Is it legal?"* Most of the issues involved nondisclosure of facts that an investor would have deemed important in making their investment decisions. The category, for the most part, was false impression because the investors were not aware of Goldman's positions in the market or that it had found a way around candor about its internal discussions on risk and the quality of instruments as well as the direction of the market. There is also a good point to discuss "moral hazard" and how allowing AIG to be bailed out provided cover for Goldman on its activities. The "too big to fail" issue arises in this discussion because investors lost money, but Goldman was protected. The front-page-of-the-newspaper test is a good one here because the headlines were not flattering to Goldman. The questions of the senators reflect the struggle with people trying to understand how what Goldman did could comply with the law but still seem so deceptive. The law is but one part of ethical analysis. Over the long term, Goldman failed to think through the consequences of additional regulations, the fines, and the loss of clients because of the perception that Goldman could not be trusted and may not always be acting in its clients' best interests.

3. *List all those who were affected by the Goldman gray areas you have found. Describe the impact of Goldman's strategies and products up and down the economic chain.* Those affected by Goldman strategies and gray areas: investors, the market, the U.S. economy and the global economy, AIG, AIG investors, employees of AIG and other companies and investment banks that had to be dissolved or acquired or reduced in size, employees of dot-coms, beneficiaries of donations by companies and investment bankers (nonprofits) (also affected because they had their endowment funds invested), real estate market because of the impact in value, all those affected by a downturn in the real estate market including real estate agents and brokers, contractors, furniture and window covering companies, decorators, landscapers, etc. Students can create flow charts to show the ripple effect of these behaviors.

4. *What factors in the Goldman culture influenced the decisions of the employees, executives, traders, and advisers?* The factors that influenced their decisions were the management mantras of "Filthy rich by 40," and the incentive structures that produced so many millionaires so early in their lives. Goldman was also a "toes to the line" culture – finding the next big loophole to use. The culture was also, "If it's legal, then it's ethical."

5. *During the April 2010 hearings on Goldman's CDO transactions, Senator Claire McCaskill said to Mr. Blankfein as he testified before Congress, "It feels like you guys are betting on the game you're playing," and securities law expert, Professor John Coffee, said, "I think we're seeing another one of those periodic eruptions because we see this story of investment bankers who seem to be playing both sides against the middle, and the investor looks like a sucker."*

   *The SEC complaint on the Goldman CDOs paints a picture of a company playing both sides of a deal even as it knew the hands both sides were playing. Senator John Ensign, a senator from Nevada, was offended when other senators referred to Goldman's operations as akin to running a Las Vegas casino, because he said it was an insult to the casinos. Continuing the metaphor, Senator Ensign explained that Goldman was running the casino and using an eye-in-the-sky to figure out any hand played by its patrons. Gambling math does give the house a leg or two up anyway, but the SEC complaint paints a picture of investors never having a chance because the other side not only knew the hand they played but the other side, Goldman, was setting up the cards to be dealt and the nature of the deck before the game began.*

   *Think back to the Albert Carr reading on ethics in business (Reading 2.3), and apply it to what happened in the CDO market. Was Goldman just bluffing, or did it have cards up its sleeve? Evaluate Mr. Blankfein's statement that Goldman does not have disclosure responsibilities to those who are "qualified" or "sophisticated" investors under SEC rules.* The Goldman behaviors are a classic illustration of Carr's theories. Was it just bluffing for Goldman to not disclose its positions or was it a card up the sleeve? Not everyone knew the rules of the Wall Street game – the large investment bankers clearly did from their involvement in IPOs to auction securities to their structuring of the CDOs. However, these investments made their way to the retail level where the knowledge base was just not there. Goldman and others believed them to be sophisticated investors by definition and it was not necessary to disclose. However, that definition is now changed and more disclosure will be required because they clearly did not understand the double positions.

6. *Howard Chen, a banking analyst, issued these observations on the Goldman settlement: (1) He observed that there would be no management changes at Goldman and (2) said, "We do not anticipate any material long-term impact to the firm's client franchise." What concerns do you have about these perhaps very accurate observations about the settlement?* The translation of these two sentences is that the culture that existed at Goldman before will remain, with all the drive to success and that Goldman does not feel that its client base will be affected. In other words, Goldman emerges with a fine but little contrition and a plan to go forward with the status quo. The lessons learned do not seem to be there.

7. *In one of his e-mails, Fabrice Tourre, who made $1.7 million in 2007, the year of the Paulson deals, wrote, "… not feeling too guilty about this, the real purpose of my job is to make capital markets more efficient and ultimately provide the US consumer with more efficient ways to leverage and finance himself, so there is a humble, noble, ethical reason for my job ;). amazing how good I am in convincing myself." Describe his method of ethical analysis.* Fabrice was using a complex form of rationalization – he believed that what he was doing improved the world because high finance allowed everyone in the U.S. to improve his or her lot in life through investments. This mantra was something that was repeated throughout the Goldman culture – Mr. Blankfein believed that he was doing God's work. This assurance allows them to continue with the gray area activities because the cause has been defined as noble.

**<u>Compare & Contrast</u>**

*Senator Susan Collins of Maine posed a question to several Goldman executives during the April 2010 congressional hearings, "I understand that you do not have a legal fiduciary obligation. But did the firm expect you to act in the best interests of your clients as opposed to acting in the best interests of the firm? Could you give me a yes or no [as] to whether or not you considered yourself to have a duty to act in the best interests of your clients?" Fabrice Tourre responded only with, "I* *believe we have a duty to serve our clients well." Mr. Blankfein responded with the following, "While we strongly disagree with the SEC's complaint, I also recognize how such a complicated transaction may look to many people. To them, it is confirmation of how out of control they believe Wall Street has become, no matter how sophisticated the parties or what disclosures were made. We have to do a better job of striking the balance between what an informed client believes is important to his or her investing goals and what the public believes is overly complex and risky." Other Goldman executives provided the following responses to Senator Collins, "It's our responsibility . . . in helping them transact at levels that are fair market prices and help meet their needs," and "Conceptually it seems like an interesting idea."*

*In another e-mail, Mr. Tourre wrote, "I'm [sic] managed to sell a few abacus bonds to widows and orphans that I ran into at the airport, apparently these Belgians adore synthetic abs cdo2" (June 17, 2007). What is Senator Collins asking of the Goldman executives in terms of what you have learned about stakeholders and ethical analysis? Evaluate Mr. Tourre's and Mr. Blankfein's postures and those of the other Goldman executives on the role of business in society. Given the regulation that resulted from the Department of Labor, discuss whether the outcome showed that they served their shareholders first.* Senator Collins has pointed out that there was no legal fiduciary duty but she was asking whether Goldman needed to act in its clients' best interests as a matter of good business practice. As the discussion indicates, Goldman struggled with that answer and could only conclude that it was "an interesting idea." Goldman has a sort of survival-of-the-fittest mentality about the markets. However, it is not factoring in the new regulations, the changes in the market so that it can no longer occupy those legally gray areas and will be required to compete on a different basis other than loopholes. This is a good example for discussing self-interest vs. selfishness – the Ayn Rand model.

## CASE 2.11 – PENN STATE: FRAMING ETHICAL ISSUES

### Legal Issues

Penn State has already settled a number of cases related to the conduct of the former assistant coach. There are other claims that will go to trial or be settled because there is liability for injury that results from the failure to fulfill your duties.

Use ***PowerPoint Slide 118*** to keep the identity of so many people involved in the situation clear.

Organizations that experience ethical lapses that bring them front-page/Huffington Post headlines have common practices and issues. Penn State is now grappling with the departures of its president, athletic director, longstanding head football coach, Joe Paterno, and a vice president following criminal charges of child sexual abuse against a former assistant football coach. Penn State lost so many leaders because two of them face criminal charges related to their alleged failure to take action to stop the child sexual abuse, some of which may have occurred on the campus.

MF Global's bankruptcy trustee is hard at work trying to find $1.2 billion in missing client funds. MF Global collapsed after the firm's former chairman, Jon Corzine, bet wrong on Greek government debt. Oddly, Mr. Corzine bet the funds would increase in value. Mr. Corzine has resigned, and it would be easier to list the federal agencies not investigating MF Global as opposed to listing those that are. From the SEC to the FBI to Congress, MF Global is under the microscope.

What do a hedge fund and a university have in common? Well, both are facing the clean-up from accusations that destroy reputations and, in MF Global's case, the ability to move forward. However, both may well be in their pickles because of decisions made as their ethical collapse lurched forward. One clear common factor and a certain precursor to headline ethical issues is the termination of dissenters. Silence those who raise issues within your organization and, well, you end dissent. Organizations with monolithic views are organizations that are vulnerable to ethical lapses.

Mr. Corzine fired his chief risk officer because, well, that chief risk officer had the temerity to disagree with Mr. Corzine on the Greek bet. Penn State's standards and conduct officer clashed repeatedly with Coach

Paterno over the level of discipline that was appropriate for student-athletes who violated the university's code of conduct (and worse). At one point, Dr. Vicky Triponey wrote to the now-departed university president about her concerns following assaults by football players on other students, "I would respectfully ask that you do something to stop this atrocious behavior before this team and an entire generation of Penn State students leave here believing that this is appropriate and acceptable behavior within a civil university community." Dr. Triponey would then resign, citing "philosophical differences."

The resignation or termination of dissenters, of course, ends dissent from the departed ones. However, their departure also puts a big damper on remaining employees' willingness to raise concerns. In short, get rid of those who disagree and disagreement ends. When disagreement ends, perspective departs. And when perspective departs, well, you find yourself betting on a failing Greece and failing to report conduct that makes us shudder.

Don't drive out the dissenters – let 'em speak, early and often.

**Answers and Key Discussion Items**

1. *"Penn State is an honorable institution that is trying desperately to defend it's [sic] ethics and all of the individuals who had nothing to do with this horrific scandal, which have been destroyed by the actions/inactions of a few individuals … "*

   *The quote comes from a blog on the Penn State scandal. Evaluate the accuracy of the blogger's thoughts. Why does it happen that many are punished for the actions of a few? Or is that an accurate assessment − is it the actions of a few?* The blog quote is not unusual. The comment to the blog has expressed what I hear from many employees who find themselves coping with their organizations' ethical and/or legal lapses that make their way to the front page of the newspaper or become the first story on The Huffington Post. Quite simply, these employees are saying, "Hey, I didn't do it!" "We're not all like them!" and "Other than this, we are an honorable [company][hospital][university]. . . !"

   The employees are quite correct. Fully 99.94% of the folks who work at Penn State were nowhere near the showers, the athletic department, or the non-profit the assistant coach founded that allegedly became his source for these young boys. Penn State employees who did nothing wrong are painted with the same broad brush. They simply did not have and could not have access to people and information that would have allowed them to realize the awful things that were going on at an organization they valued as they toiled under leaders they respected. Stop! No more!

   Therein lies the problem. The hard truth is that you can never know everything that any one of tens or hundreds of thousands of employees is doing. Look at the difficulty pharmaceutical firms have in reining in sales forces. Read the newspaper on any given day and you will find another company admitting to FCPA violations because of bribery by employees that somehow got away from them. As this goes to press, a former senator, governor, and head of Goldman Sachs is trying to explain how $1.2 billion in customer funds invested at MF Global has gone missing. That missing part is where we need to channel innocent employees' frustration.

   My response to employees who are outraged about very public missteps by isolated employees and defensive about their organizations' reputation is simple, "I could talk myself blue defending you and nothing would take. The way to prove that this was indeed an isolated incident, thereby re-earning that reputation is to try a little soul-searching, "'How did this happen?' "'What did we miss?'" If we fail to explore this question, "Could this have been prevented?", we continue to chase the tiger by the tail, chalking up the incident to a black-swan type of event that no one could have prevented. We are usually wrong when we try to depict ethical and legal missteps as black-swan events that no one saw coming.

   Another hard truth is that we can always learn by finding missteps and then proceed to fix the processes and procedures. What is traveling as a wave across the nation's colleges and universities is this question, "Do we have a Penn State problem?" Colleges and universities are sending around e-mails to all hands advising, “If you see something, speak up.” Oh, and, “Here’s the person to whom you speak up!” Colleges and universities are raising money to help child sexual abuse victims. Such an approach is far too narrowly focused. The end result of these efforts will be higher reporting of sexual abuse crimes and activities. There is nothing wrong with addressing child sexual abuse, and emphasize the obligation to report such abuse. However, if we are to escape the next great scandal, we are already behind if we are looking for child sexual abuse. Another hard truth is that you never know what the next ethical or legal issue will be. What we need are the systemic fixes that can catch any sort of misstep.

Penn State’s experience provides a classic case study in answering, “What Did We Miss?” A cursory view of the Penn State case finds the following:

- The former general counsel for Penn State University served as the attorney for The Second Mile, the charity the former assistant coach founded and with which the young alleged victims were associated. He was general counsel for both Penn State and the charity when he reviewed the Penn State police report in 1998 on the assistant coach’s behavior with these young boys.
- A janitor witnessed the alleged sexual contact of the former assistant coach with a young boy in the campus athletic department showers and was visibly shaken by what he had seen, but there was no follow-up on his concerns.
- Other staff members who witnessed behaviors by the assistant coach explained that fear of termination prevented them from reporting the incident further.
- The young graduate assistant who told Mr. Paterno that he saw “severe sexual acts” between the young boy and the assistant football coach explained that he could use certain terms in talking with the coach and that he only reported it to Mr. Paterno despite being disturbed that the assistant coach was still on the campus.
- Students at Penn State rioted following the announcement of Mr. Paterno’s termination.
- Penn State’s former standards and conduct officer clashed repeatedly with Mr. Paterno over the level of discipline that was appropriate for student-athletes who violated the university’s code of conduct (and worse). Vicky Triponey wrote in an e-mail that Mr. Paterno had, "no interest, (or business) holding our football players accountable to our community standards. The Coach is insistent he knows best how to discipline his players…and their status as a student when they commit violations of our standards should NOT be our concern…and I think he was saying we should treat football players different from other students in this regard." Dr. Triponey resigned in 2007, citing “philosophical differences.” The investigation resulted in the release of e-mails, one of which Dr. Triponey wrote to the former Penn State president expressing her concern about the culture, “I would respectfully ask that you do something to stop this atrocious behavior before this team and an entire generation of Penn State students leave here believing that this is appropriate and acceptable behavior within a civil university community.” She was addressing the conduct of six football players in beating other students in their apartment. Mr. Paterno’s lawyer responded by indicating there was context for these issues and that the coach had produced many successful student-athletes.

There it is again – that rationalization! "Why let one thing outweigh so much good? So there were a few beatings. Look at the good Coach Paterno has done.” To offer this type of a response is to sentence ourselves to future missteps.

As we glance down this list, the systemic issues are obvious. At the top of the organization there was a tin ear when it comes to conflicts. The general counsel for a foundation founded by the suspect in a university police report should not be reviewing that report.

There was a lack of follow-up on employee concerns that were reported. There was a culture of fear and silence that left frontline employees (those who are most likely to have the information we need to stop and/or correct behaviors) unwilling to disclose even the most deviant behaviors. The university official responsible for the enforcement of standards expressed frustration and concerns over at least a two-year period and resigned in the midst of a controversial case citing “philosophical differences.”

Perhaps the riots following Mr. Paterno's termination provide the greatest systemic insight. Information had surfaced that alleged horrific acts against children had occurred on the Penn State campus and that, despite knowledge, no meaningful action was taken to stop abuse that would continue elsewhere. The riots should have been about the harm to the victims. Instead the riots were over the loss of a football coach. Here was a culture that was overpowered by the star power of Mr. Paterno as well as the lure of the pedestal and funds that a successful college football team brings to a university. A university community, at best, turned a blind eye to conduct that made those who allegedly witnessed it physically sick. And, at worst, this university and a few of its employees may have enabled such conduct. Indeed, the conduct was allowed to continue for years following the university's inaction.

"Yes, but we are a good organization with a great reputation," goes the outrage from employees who were not directly involved. One final hard truth is that no organization is perfect. Those organizations that avoid top-fold, front page scandals are those that respond when a janitor raises a concern, when a graduate student reports graphically on the conduct of an assistant coach, when the general counsel has dual roles in a matter under review, or when the chief compliance officer resigns. Saying, "But we didn't do it!" will not prevent the next misstep. The key is for good employees to backtrack with a singular focus, "What did we miss that resulted in this scandal?"

There is always a path. There were always precursors. There is always work to do in making sure that employees are comfortable raising issues and that someone addresses those issues. Cultures are tricky things; they can get away from us and when we lose them, as Penn State did, we open the door for that one employee to hurl us onto the front page. You cannot know what every employee is doing every minute, but you can have the systems and culture in place to allow that information to get to where it needs to be addressed and, hopefully, stopped.

2. *Oregon State President Ed Ray, who announced the Penn State sanctions, said that what happened occurred because of the Penn State culture, that the football program had consumed the values of the university. What does he mean? What can you point to in the case that illustrates his point?* The cultural issues in the case are fascinating – Why was a report not filed when the first incident came to the attention of the administrators? Why were they so "humane" with Sandusky? Why didn't the local people, the social worker and others, take action? Why wasn't the board informed? Why did administrators frame the issue in terms of protecting Penn State instead of protecting the young boys? The culture was protection of the players and the football program, regardless of harms to others and signals sent through inaction. Other issues, such as those raised by Dr. Vicky Triponey, were warnings about the ethical priorities on the campus and its culture – that should have been a sign of things to come.

3. *List all of the categories of ethical issues you see that occurred over the course of the events.* Giving or allowing false impressions, saying things that you know are not true, interpersonal abuse, organizational abuse, conflicts of interest, failure to balance ethical dilemmas by considering the impact on all involved, personal decadence, failure to speak up when you see an ethical issue – this case has virtually all the categories of ethical dilemmas.

4. *Make a list of all the stakeholders in this case.* The stakeholders are the boys, their families, members of the community, businesses in the community, students, current players, prospective players, the NCAA, taxpayers who support state-funded universities, law enforcement agencies, elected officials.

5. *What does the case teach us about the importance of speaking up? Of raising objections? Give examples of why people did not speak up in this case.* The case teaches us that we not only have an obligation to speak up – that we need to keep speaking up until a problem is resolved. The damage that was done after several incidents might not have occurred had those involved raised the issue and continued to raise it until it was resolved.

6. *What do you learn about the differences between legal and ethical conduct from this case?* Despite all the litigation, the parties have ended up settling a great deal. Those who have gone forward –

McQueary and Spanier have found it a tough slog with all the motions and litigation. Also, proving a crime is tough – what may look to be the wrong conduct – protecting a coach or employee does not necessarily rise to the level of criminal conduct.

## CASE 2.12 – DEFLATEGATE AND SPYGATE: THE NEW ENGLAND PATRIOTS

Use ***PowerPoint Slides 119 and 120***.

**Answers and Key Discussion Items**

1. *What significance do you attach to Tom Brady's answer, "I don't believe I cheated"?* Have the students discuss how they would answer if they were accused of cheating and they did not indeed cheat. Would their response be similar? Have the students address Tom Brady's unwillingness to turn over his text messages and cell phone to the investigator.

2. *Evaluate how the legal issues ended up vs. the ethical issues that you see and discuss the issue of proof.* This concept is important for the students to understand. Following the law and meeting legal standards is but one test for ethics. We can do many things that harm others, but may not violate the law (adultery discussed in Unit 1). Discuss with them the high legal standards and the notions of fairness, forthrightness and the other qualities discussed in the reading on the make-up of an ethical person.

3. *Is there anything that a credo might have helped with in this situation?* A credo that deals with whether you would ever violate the rules of a game to win. Be sure to address with the students all the rationalizations that are in this case : "Everybody does it." So, why have the rules? "It really could not make that much of a difference." So, why do it? "Who's to know?", etc.

## CASE 2.13 – DAMAGING REVIEWS ON THE INTERNET: THE REALITY AND THE HARM

Use ***PowerPoint Slide 121***.

**Answers and Key Discussion Items**

1. *What can you think of as a defense for someone who posts a review and whose identity is revealed to the business?* Sometimes their anger about being treated unfairly results in perceptions that may not include all the facts. As noted, some of this is opinion and those opinions may not reflect what truly happened.

2. *Discuss the ethics of companies whose business it is to write negative reviews for competitors in order to increase business?* These reviews are false impressions and taking unfair advantage – no one can find the reviewers, and the praise is there. Is this fair competition? if you were a business owner how would you feel about business obtained using these tactics? Competition on the merits or on out-maneuvering the other party?

3. *Evaluate whether you have been fair in your own posted evaluations of businesses. If you were the business owner, how would you feel about the review that you wrote?* A little introspection here – sometimes we are so angry about what happened that we get carried away – state the facts and all the facts then draw your conclusions so that those who seek reviews can make judgments about the company based on accurate information and fair opinions.

# *Business Ethics: Cases and Selected Readings,* 9th Ed.

Marianne M. Jennings

## Unit 2

## Solving Ethical Dilemmas and Personal Introspection

# Section A: Business and Ethics: How Do They Work Together?

# Reading 2.2: Peter Drucker

- *Primum Non Nocere* – Above all, not knowingly do harm

# Reading 2.3: Carr Dilemmas

- Would you dye your hair to look younger?
- What about contact lenses?
- What about covering up tattoos for an interview?
- Would you donate to a political candidate you do not support personally because your employer asked you to make that donation?

# Carr and Rationalizations

**“Everybody else does it.”**

*“I think all teams do that. That’s been going on forever.”*

Jacksonville Coach Jack Del Rio on the Patriots’ videotaping to steal defensive signals

*What is right is right even if no one is doing it.*

*What is wrong is wrong even if everyone is doing it.*

Source unknown

# Section B: What Gets in the Way of Ethical Decisions in Business?

# Reading 2.4: How Leaders Lose Their Way

- Even the largest missteps start with small, seemingly inconsequential, decisions
- Review the “first step” and “initial decision” materials from Unit One
- Review Andersen story

# How Leaders Lose Their Way

- Unwillingness to tolerate dissent
- Losing their good purpose
- Disregard for the rules
- Sense of self comes from the trappings of success
- Sense of invincibility

# Victims of the Bathsheba Factor

- Mark Hurd – HP
- Raj Rajaratnam – Galleon Hedge Fund
- Phil Condit – Boeing
- Michael Sears – Boeing
- Harry Stonecipher – Boeing
- Richard Scrushy – HealthSouth
- Steven J. Heyer – Starwood Hotels
- Al Dunlap – Scott Paper and Sunbeam
- Enron – most of the senior team
- Thomas Coughlin – Walmart
- Gustavo Martinez – J. Walter Thompson
- Steven Nardizzi – Wounded Warrior
- Marcelo Odebrecht – Odebrecht SA “the Prince of Contractors”
- Aubrey McClendon – Chesapeake Energy
- Scott Thompson – Yahoo
- Major General David Haight
- Major General Ronald F. Lewis
- Governor Robert Bentley (Alabama)
- Lee Jae-yong, Samsung CEO
- James Staley –CEO Barclays
- David Petraeus – CIA
- Dennis Kozlowski – Tyco
- Bernie Ebbers – WorldCom
- John Thain – Merrill Lynch
- Mike Lynch – Autonomy
- Bernie Madoff –Madoff Securities
- Brian Dunn – Best Buy
- John Browne – BP
- Chris Albrecht – HBO
- Mark Everson – American Red Cross
- Martin Shkreli – Turing
- Lynn Tilton – Patriarch Partners
- Garth Saloner – Dean, Stanford Business College
- Julie Hamp – Toyota
- Alex Molinari – Johnson Controls
- Christopher Kubasik – Lockheed Martin
- Stephen MacMillan – Stryker Corporation (board gave permission)
- Noel Biderman – Ashley Madison
- Jack Welch – General Electric
- Dov Charney – American Apparel
- John Dodds – Kier Group
- Charles Phillips – Oracle
- Darren Houston – Priceline
- Barbara Byrd-Bennett – Head of Chicago Public Schools

# Reading 2.5: Defining the Issue – Define Dilemmas by Values, Not Circumstances

- Avoid the either/or conundrum and its false security
  - The ease of resolution vs. the long-term implications
  - Failure to define the issue properly

# Reading 2.6: Pressure – Probability from the Financial Analysts Institute

$$P = f(x)$$

x = amount of money involved

P = probability of an ethical outcome

# Case 2.7: BP and Safety

- Texas City Refinery
- Prudhoe Bay
- Trading Markets
- Offshore Oil Rigs

- What are the common factors in these areas?
- Anything different?

# BP Texas City Refinery Issues

- 15 deaths; 170 workers injured
- 4,000 suits totaling $2.1 billion in damages
- OSHA found 271 safety violations at the plant prior to the explosion (unaddressed)
- After the explosion, OSHA found 439 “willful and egregious violations”
- $87 million OSHA fine (4X the last largest fine)
- $50 million fine to EPA
- Maintenance budget cut each year

# Findings on BP Atlantis Problems: Consultant's Report

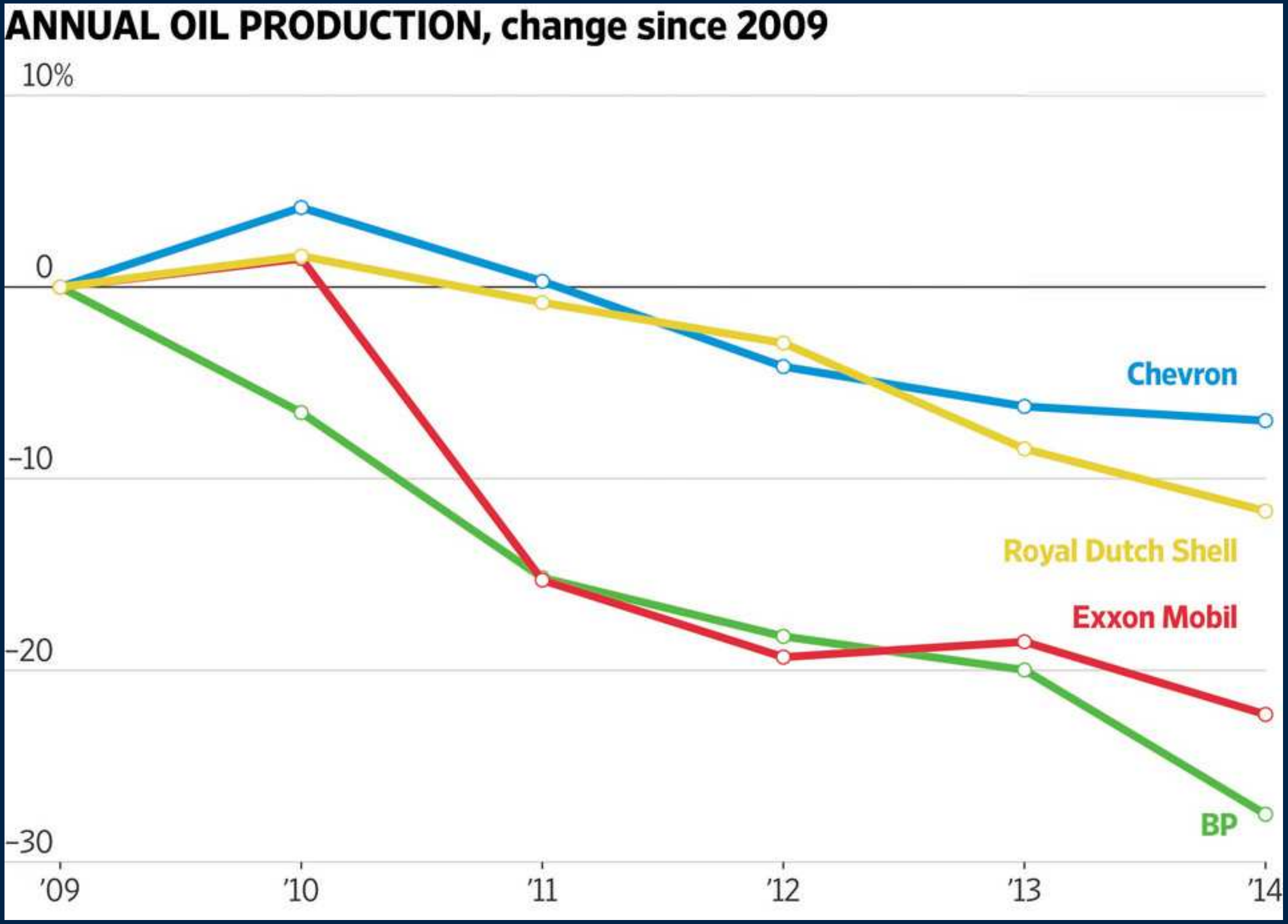
- "Put off repairing the pump in the context of a tight cost budget."
- "Leadership did not clearly question the safety impact of the delay in repair."
- Employee safety officer: "You only ever got questioned on why you couldn't spend less."

# BP Headlines

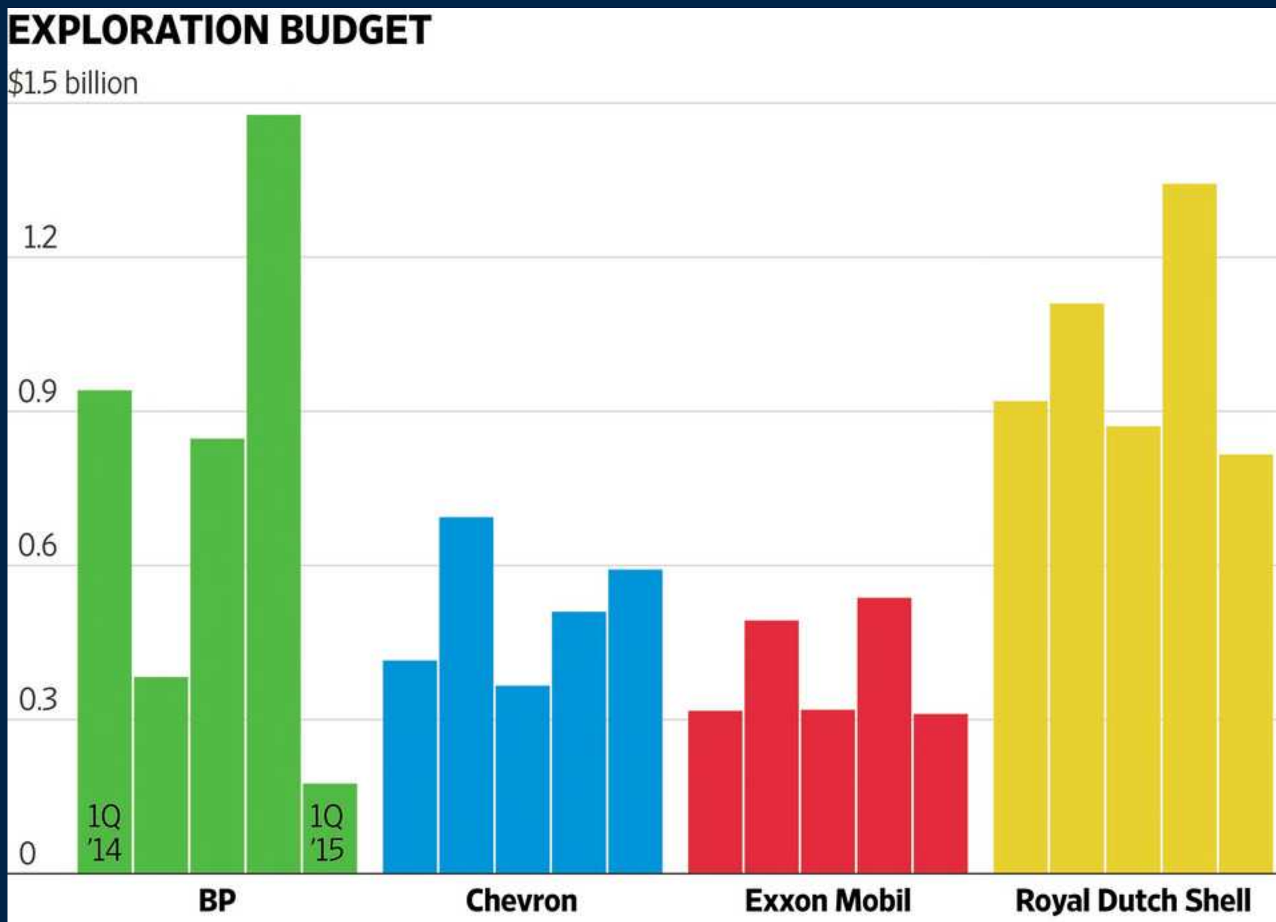
- "BP Crew Focused on Costs," *Wall Street Journal,* June 15, 2010, p. A1.
- "Unusual Decisions Set Stage for BP Disaster," *Wall Street Journal,* May 27, 2010, p. A1.
- "Oil Execs: BP Didn't Meet Standards," *USA Today,* June 16, 2010, p. 1B.
- "Members of Past Disaster Panels See Recurring Pattern," *Wall Street Journal,* June 16, 2010, p. A4.
- "The Five Shortcuts That Prioritized Time and Money Over Safety," *Wall Street Journal,* June 16, 2010, p. A4.
- "BP Chose Riskier of Two Options for Well Casing," *Wall Street Journal,* May 27, 2010, p. A1.
- "Safety and Cost Drives Clashed As CEO Hayward Remade BP," *Wall Street Journal,* June 30, 2010, p. A1.
- "BP Relied on Cheaper Wells," *Wall Street Journal,* June 19-20, 2010, p. A1.

# BP Production Post-Deepwater

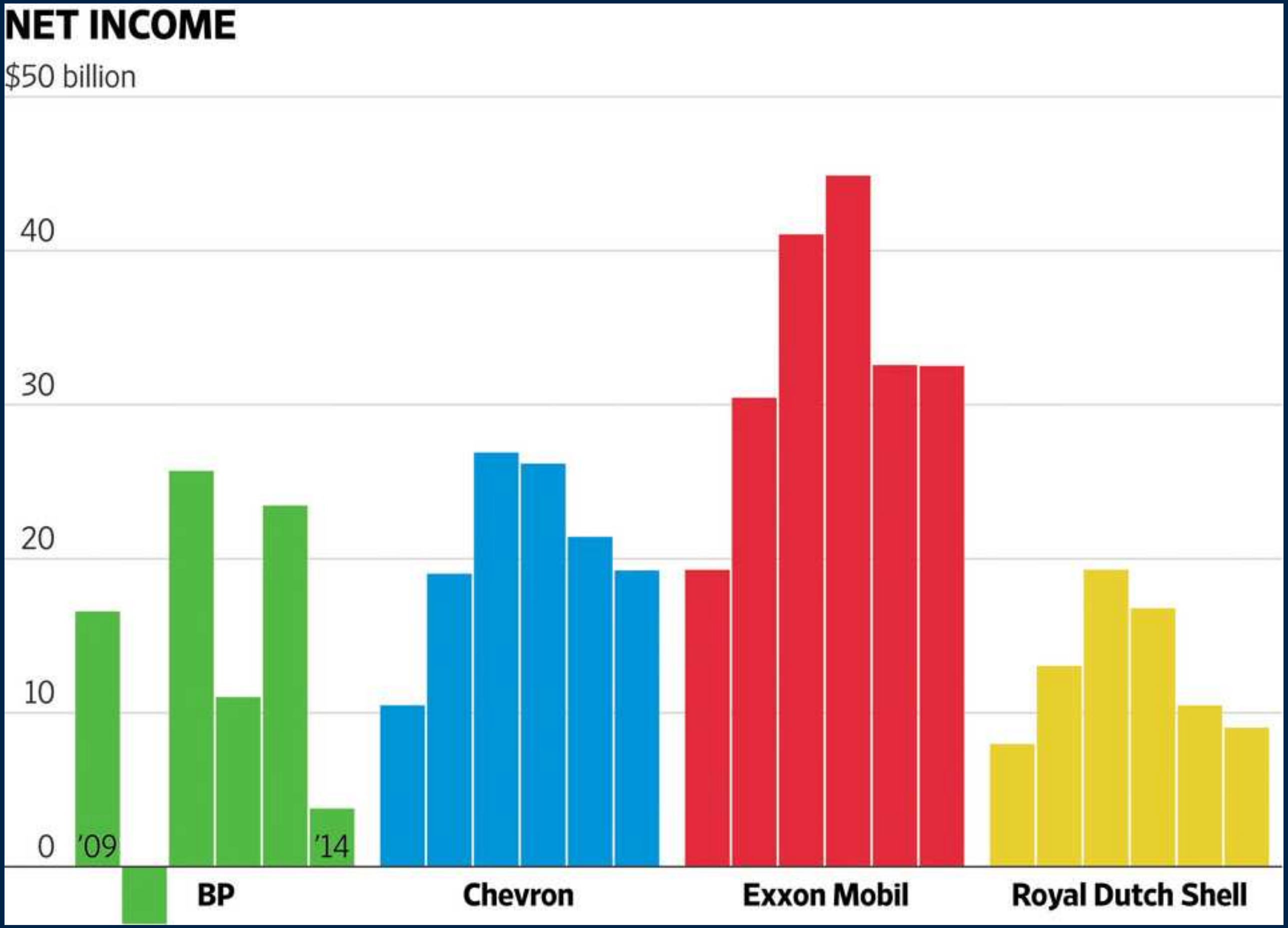
**Wall Street Journal, July 22, 2015, p. A12**



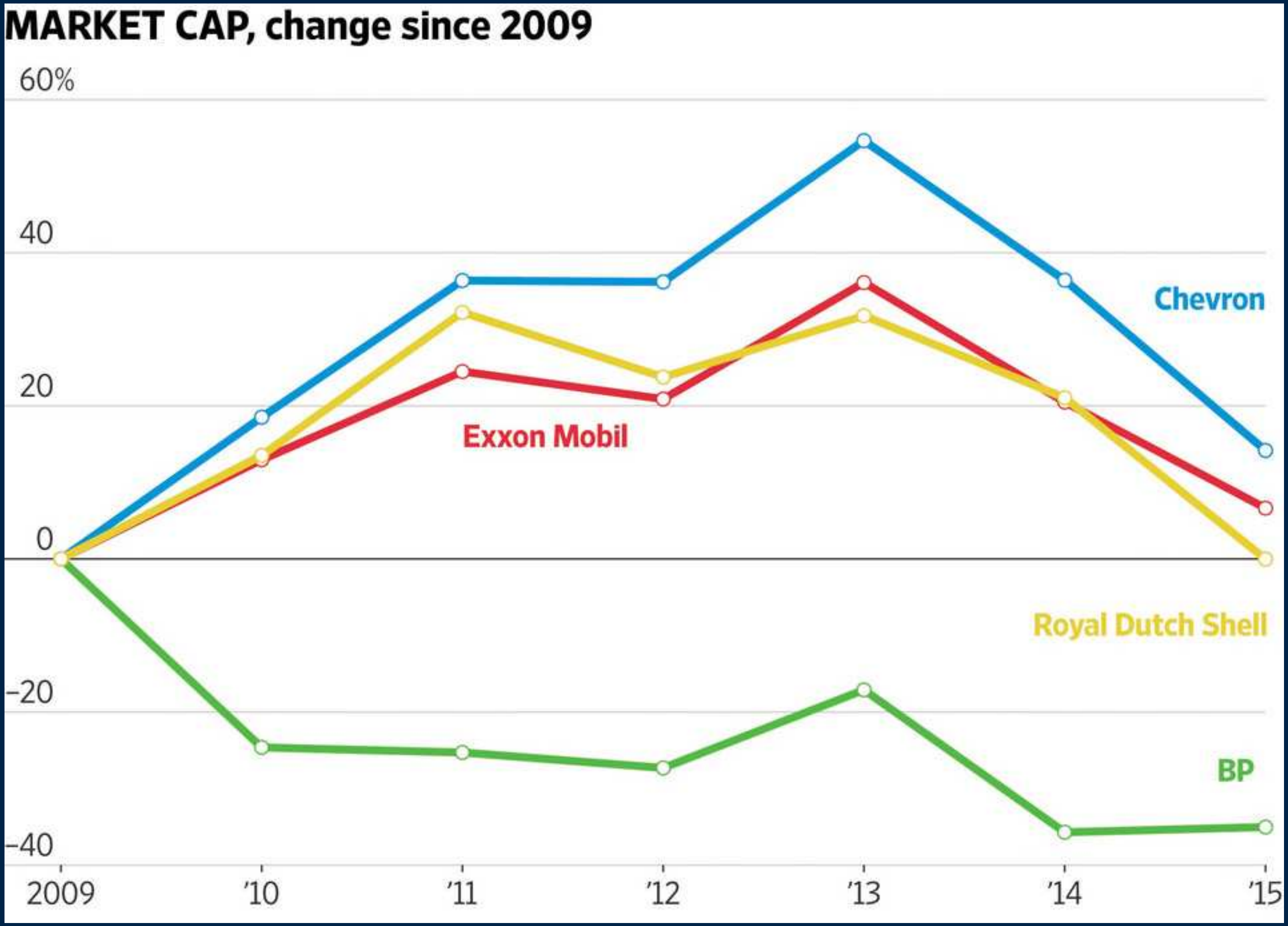
# BP Exploration Post Deepwater



# BP Net Income Post-Deepwater



# BP Market Cap



# Case 2.8: Valeant

| Drug | Pre-Valeant Price | Valeant Acquisition | Post-Acquisition Price |
|---|---|---|---|
| Glumetza (diabetes) | $896 (90 tablets) | 2015 | $10,020 (90 tablets) |
| Syprine (Wilson's Disease | $1,395 (100 capsules) | 2010 | $21,267 (100 capsules) |
| Cuprimine (Wilson's Disease) | $888 (100 capsules) | 2010 | $26,189 (100 capsules) |
| Isuprel (slow or irregular heart rate) | $4,489 (25 ampules (0.2)) | 2010 | $36,811 (25 ampules (0.2)) |

# Valeant - Question #4 (slide 1)

| Name | Title | Company | Reason | Fate |
|---|---|---|---|---|
| Tara Poseley | CEO | Design Within Reach | “Spend more time with family and pursue other interests.” | Named President of Disney Retail Stores just five months later |
| Beryl B. Raff | CEO | Zales | “Well, this afternoon I’m going to be driving the carpool. And my son’s very excited about that.” | Named Senior VP of JCPenney three months later |
| John N. Ford | State senate | Tennessee | “To spend the rest of my time with my family clearing my name.” | Convicted on one count of bribery for taking $55,000 in bribes from contractors; other federal charges on bribery are pending; sentenced to sixty-six months in prison |

# Valeant - Question #4 (slide 2)

| Name | Title | Company | Reason | Fate |
|---|---|---|---|---|
| Brenda C Barnes | CEO | Pepsi NA | "To devote more time to her three young children." (1997) | Interim president Starwood Hotels (1997); took board positions (1997); CEO Sara Lee (2004) |
| Afshin Mohebbi | Pres./COO | Qwest | "Spend more time with family." (2002) | Forty-two-count indictment (2004) immunity for testimony |
| Daniel P. Burnham | CEO Chairman | Raytheon | "Spend more time with family, teach, and join corporate boards." (2003) | 2006 SEC filed complaint on accounting improprieties by Burnham and others; returned bonuses |

# Valeant - Question #4 (slide 3)

| Name | Title | Company | Reason | Fate |
|---|---|---|---|---|
| Carly Fiorina | CEO | Hewlett-Packard | She felt she had been fired and refused a generic family statement because, “No, that’s not the truth. Telling the truth is about what’s right and wrong. It’s pretty basic.” | Best-selling book; ran for U.S. Senate in California (2010) |
| Stephen Collins | CEO | Double Click | “Spend more time with family.” | Still spending time with family |

# Valeant - Question #4 (slide 4)

| Name | Title | Company | Reason | Fate |
|---|---|---|---|---|
| Steve Jobs | Late-CEO | Apple | "Health matters are private." | Apple was not forthcoming with information until Mr. Jobs had to leave the company; switching him to chairman in September 2011; Mr. Jobs died in October 2011 after years of treatment, transplants, and leaves. Apple today is struggling from what is perceived to be the lack of effective succession planning. |

# Valeant - Question #4 (slide 5)

| Name | Title | Company | Reason | Fate |
|---|---|---|---|---|
| Jamie Dimon | CEO and Chairman | JPMorgan Chase | Disclosed throat cancer in a letter to shareholders and employees; Disclosed that he would have 8 weeks of treatment at Memorial Sloan Kettering Cancer Center for chemotherapy and radiation; disclosed the tests he had undergone to find the diagnosis | |

# Valeant - Question #4 (slide 6)

| Name | Title | Company | Reason | Fate |
|---|---|---|---|---|
| J. Michael Pearson | CEO | Valeant | Made no disclosure about his condition until one month after the company announced that he was hospitalized (December 2015) with pneumonia; no explanation and no updates; CFO appointed interim CEO | Returned to work as CEO in February 2016 and made no disclosures about his health |

# Valeant - Question #4 (slide 7)

| Name | Title | Company | Reason | Fate |
|---|---|---|---|---|
| Oscar Munoz | CEO | United Continental Holdings | Disclosed heart attack and hospitalization in October 2015 after *Wall Street Journal* report; Company then offered updates, including announcement of his heart transplant in January 2016. United disclosed in its regulatory filing that if Munoz missed more than 180 days of work that he would be deemed physically incapable of doing his job; the filing also disclosed that he lost a bonus of almost $7 million if he was not on the job for six straight months during 2016. | Returned to CEO position on March 14 2016, two months after his heart transplant |

# Valeant - Question #4 (slide 8)

| Name | Title | Company | Reason | Fate |
| --- | --- | --- | --- | --- |
| Lloyd Blankfein | CEO | Goldman Sachs | Disclosed his lymphoma shortly after his diagnosis and announced plans to continue to work | Kept work and announced positive results of his treatment |
| Patrick Byrne | CEO | Overstock.com | Disclosed that he was diagnosed with Stage IV Hepatitis C that he contracted in China 30 years ago | Finished treatment and took a leave of absence with no time set for return; "[I] think I have it beat, but only time will tell." |

# Section C:
# Resolving Ethical Dilemmas

# Reading 2.9: Steps in Ethical Analysis

1. Do your numbers
2. Recall and apply the categories
3. Apply questions from the models
4. Check for the warm language labels and rationalizations
5. Consider other cases for precedent
6. Bring in other areas of business to be sure you are seeing the issues
7. Frame the issue carefully

# Case 2.10: Some History

- Founded in 1869
- Partnership with Marcus Goldman and his son-in-law, Samuel Sachs
- Began as a clearinghouse for commercial paper

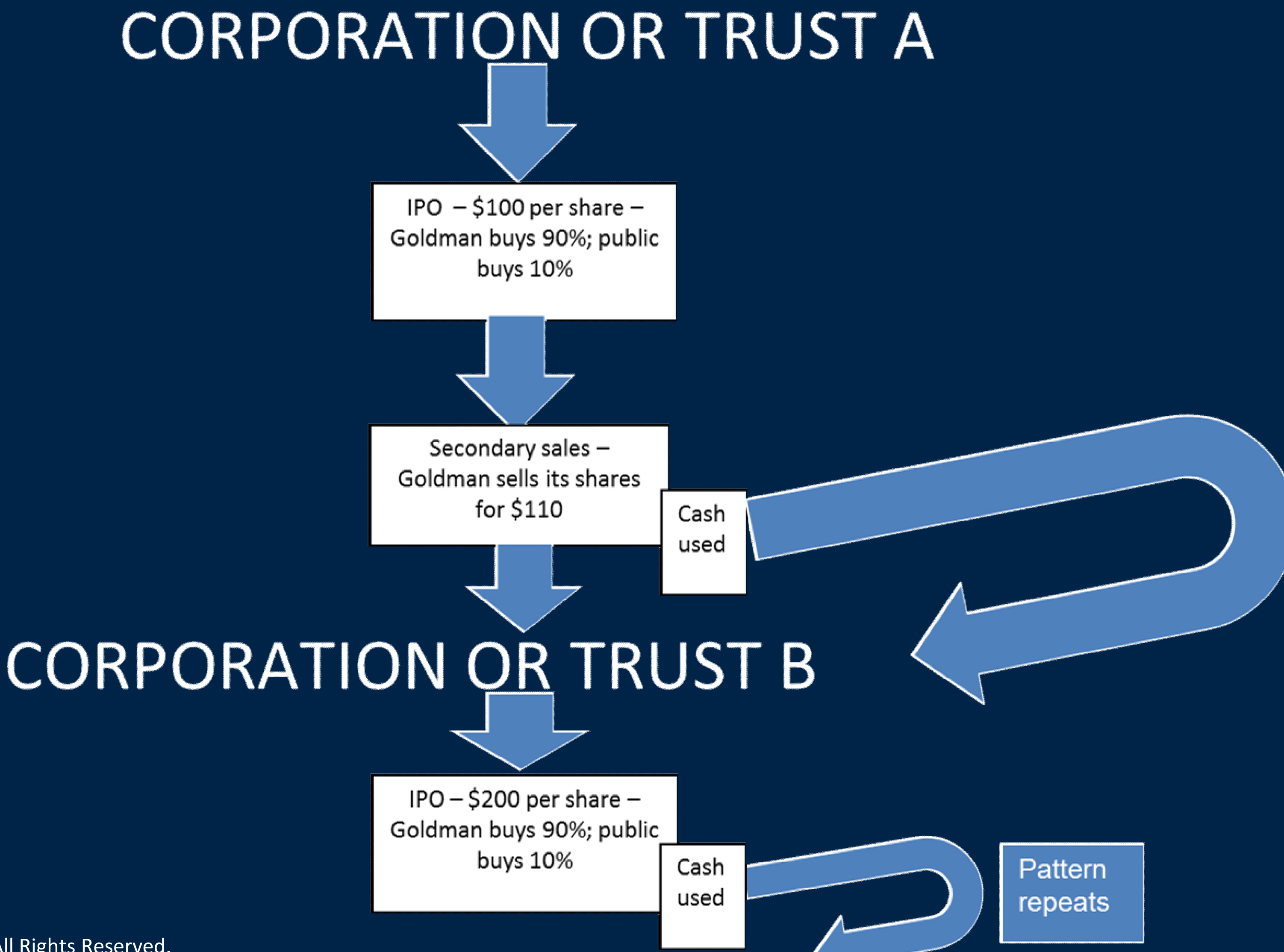
# Legal Issues to Discuss

- What are the liabilities in a partnership?
- How would that personal liability structure affect the partnership’s strategies and decisions?

# The Roaring Twenties

- New hires felt commercial paper was stodgy
- Investment trusts were launched
- Small investors could purchase trust interests in pools of securities

# 1920s and Layering



# 1990s, dot-coms, and IPOs (slide 1)

- Standard requirement of three years of profitability before an IPO was waived
- Eased back to one year
- Eventually eased back to one quarter of profits
- Public was not aware that underwriting standards had changed

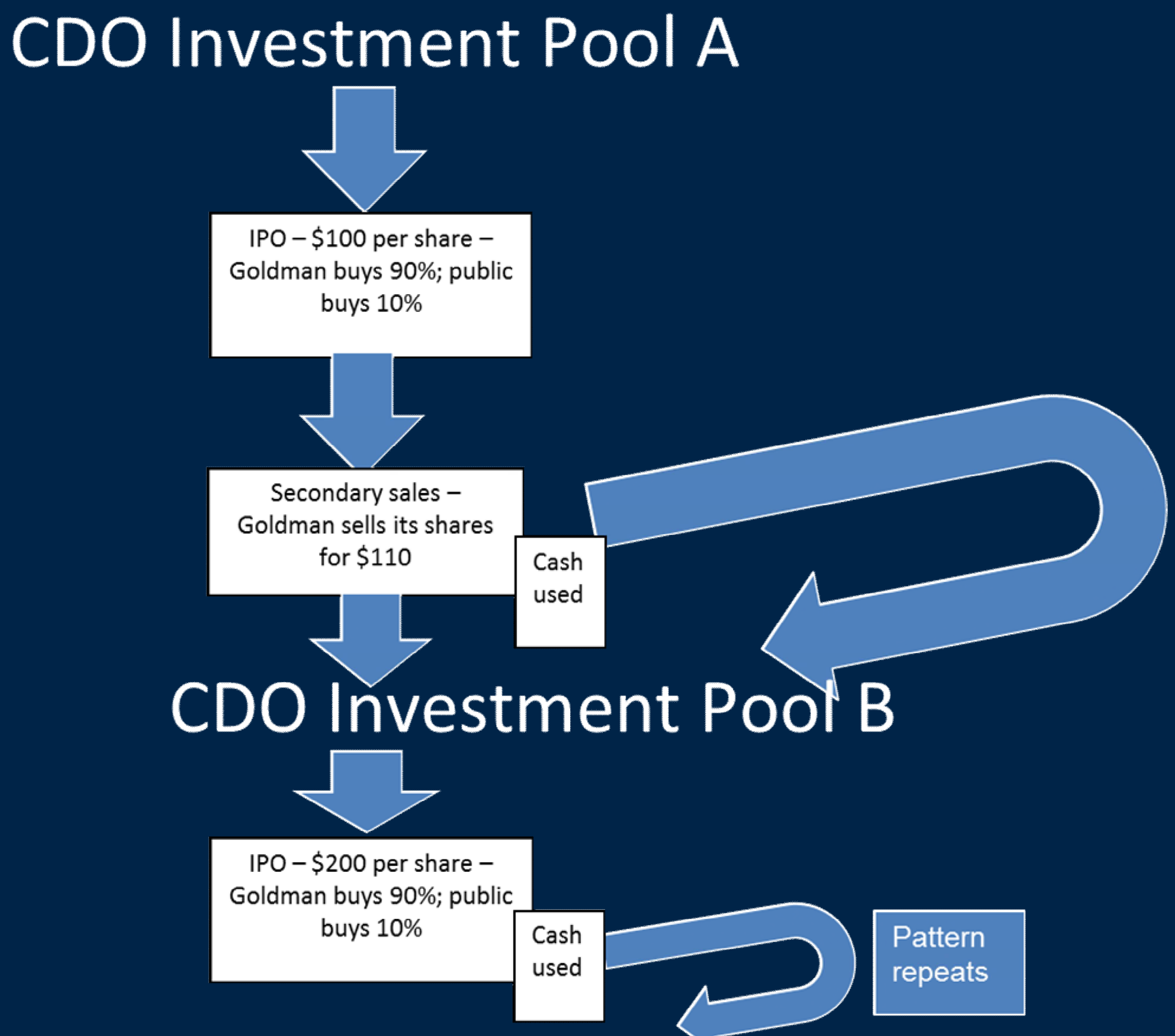
# 1990s, dot-coms, and IPOs (slide 2)

- Underwriter (Goldman) agrees to underwrite a dot-com's initial offering
- Good clients get access to IPO
- Participate in the roll-out of the share initially
- Have to agree to buy more after the first wave at \$10-\$15 per share higher
- Laddering: shares are guaranteed to rise
- Everyone makes money but general public does not know

# eToys

- IPO priced at $20
- Price climbed, through laddering, to $75 per share on the first day
- Goldman settled with the SEC for $40 million after then-chairman Hank Paulson condemned laddering

# 2008 and Layering



# Other Goldman Activities: Huddles and Client Disclosures

- Trading huddles: analysts and traders discuss the market, shares, etc.
- Analysts cannot contradict their internal opinions in external releases
- Goldman analysts did not disclose the trading huddle info
- They were analysts from “Fundamental Strategies Group” not the “Analysts Group”

# The Goldman Opinions in Emails

- *CDO securities are "junk," "s______" or "crappy."*

Michael M. Phillips, "Senators Seek, Fail to Get an 'I'm Sorry'," *Wall Street Journal,* April 28, 2010, p. A3 at A5.

# The January 10, 2010 Memo to Clients from Goldman

- *"We may trade, and have existing positions, based on trading ideas before we have discussed those ideas with you."*

Andrew Ross Sorkin, "At Goldman, E-Mail Message Lays Bare Conflicts in Trading," *New York Times,* January 13, 2010, p. B1.

# Other Goldman Activities: Auction-Rate Securities

- Touted as mutual-fund grade investments
- Goldman and others bid up the price
- Clients were convinced that there was a vibrant market
- Clients were not told about Goldman's bidding
- Clients were left holding $40 billion in worthless auction securities

# Settlements

- Goldman agreed to buy back $1.5 billion in auction securities
- Pays $22.5 million fine
- Merrill Lynch bought back $10 billion in securities and paid $125 million fine

# Other Goldman: Abacus

## The Cast of Characters

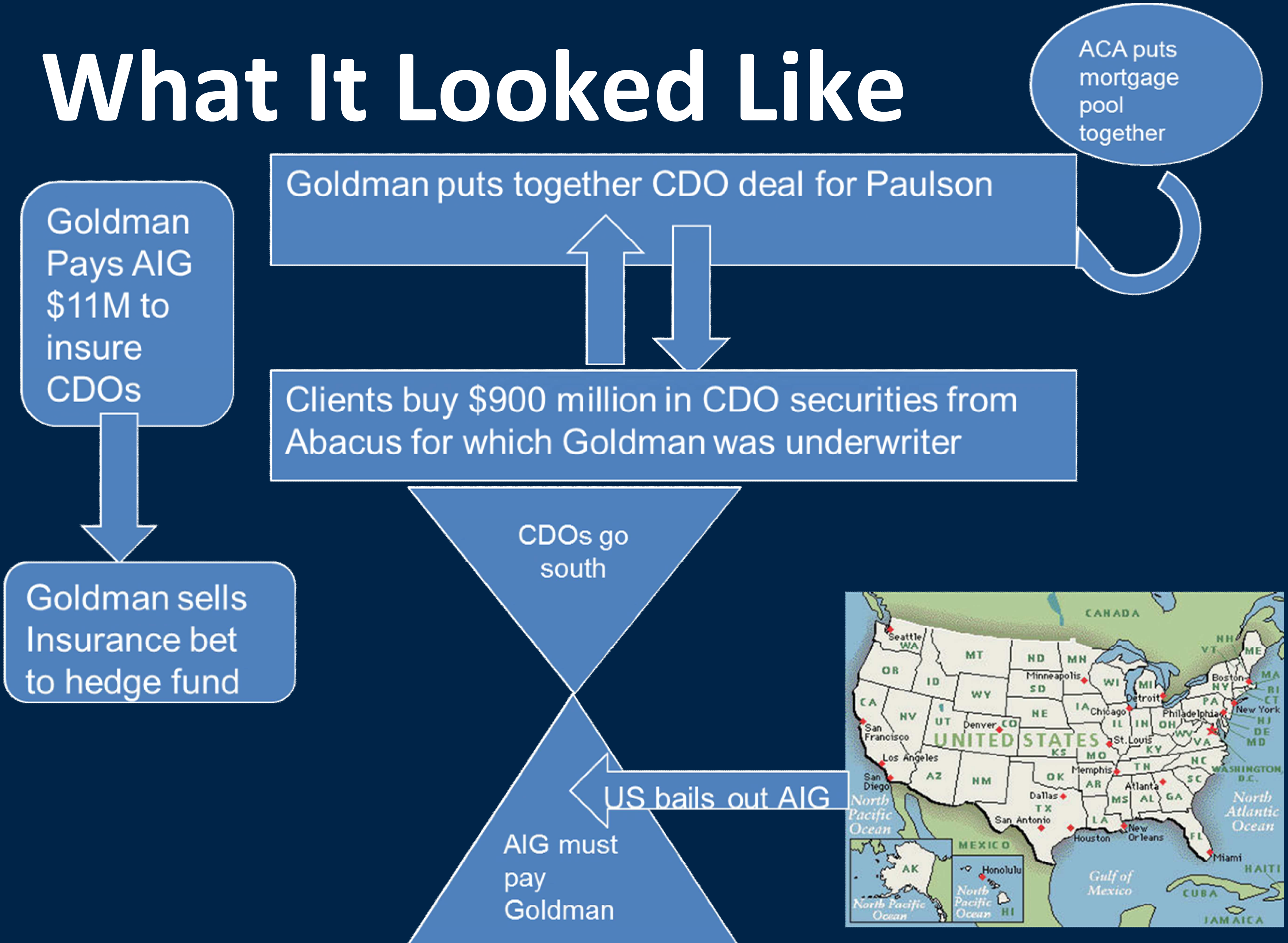
# Fabrice Tourre:
# The Fabulous Fab

# John Paulson: Very Rich Guy

# Goldman Agrees to Structure a Mortgage-Backed Securities Deal for Paulson

- Fabulous Fab is put in charge
  - 32 years old
  - $2,000,000 per year compensation
- Goldman feels it has a conflict
  - ACA put in charge
  - Input on types of mortgages is odd
  - ACA asks, “Why would they not want Wells mortgages in the pool?”

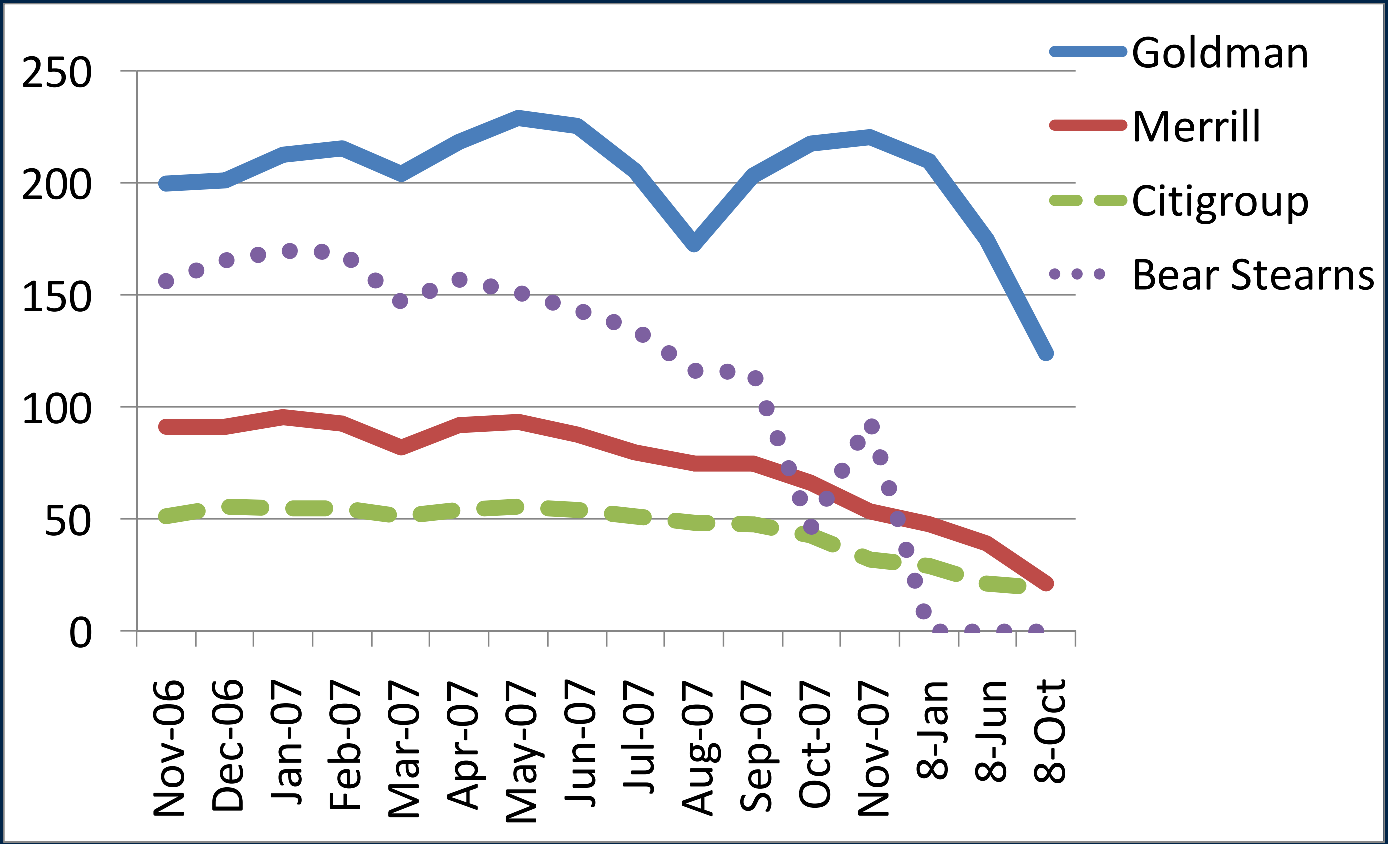
# What It Looked Like



# Key was Understanding Goldman's and Paulson's Position

- They would be positioned short
- That is, they would make money if the CDOs failed (i.e., declined in value)
- They did decline; Goldman and Paulson made money
- Goldman clients and others who bought Abacus finished with worthless instruments

# Subprime Zig vs. Zag



# The Emails

# Goldman Manager Fabrice Tourre on Mortgage Securities

*"The whole building is about to collapse anytime now. . . . Only potential survivor, the Fabulous Fab . . . Standing in the middle of all these complex, highly leveraged, exotic trades he created without necessarily understanding all of the implications of those monstruosities!!! [sic]"*

# E-mail from Goldman Trader, Fabrice Tourre, to His Girlfriend on His Sales of Subprime CDOs

*"I'm [sic] managed to sell a few abacus bonds to widows and orphans that I ran into at the airport, apparently these Belgians adore synthetic abs cdo2."*

# The Congressional Hearings

# Senator Claire McCaskill

*"It feels like you guys are betting on the game you're playing."*

Senate hearings on financial regulation

April 27, 2010

# Senator Susan Collins

*"I understand that you do not have a legal fiduciary obligation. But did the firm expect you to act in the best interests of your clients as opposed to acting in the best interests of the firm? Could you give me a yes or no to whether or not you considered yourself to have a duty to act in the best interests of your clients?"*

Wall Street and the Financial Crisis: The Role of Investment Banks, Hearings of the Permanent Subcommittee on Investigations, April 27, 2010, http://hsgac.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=f07ef2bf-914c-494c-aa66-27129f8e6282

# Lloyd Blankfein, CEO of Goldman

# Did Goldman Owe a Fiduciary Duty? Blankfein Responds:

*"While we strongly disagree with the SEC's complaint, I also recognize how such a complicated transaction may look to many people. To them, it is confirmation of how out of control they believe Wall Street has become, no matter how sophisticated the parties or what disclosures were made. We have to do a better job of striking the balance between what an informed client believes is important to his or her investing goals and what the public believes is overly complex and risky."*

# Lloyd Blankfein on His Role

- [I am just a banker] "doing God's work."

John Arlidge, "I'm Doing God's Work. Meet Mr. Goldman," *London Times Interview, The Sunday Times,* November 8, 2009, p. 1.

# Professor John Coffee

*"I think we're seeing another one of those periodic eruptions because we see this story of investment bankers who seem to be playing both sides against the middle, and the investor looks like a sucker."*

David Lynch, "Goldman Hearings Strike a Defiant Note," *USA Today,* April 28, 2010, p. 1B, at 2B.

# Goldman Settles

- $550-million fine
- Legislative and regulatory reforms
- What were the violations?
- Which securities laws apply?

# Case 2.11: Penn State Players

| **Name** | **Title/Role** |
|---|---|
| Joe Paterno | Head football coach at Penn State from 1966–2011 |
| Gerry Sandusky | Assistant football coach at Penn State from 1969–1999 |
| Wendall Courtney | Attorney for Sandusky charity; outside counsel for Penn State for twenty-eight years |
| Alycia Chambers | Psychologist in State College, PA—first contacted about abuse |
| Ron Schreffler | Detective at Penn State University Police Department |
| Jerry Lauro | Case worker who handled the first Sandusky complaint |
| Graham Spanier | Penn State president during Sandusky years until 2011 |
| Tim Curley | Penn State athletic director during Sandusky years |
| Gary Schultz | Penn State senior VP for finance and business |
| Thomas Harmon | Penn State police chief |
| Jim Calhoun | Penn State janitor who witnessed Sandusky incident in 2000 |
| Michael McQueary | Grad student and assistant football coach under Paterno |
| Cynthia Baldwin | Penn State general counsel |
| Vicky Triponey | Penn State standards and conduct officer who left the university |

# Case 2.12: Deflategate and Spygate – The Patriots

*"We have never used sideline video to obtain a competitive advantage while the game was in progress."*

-Patriots head coach and general manager following the NFL fines and penalties for videotaping signaling plays

# Deflategate and Spygate – The Patriots

*"I don't believe so."*

- New England Patriots quarterback Tom Brady when asked if he was a "cheater" during a press conference on deflategate (February 2015)

# Case 2.13: Online Reviews

- Four Problem Areas
  - The reviews are posted by individuals hired to write negative reviews. In some cases, there are companies that specialize in getting companies these negative reviews on competitors as a means of increasing their own business.
  - The reviews are actually posted by competitors (or their employees) as a means of gaining business.
  - The reviews are posted by employees of the online sites themselves as a way of forcing the businesses with negative reviews to advertise with the sites.
  - The reviews are written by those related to customers who have had a bad experience in order to force the business into providing the customer with some remedy.