

## **Chapter 2**

### *Ethics and Social Responsibility of Business*

*What is “right”?*

#### **I. Teacher to Teacher Dialogue**

The study of ethics and law has been interwoven from the onset. Both disciplines stress the moral underpinnings of their respective efforts at defining proper human behavior. In spite of this long interaction, using business ethics issues as a freestanding chapter in mainline business law texts is a relatively recent phenomenon. The reasons for this vary, but one of them is, no doubt, the difficulty many traditional law teachers have had in adapting to the language of philosophers and other related social scientists. Given the obvious need for more emphasis on ethics training in all aspects of business education, this increase in emphasis on law/ethics issues has come none too soon.

In this chapter, Professor Cheeseman clearly outlines the key schools of ethical studies and then provides excellent case examples in which to test the various approaches discussed in the text.

#### **II. Chapter Objectives**

- ❖ Describe how law and ethics intertwine.
- ❖ Describe the moral theories of business ethics.
- ❖ Describe the theories of the social responsibility of business.
- ❖ Examine the provisions of the Sarbanes-Oxley Act.
- ❖ Describe corporate social audits.

#### **III. Key Question Checklist**

- ❖ When a corporate behavior is questioned, which school of ethics would be most appropriate to examine?
- ❖ Is the behavior unethical?
- ❖ What standard of ethical behavior should be applied?
- ❖ How could the corporate entity have prevented the behavior?
- ❖ If you were in a position of judgment to respond, what would you do?

#### **IV. Chapter Outline**

The study of ethics revolves around the examination of rules, conduct, and character through a morally tinted microscope. That law should be grounded in some sort of morality-based foundation is self-evident. The goals of all the ethical schools of thought are to identify some sort of morally based rationale for human behavior. This rationale may be found in outside sources as seen in schools of ethical fundamentalism or in the rule that provides the greatest good to society as illustrated by utilitarianism. Others such as Kant and Rawls have sought to devise formulas of behavior based on universal rules or social contract, respectively. In all these systems, a morally based methodology is sought as a guidepost for behavior. If these guideposts are universally accepted, the odds are very high that they will no longer be advisory, but rather required by law. The process by which morally based ethical behavior is first desired, then expected, and finally mandated is really the evolution of law.

Because so many of our legal and economic activities are conducted in the corporate format, juristic (law made) business entities cannot ignore this constant and dynamic tug and pull between ethics and law. The bottom line in the study of ethics is ultimately personal, and our job as teachers is to help students prepare for these challenges in both their professional and personal ethical lives.

### **Introduction to Ethics and Social Responsibility of Business**

- ❖ Businesses organized in the United States are subject to its laws
- ❖ They are also subject to the laws of other countries in which they operate
- ❖ Business persons owe a duty to act ethically in the conduct of their affairs
- ❖ Businesses owe a social responsibility not to harm society

### **Ethics and the Law**

- ❖ **Ethics** – A set of moral principles or values that governs the conduct of an individual or a group – doing what is right
- ❖ What is lawful conduct is not always ethical conduct
- ❖ The law may permit something that would be ethically wrong

### **Business Ethics**

There do seem to be some universal rules about what conduct is ethical and what conduct is not.

Ethical Fundamentalism – Persons look to an outside source or central figure for ethical guidelines.

#### **Ethics: *Corporation Ratted Out Under the Whistleblower Statute***

The Bayer Corporation, in response to a threat by Kaiser Permanente that they would discontinue purchase of the antibiotic Cipro unless it reduced the price, devised a scheme by which they repackaged and renamed the antibiotic and sold it to Kaiser at a 40 percent saving, while continuing to sell Cipro to the federal government's Medicaid program at the full price. After attending a mandatory ethics training class, one of the executives questioned the practice, sending a memo to his boss calling attention to the potential illegality of the private label program. After he received no response, he chose to file a *qui tam* lawsuit under the federal False Claims Act, also known as the Whistleblower statute. As per the statute, the U.S. Department of Justice took over the case, with Bayer eventually settling for \$257 million, of which the executive received \$34 million, pursuant to the act.

Utilitarianism – Persons choose the alternative that would provide the greatest good to society.

Kantian Ethics – A set of universal rules establishes ethical duties. The rules are based on reasoning and require (1) consistency in application and (2) reversibility. Kant's categorical imperative – "Do unto others as you would have them do unto you." This is duty ethics or deontology.

Rawls's Social Justice Theory – Moral duties are based on an implied social contract. Fairness is justice. Rules are established from an original position.

Ethical Relativism – Individuals decide what is ethical based on their own feelings as to what is right or wrong.

### **Social Responsibility of Business**

- ❖ Business does not operate in a vacuum

- ❖ Decisions made by business have far-reaching effects on society
- ❖ In the past, many business decisions were made solely on a cost-benefit analysis
- ❖ Such decisions may cause negative externalities for others
- ❖ Corporations are considered to owe some degree of social responsibility for their actions

Maximizing Profits – To maximize profits for stockholders.

**Case 2.1 Business Ethics:** *Wal-Mart Stores v. Samara Brothers, Inc.*

**Facts:** Wal-Mart Stores, Inc., was sued by Samara Brothers, Inc., for allegedly stealing the “trade dress” of Samara under Section 43(a) of the Lanham Act. Wal-Mart had directed one of its suppliers to make exact copies of children’s clothing that Samara had designed and sold. Wal-Mart was then able to sell the exactly copied goods to the public for less than Samara’s retailers were able to purchase the goods for. The District Court held for Samara, but did not make a finding for the clothes having acquired a secondary meaning as the act required. The Court of Appeals affirmed the decision, and Wal-Mart appealed to the U.S. Supreme Court.

**Issue:** Must a product’s design have acquired a secondary meaning before it is protected as trade dress?

**Decision:** Yes.

**Reason:** The act requires that the allegedly infringing materials must cause confusion with the product for which protection is sought. The U.S. Supreme Court found that in order to prevail in the case of an unprotected trade dress, the product’s design must show a secondary meaning in the public’s eye. They reversed the decisions of the lower courts.

**Case Questions**

**Critical Legal Thinking:** Trade dress is the look and feel of a product, and is often protected under the Lanham Act. It should have been protected under the case.

**Ethics:** Wal-Mart acted unethically.

**Contemporary Business:** Companies need to patent their designs to protect themselves from unscrupulous companies.

Moral Minimum – To avoid causing harm and to compensate for harm caused.

**Landmark Law:** *Sarbanes-Oxley Act Requires Public Companies to Adopt Codes of Ethics*

Sarbanes-Oxley Prompts Public Companies to Adopt Code of Ethics – SOX, coupled with stronger enforcement and wrongdoer punishment, should force officers and directors to be more ethical. However, the entire corporate culture may need to change before organizations can be more ethical.

Stakeholder Interest – To consider the interests of all stakeholders, including stockholders, employees, customers, suppliers, creditors, and local community.

**Case 2.2 Corporate Political Speech and Ethics:** *Citizens United v. Federal Election Commission*

**Facts:** Federal campaign financing laws are administered by the Federal Election Commission (FEC), a federal government agency. Violations of the laws provide for civil and criminal penalties. In January 2008, Citizens United released a film entitled *Hillary: The Movie* (Hillary). Citizens United wanted to promote a planned video-on-demand offering of *Hillary* by running advertisements on broadcast and cable television. In December 2007, Citizens United sued the FEC, alleging that the federal restrictions on campaign financing violated the corporation’s free speech rights as guaranteed by the First Amendment. The U.S. District Court denied Citizens United’s motion for an injunction. The U.S. Supreme Court agreed to hear the case.

**Issue:** Do the challenged federal restrictions on campaign financing and electioneering violate the free speech rights of Citizens United?

**Decision:** The Supreme Court held that the First Amendment free speech rights of Citizens United had been violated.

**Reason:** The Court has recognized that First Amendment protection extends to corporations. Corporations and other associations, like individuals, contribute to the discussion, debate, and the dissemination of information and ideas that the First Amendment seeks to foster. Political speech is indispensable to decision-making in a democracy, and this is no less true because the speech comes from a corporation rather than an individual.

#### **Case Questions**

**Critical Legal Thinking:** Corporations and other associations, like individuals, contribute to the discussion, debate, and the dissemination of information and ideas that the First Amendment seeks to foster. Yes. Corporations have the same First Amendment free speech rights as individuals

**Ethics:** Student answers may vary.

**Contemporary Business:** Highly important.

Corporate Citizenship – To do well and solve social problems.

### **V. Answers to Ethics Cases**

**2.1 Ethics:** No. Papa John's advertising slogan "Better Ingredients. Better Pizza" is not false advertising. One form of non-actionable statements of general opinion under Lanham Act has been referred to as "puffery." Prosser and Keeton on the Law of Torts (5th edition) define "puffing" as "a seller's privilege to lie his head off, so long as he says nothing specific, on the theory that no reasonable man would believe him, or that no reasonable man would be influenced by such talk." Bisecting the slogan "Better Ingredients. Better Pizza," it is clear that the assertion by Papa John's that it makes a "Better Pizza" is a general statement of opinion regarding the superiority of its product over all others. Consequently, it appears indisputable that Papa John's assertion "Better Pizza" is non-actionable puffery. Moving next to consider the phrase "Better Ingredients," the same conclusion holds true. Like "Better Pizza" it is typical puffery. Thus, it is equally clear that Papa John's assertion that it uses "Better Ingredients" is one of opinion not actionable under the Lanham Act. Consequently, the slogan as a whole is a statement of non-actionable opinion. The U.S. Court of Appeals found that no false advertising had occurred and held in favor of Papa John's.

Did Papa John's act unethically in this case? Probably not. Since this type of advertising is mere "puffery" and most consumers would realize it was so, Papa John's did not act unethically. However, if one considers the claims made by so many advertisers to get potential customers' attention, these advertisements collectively might be considered unethical to some people. *Pizza Hut, Inc. v. Papa John's International, Inc.*, 227 F.3d 489, Web 2000 U.S. App. Lexis 23444 (United States Court of Appeals for the Fifth Circuit)

**2.2 Ethics:** No. Plaintiff Jazlyn Bradley has not stated a valid case against McDonald's for deceptive and unfair acts and practices in violation of the New York Consumer Protection Act. It is well-known that fast food in general, and McDonald's products in particular, contain high levels of cholesterol, fat, salt and sugar, and that such attributes are bad for one. The plaintiff therefore either knew or should have known enough of the critical facts. Bradley is alleged to have "consumed McDonald's foods her entire life during school lunch breaks and before and after school, approximately five times per week, ordering two meals per day." What the plaintiff has not done, however, is to address the role that a number of other factors other than diet may come to play in obesity and the health problems of which the plaintiff complains. In order to

allege that McDonald's products were a significant factor in the plaintiff's obesity and health problems, the complaint must address these other variables and, if possible, eliminate them or show that a McDiet is a substantial factor despite these other variables. Similarly, with regards to plaintiff's health problems that she claims resulted from her obesity, it would be necessary to allege that such diseases were not merely hereditary or caused by environmental or other factors. Without this additional information, McDonald's does not have sufficient information to determine if its foods are the cause of the plaintiff's obesity, or if instead McDonald's foods are only a contributing factor. The U.S. District Court granted the motion of defendant McDonald's to dismiss the plaintiff's complaint.

McDonald's knew that it sold food products that could cause obesity. As required by law, McDonalds and other fast food restaurants must now disclose calorie and other information about its food products. McDonald's does not, however, disclose at its restaurants that "super heavy users"—defined as those persons who eat McDonald's ten times or more a month—make up approximately 75 percent of McDonald's sales. This by itself could be unethical conduct. *Bradley v. McDonald's Corporation*, Web 2003 U.S. Dist. Lexis 15202 (United States District Court for the Southern District of New York)

**2.3 Ethics:** Whether or not Warner-Lambert acted unethically would depend upon the extent to which it knew the claims it was making were false. Ethicists would point out that one does not have to have perfect vision and information in order to recommend a product. The state of science is such that medical positions today will be supplanted by others tomorrow. For example, in 1879, alcohol, Listerine's major ingredient, was presumed to kill certain germs. This is even today a partial truth.

The company's claim is misleading. Warner-Lambert was ordered to include a disclaimer that "Listerine does not kill the germs that cause colds" on its labels for two years. The court declined to include prefatory language requested by the FTC, "Contrary to previous claims." *Warner-Lambert Co. v. FTC*, 562 F.2d 749 183 U.S. App. D.C. 230, 562 F.2d 749, **Web** 1977 U.S. App. Lexis 11599 (United States Court of Appeals for the District of Columbia Circuit).

**2.4 Ethics:** Yes, an ethicist applying the utilitarian approach to the question of bankruptcy might approve of the company's decision to seek bankruptcy protection. Identifying and weighing the good and bad in this case would reveal some of the following. Filing a petition in bankruptcy erects a barrier against those claimants who have already gone to court to demand immediate relief in the form of compensation for their terrible loss. The initial order of relief granted by a bankruptcy court freezes all such proceedings pending in other courts. The benefits (the good) from filing in bankruptcy include preserving the assets of the company so that it can ultimately accept responsibility and compensate many more, if not all, who have a valid claim. Further, it would do the company employees no good for the company assets to be quickly dissipated by payment to those first in line. There are other goods that flow inferentially from those stated above. Given the points raised above, the company has met its social responsibility. A director could ethically, and practically, have voted for a filing in bankruptcy for the reasons stated above. *In re Johns-Manville Corporation*, 36 B.R. 727, **Web** 1984 Bankr. Lexis 6384 (United States Bankruptcy Court for the Southern District of New York).

**2.5 Ethics:** The Sullivan Principles propose commitments that fit the corporate citizenship model. Its precepts include more than ethical positions within the company (e.g., provide equal and fair employment practices), it embraces company action toward improving the lot of the blacks in South Africa (e.g., assist in schooling, housing, etc.). A company that acts according to the Sullivan Principles is behaving as a corporate citizen, a standard somewhat above the ethical duty of business organizations under several approaches.

Duties are owed when they are clear answers to problems. Not all problems have clear solutions. The utilitarian, for example, might reach a different conclusion regarding the need for a company to withdraw from South Africa. Indeed, this was the strong argument made by those companies who failed to commit to such a plan. The position of these companies was that more bad would come to the region and the affected people than good by their pullout. Where these speculations have validity, the consequentialist could argue that the pressure from withdrawal has less worth than the misery unintentionally caused by the withdrawal of business, and, accordingly, jobs for the needy.

Universities, on the other hand, could defend their divestment of holdings in companies who failed to withdraw much easier and with less ill effect on the parties they wish to assist. To the extent that the stock investment manifests a vote for present policies, a divestiture would provide further moral stature to the position regarding apartheid. The duty-based examiner must ask the question as to whether investment is a vote for willing evil by the company's participation in the business of South Africa. Here, the principle of proportionality requires that the extent to which such holdings contribute to the company would be invoked, a major issue in determining to decide to discontinue stock ownership.

**2.6 Ethics:** The question as to whether companies owe a duty of social responsibility to provide an affirmative action program is dependent upon which ethical view a moral judge takes of the corporate purpose. If corporations are merely organizational vehicles to achieve profit for their owners, the extent to which they should expend assets for the general benefit of society is limited. Following a legal analogy, one can see why a company should donate funds to a local hospital that would ultimately take care of its employees. That such a company should donate to another hospital in a town some distance away is questionable unless the company entertains a corporate citizenship stance.

By analogy, affirmative action programs are almost like the hypothetical hospital some distance away. Further, affirmative action programs bear an additional burden. The moral position for affirmative action is based on a restitution theory that, unfortunately, looks for relief from those who did not cause the loss. The U.S. Constitution demands equality, equal protection, and an ethical position. To suspend such equality for the purposes of restitution seems fair if the party required to contribute caused the loss.

In this case, the training program is legal under Title VII. Despite the plain language of the statute, which prohibits discrimination in the terms, conditions, and benefits of employment, the Court reasoned that: This situation was one the statute was intended to remedy; the method chosen was agreed to by the union as representative of all workers; the number and duration of the minority preference was limited to such time as the percentage of minorities in skilled jobs mirrored the population in the local workforce. *Steelworkers v. Weber*, 443 U.S. 193, 99 S.Ct. 2721, 61 L.Ed.2d 480, **Web** 1979 U.S. Lexis 40 (Supreme Court of the United States).

**2.7 Ethics:** Here again one must determine under what standards the business behavior of the corporation are to be judged. If the appropriate ethical component requires only that corporate agents do no harm to the community, the issue turns on the quality of the behavior toward animals. While the moral position is generally that man may use the resources of the world as long as it does not injure society or the environment, the level of behavior toward animals is the question. However, cruelty by itself is immoral, and when practiced on a living thing, albeit an animal, it is considered improper. Being truly human, according to the Kantian view, is to practice those virtues that elevate man and do not demean or hurt. Accordingly, the strongest argument against the corporate practice is having its agents acting inhumanely.

A refusal to permit the stockowners an opportunity to express their view about the function of a corporation and the behavior it wished to accept would be ethically wrong under certain approaches.

In this case, the shareholder wins the right to put the issue on the proxy. The ethical and social significance of plaintiff's proposal and the fact that it implicates significant levels of sales, supports the likelihood of prevailing on the merits with regard to the issue of whether his proposal is "otherwise significantly related" to Iroquois/Delaware's business. The result would be different if plaintiff's proposal was ethically significant in the abstract but had no meaningful relationship to the business of Iroquois/Delaware as Iroquois/Delaware was not engaged in the business of importing *pate de foie gras*. *Lovenheim v. Iroquois Brands, Ltd.*, 618 F.Supp. 554, **Web** 1985 U.S. Dist. Lexis 21259 (United States District Court for the District of Columbia).

## **VI. Key Terms and Concepts**

- Corporate citizenship—A theory of social responsibility that says a business has a responsibility to do good.
- Corporate social audit—An audit of a corporation, usually conducted by independent auditors, that examines how well employees have adhered to the company's code of ethics and how well the company has met its duty of social responsibility.
- Ethical fundamentalism—When a person looks to an outside source for ethical rules or commands.
- Ethical relativism—A moral theory that holds that individuals must decide what is ethical based on their own feelings as to what is right or wrong.
- Ethics—A set of moral principles or values that govern the conduct of an individual or a group.
- Ethics and the law—Ethics and the law are intertwined. Sometimes the rule of law and the rule of ethics demand the same response by a person confronted with a problem.
- False Claims Act—Permits private parties to sue companies for fraud on behalf of the government.
- Kantian ethics—A moral theory that says that people owe moral duties that are based on universal rules such as the categorical imperative "Do unto others as you would have them do unto you."
- Maximize profits—A theory of social responsibility that says a corporation owes a duty to take actions that maximize profits for shareholders.
- Moral minimum—A theory of social responsibility that says a corporation's duty is to make a profit while avoiding harm to others.
- Rawls's social justice theory—A moral theory that says each person is presumed to have entered into a social contract with all others in society to obey moral rules that are necessary for people to live in peace and harmony.
- Sarbanes-Oxley Act—Makes certain conduct illegal and establishes criminal penalties for violations.
- Section 406 of the Sarbanes-Oxley Act—A section that requires a public company to disclose whether it has adopted a code of ethics for senior financial officers.
- Social responsibility of business—Social responsibility requires corporations and businesses to act with awareness of the consequences and impact that their decisions will have on others.
- Stakeholder interest—A theory of social responsibility that says a corporation must consider the effects its actions have on persons other than its stockholders.
- Utilitarianism—A moral theory that dictates that people must choose the action or follow the rule that provides the greatest good to society.