CHAPTER 1

Meet the Three Pillar Model (Strategy, Law, Ethics)

EVERYDAY DECISIONS AND THE THREE PILLARS

While your friend is driving to your apartment, you develop a sudden craving for pizza and place an order with a nearby restaurant. You then text your friend and ask her to pick up the pizza on the way to your apartment.

US President Barack Obama decides, in his words, "to make the killing or capture of Osama bin Laden the top priority of our war against al Qaeda." He then authorizes the operation that results in bin Laden's death.

What does your personal decision to buy a pizza have in common with the President's leadership decision?

Both scenarios illustrate the Three Pillars that provide the foundation for decisions in business, leadership, and everyday life: strategy, law, and ethics. This book focuses on the Three Pillars as they relate to business decisions. But these pillars are also important when making a variety of decisions beyond business, ranging from your personal decision to order a pizza to the President's decision to authorize the bin Laden operation.

Let's start with the pizza example. You probably did not complete a Three Pillar analysis when deciding to ask your friend to pick up your dinner. But had you done so, your focus might have been only on the Strategy Pillar. In the language of strategy, your decision focused on "formulating" and "implementing" a strategy. You formulated your strategic goal—acquiring a pizza—and developed an implementation plan that involved ordering the pizza and texting your friend to ask her to pick it up. In all likelihood, you did not consider the legal and ethical implications of your strategy. But your failure to consider the Law and Ethics

Pillars does not mean they were absent. And this failure might have dramatic consequences for you, your friend, and others.

Consider the case of *Kubert v. Best*, decided in 2013 by an appellate court in New Jersey. The case resulted from an accident on September 21, 2009. A husband and wife were riding a motorcycle when a pickup truck heading in the opposite direction crossed the centerline and struck them. The husband and wife were severely injured, and their left legs had to be amputated. Immediately before the accident, a friend sent a text message to the truck driver, and he responded by texting a reply. The husband and wife sued both the driver and his friend. They settled with the driver, and the case proceeded against the friend who sent the message.

The court noted that under New Jersey law, it is illegal to drive while using a cell phone that is not hands-free, and a driver who injures someone using a handheld cell phone is subject to a possible prison sentence. But this case's resolution did not turn on criminal law or the driver's involvement. Instead, the issue was whether someone who sends a text to a driver can be held liable for damages. The court decided that "the sender of a text message can potentially be liable if an accident is caused by texting . . . if the sender knew or had special reason to know that the recipient would view the text while driving and thus be distracted." Despite this potential liability, the court decided that the friend who sent the text was not liable in this case because there was no proof that she "knew or had special reason to know that the driver would read the message while driving. . . ."

As this case illustrates, when you are considering the strategic decision (the Strategy Pillar) of whether and how to obtain a pizza, you should also consider whether your decision is legal (the Law Pillar). In this situation, the Law Pillar of decision making requires you to consider liability for damages. This pillar also involves decision making under uncertainty. For example, if you aren't in New Jersey, how likely is it that the country or state where you are located will apply a rule similar to the New Jersey rule? And even if you are in New Jersey, do the facts in your case fall within the rule? In other words, how likely is it that a jury would decide that you knew or had a special reason to know that your friend would read the text while driving?

If you are risk-averse, you probably would decide to change your strategic implementation plan by, say, asking the restaurant to deliver the pizza or making the pizza yourself. But even if you proceed as originally planned despite the legal risk, you must still consider the third pillar—the Ethics Pillar. Is it ethical to place your friend (and others) at risk by texting her while she is driving? Considering

the Ethics Pillar is important even when you are absolutely certain that your decisions are legal.

Let's now move from this personal decision to leadership decision making—President Obama's decision to authorize the operation that led to bin Laden's death. The President and his advisors initially focused on the Strategy Pillar as they formulated the strategy to capture or kill bin Laden. They also developed an implementation plan—the raid on bin Laden's compound.

With a strategy in place, the President then focused on the Law Pillar. His strategy, like virtually any other personal, business, or leadership strategy, raised several legal questions. Three questions were especially important: did the President have the legal right to "authorize a lethal mission, to delay telling Congress until afterward, and to bury a wartime enemy [bin Laden] at sea"?[1]

According to an account in *The New York Times*,[2] a few days before the raid, a top-secret team of four lawyers provided the President with legal advice relating to these questions. As with most legal advice, the law was not entirely clear. And like other political or business leaders, the President had to decide whether to proceed under conditions of legal uncertainty. In addition, even if the law clearly supported the strategy, the President still had to consider the Ethics Pillar: what were the ethical ramifications of authorizing a mission to kill bin Laden?

As these examples illustrate, the Three Pillar model provides the framework for everyday decisions as simple as ordering a pizza and leadership decisions as complex as the bin Laden raid. This model is especially important in making business decisions, which are the focus of this book. Business decision-makers who overemphasize the Strategy Pillar to the detriment of the Law and Ethics Pillars risk destroying their companies and careers.

ORIGINS OF THE THREE PILLAR MODEL

The Three Pillar model has foundations in naturalistic, philosophical, and sociological theories. In "How Relationality Shapes Business Ethics," Timothy L. Fort (Everleigh Chair in Business Ethics in the Business Law and Ethics Department at Indiana University's Kelley School of Business) provides an insightful analysis of the Three Pillar model's origins. The end result of his analysis is a framework that enables business leaders to take "into account all the forces that are a natural part of human life" when making decisions. These forces are based on "legal, economic, and ecologizing (integrity-based) values."[3]

Emphasizing a corporate social responsibility perspective but arriving at a conclusion similar to Fort's model, Archie B. Carroll (a professor emeritus at the

University of Georgia's Terry College of Business) and Mark S. Schwartz (a business law and ethics professor at York University) developed a three-domain model that builds on earlier work by Carroll. In their model, the three overlapping domains are economic, legal, and ethical.

Their concept of the economic domain covers activities designed to have a positive economic impact on a business, specifically "(i) the maximization of profits and/or (ii) the maximization of share value." They divide the legal domain into three categories: compliance, avoidance of civil litigation, and anticipation of changes in legislation. The ethical domain "refers to the ethical responsibilities of business as expected by the general population and relevant stakeholders."[4]

TRANSLATING THEORY INTO PRACTICE: THE HARVARD MODEL

The clearest practical perspective on the Three Pillar model comes from the Harvard Business School (HBS). Years ago, HBS designed a module called "Leadership, Values and Decision Making" that was taught to all students entering the school's MBA program. Although the module appeared to successfully address the intersection of economic, legal, and ethical issues that shape business decisions, faculty members at Harvard "examined the need to teach more about business law" in light of the globalization of business and increased use of technology.[5] The faculty eventually voted to expand the module into an entire course that all MBA students would be required to take. Following input from many stakeholders (students, alumni, advisory boards, etc.), the course was offered for the first time in 2004 under the name "Leadership and Corporate Accountability" (LCA).

Professor Lynn Sharp Paine was one of the key leaders in developing the course. Paine, the John G. McLean Professor at Harvard Business School, holds a law degree from Harvard and a doctorate in moral philosophy from Oxford. Although she has earned international renown for high-quality research, Paine emphasizes the practical focus when she describes the course: "We are training future practitioners. . . . We focus not on rare events or abstract issues in moral philosophy, but on decisions that students will have to make in their careers."[6]

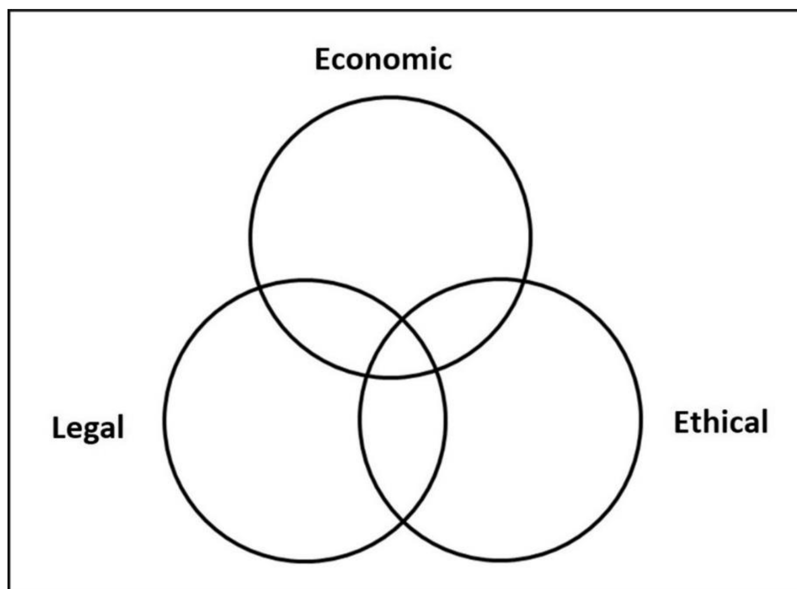
LCA focuses on three key elements—economics, law, and ethics—that form the foundation for decision making in business. As described in the 2011 online version of the course syllabus, a business leader's responsibilities "fall into three broad categories: economic, legal, and ethical. Economic responsibilities relate to resource allocation and wealth creation; legal responsibilities flow from formal

laws and regulations; and ethical responsibilities have to do with basic principles and standards of conduct."[7]

The HBS course mirrors the theoretical work by Fort, Carroll, and Schwartz: "Using the tripartite framework of economics, law, and ethics, we will consider decisions that involve responsibilities to each of the company's core constituencies—investors, customers, employees, suppliers, and the public." These constituencies are also called stakeholders—that is, those who have an interest (a "stake") in the business.

Like other courses at HBS, LCA is not static and continues to evolve to reflect new issues and cases. The online syllabus illustrates the types of issues addressed in the course that relate to the four constituencies. These issues include fiduciary duties, insider trading, conflicts of interest, product liability, fraud, the employment-at-will doctrine, labor law, discrimination, environmental responsibility, privacy, and property rights.

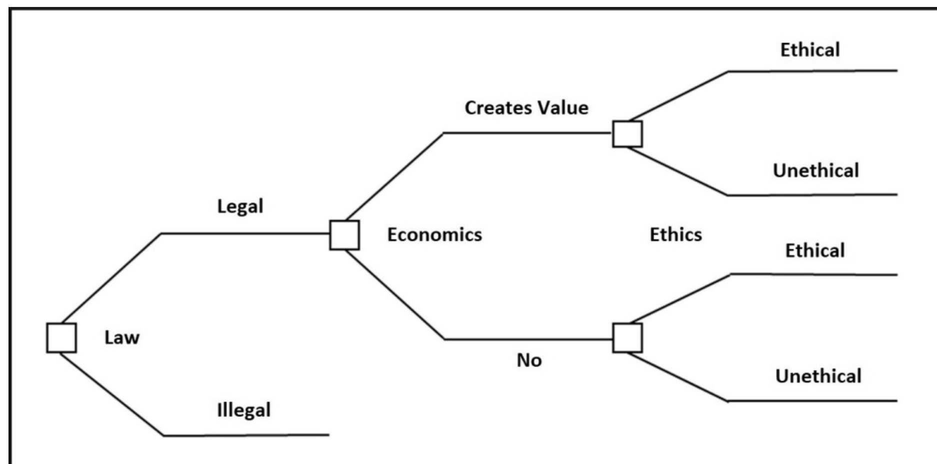
The course is especially challenging and important because it takes students beyond the basics covered in introductory courses on finance, marketing, operations, and so on into what the syllabus calls the "grey areas" of business. These real-world grey areas are shaped by the economics, law, and ethics triad that is a staple of everyday business decision making. The overlap of the three perspectives is depicted by a diagram from a course overview that students receive at the beginning of LCA.



As the course overview notes, "The basic idea is that outstanding managers develop plans of action that fall in the 'sweet spot' at the intersection of their economic, legal, and ethical responsibilities."[8] The course guide for instructors elaborates on what is also described as the "zone of sustainability":[9]

> Actions and strategies that fall inside this zone tend to be acceptable to the firm's constituencies and thus repeatable over time, while those that lie outside typically invite negative repercussions from injured, wronged, or otherwise disappointed parties. Actions outside the zone may even lead to the firm's failure, especially if pursued at length.

The three dimensions of the Harvard model can also be depicted in the form of a decision tree adapted from a diagram developed by Constance Bagley, a senior research fellow at Yale School of Management who previously held business law appointments at Harvard Business School and the Stanford Graduate School of Business. Originally appearing in "The Ethical Leader's Decision Tree,"[10] the tree is reproduced in an article Bagley coauthored with Mark Roellig and Gianmarco Massameno.[11]



The ideal decision making path would follow the Legal, Creates Value, and Ethical branches, although in some cases, another path might be justified. For example, business leaders might decide to take an action that benefits society even if it doesn't create economic value for shareholders. But this decision may raise legal concerns that will be addressed later in this chapter.

Bagley's decision tree intends to help answer the question: "What's the right thing to do?" Keeping that objective in mind, consider the following case involving Apple, Inc. and the US Government. What's the right thing for Apple to do in these circumstances? The company and federal officials have very

different views of the best option to select. This situation illustrates the difficulty companies may encounter in their actions—or lack of actions, as in this circumstance—when economics, law, and ethics are intertwined along the decision making path.

STRATEGY LAW ETHICS	***Three Pillars Case: One Bad Apple***

In 2016, the US Federal Bureau of Investigation (FBI) sought the assistance of Apple, Inc. to access the iPhone data of terrorist Syed Rizwan Farook. In this Motion to Compel, the Department of Justice (DOJ) argues why the company should cooperate with the FBI's request. This case poses an ethical dilemma for Apple as it tries to balance the interests of all the stakeholders involved.

CASE 5:16-CM-00010-SP: IN THE MATTER OF THE SEARCH OF AN APPLE IPHONE SEIZED DURING THE EXECUTION OF A SEARCH WARRANT ON A BLACK LEXUS IS300 CALIFORNIA LICENSE PLATE 35KGD203

ATTORNEYS FOR THE APPLICANT, UNITED STATES OF AMERICA. Rather than assist the effort to fully investigate a terrorist attack by obeying this court's order of February 16, 2016, Apple has responded by publicly repudiating that order. Apple has attempted to design and market its products to allow technology, rather than the law, to control access to data which has been found by this Court to be warranted for an important investigation. Before Syed Rizwan Farook and his wife Tafsheen Malik shot and killed 14 people and injured 22 others at the Inland Regional Center in San Bernardino, Farook's employer issued him an iPhone. The Federal Bureau of Investigation ("FBI") recovered that iPhone during the investigation into the massacre. . . . The phone may contain critical communications and data prior to and around the time of the shooting that, thus far: (1) has not been accessed; (2) may reside solely on the phone; and (3) cannot be accessed by any other means known to either the government or Apple. The FBI obtained a warrant to search the iPhone, and the owner of the iPhone, Farook's employer, also gave the FBI its consent . . . Because the iPhone was locked, the government subsequently sought Apple's help in its efforts to execute the lawfully issued search warrant. Apple refused.

The Order does not, as Apple's public statement alleges, require Apple to create or provide a "back door" to every iPhone; it does not provide "hackers and criminals" access to iPhones; it does not require Apple to "hack [its] own users" or to "decrypt" its own phones; it does not give the government "the power to reach into anyone's device" without a warrant or court authorization; and it does

not compromise the security of personal information. . . . In the past, Apple has consistently complied with a significant number of orders . . . to facilitate the execution of search warrants on Apple devices running earlier versions of iOS. . . . Based on Apple's recent public statement . . . Apple's current refusal to comply with the Court's Order, despite the technical feasibility of doing so, instead appears to be based on its concern for its business model and public brand marketing strategy. Accordingly, the government now brings this motion to compel.

THREE PILLARS CASE QUESTIONS

(1) Assuming Apple's refusal was legal (the case ended before this was determined because the FBI was able to access the iPhone through another source), do you think Apple's decision would create value for the company and shareholders? For iPhone users? Why?

(2) Assuming again that Apple's refusal to help the FBI was legal, is this decision ethical? How do you make this determination?

(3) Apple asserted in its public statement that its help to open Farook's phone would make information and data on all iPhones vulnerable. If true, would this be a valid reason for Apple to refuse to cooperate with the government? The government was later able to gain access to the phone through help from a third party. Does the government now have an ethical obligation to share that access information with Apple?

(4) What do you believe the government means when they say Apple is refusing to comply because of "concern for its business model and public brand marketing strategy"? If true, is this a valid reason for Apple's noncompliance?

EXPANDING THE HARVARD MODEL

The Harvard model and the decision tree provide a valuable framework for making business decisions. However, by expanding the economics perspective, the model also becomes useful in making decisions beyond the business sphere.

While economics is a key discipline relating to the business goal of value creation, other disciplines and functions also contribute to business success. Business school courses are based on three disciplines in addition to economics—law, psychology, and statistics. The landmark Carnegie study of business education, for instance, recommended that business schools place "heavy weight on preparation in the four foundation areas—quantitative methods, economics,

law and public policy, and psychology-sociology," with two required three-credit courses on regulation and law.[12]

Business success depends on key functions that draw on these disciplines. As noted in the opening sentence of a *Harvard Business Review* article on business functions: "Business units come and go, but finance, HR, IT, marketing, legal, and R&D are forever."[13]

The departmental organization of business schools often mirrors key business functions. For example, at the University of Michigan's Ross School of Business the economics discipline is represented by a Business Economics area, while other academic areas reflect the seven key business functions that are present in virtually every major company: (1) Accounting, (2) Business Law, (3) Finance, (4) Management & Organizations, (5) Marketing, (6) Strategy, and (7) Technology and Operations.

Departments at the University of Pennsylvania's Wharton School are organized along the same lines, except that Strategy is included in the Management Department and there are three additional departments—two industry-related (Health Care Management and Real Estate) and one discipline-related (Statistics).

The "Big Seven" functions represented in both company and business school organizational structures are critical to the success of businesses of all sizes. The most important issues facing an entrepreneur starting a business, for example, relate to accounting, financing, legal, marketing, operations, staffing, and strategic concerns.

Strategy is the most likely candidate among the seven functions to replace economics. Defined broadly, strategy involves establishing and achieving goals. In a business setting, strategy focuses on the goal of value creation for shareholders, which brings into play all functions and disciplines, including economics.

Strategy is also an attractive candidate because it is important in all organizations, even nonprofits that are not concerned with generating profits for shareholders. And on a personal level, your strategic ability to establish and achieve goals is key to your success, however you choose to define it. So by replacing economics with strategy, the Three Pillar model (strategy, law, ethics) becomes a framework that is more appropriate for all forms of business, leadership, and personal decision making.

THE THREE PILLAR MODEL AND BUSINESS DECISIONS

Although the Three Pillar model (strategy, law, ethics) can be applied within all organizations (public or private, business or nonprofit) and also when making personal decisions as simple as ordering a pizza, this book focuses on using the model to make business decisions. The key questions that business decision-makers should address are:

1. Strategy Pillar: What is our value creation goal, and how do we intend to achieve it? (*Note: After a strategic plan has been formulated, the remaining two pillars can be considered in either order.*)

2. Law Pillar: How can we manage the legal risks associated with our strategy?

3. Ethics Pillar: Is our proposed strategic decision ethical?

We now examine each of the pillars as they relate to business before turning in Chapter 2 to some of the major challenges in using the Three Pillar model—such as the significant gap between the Strategy Pillar and the Law Pillar.

The Strategy Pillar

According to Pulitzer Prize-winning historian Alfred Chandler, "Strategy is the determination of the basic long-term goals of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals."[14] This definition states the twin aspects of business strategy (as well as other types of strategy): formulating goals and planning for implementation. The late Yogi Berra, a baseball legend, summarized the risk in not having a strategic plan: "If you don't know where you are going, you might wind up someplace else."

The goal in business is often framed in terms of value creation. Harvard professor Michael Porter summarizes the two key issues that form the basis of strategic choice as (1) the attractiveness of industries and (2) the competitive position within an industry.

Industry attractiveness, according to Porter, is determined by "five competitive forces: the entry of new competitors, the threat of substitutes, the bargaining power of buyers, the bargaining power of suppliers, and the rivalry among the existing competitors." Competitive position within an industry is based on value creation and "superior value stems from offering lower prices than competitors for equivalent benefits or providing unique benefits that more than offset a higher price."[15]

Business leaders often frame their goals in terms of value creation for shareholders. The so-called "shareholder primacy" theory asserts that shareholders should have top priority over other corporate stakeholders. This theory has been criticized because, in emphasizing shareholder profits, it allegedly encourages short-term thinking. The legal foundations of this theory are analyzed later, in Chapter 2.

The Law Pillar

According to *Black's Law Dictionary*, law represents "A system of principles and rules of human conduct. . . ." In a business setting, law represents the "rules of the game," the framework for business operations and decision making. As a manager in an executive course at the University of Michigan put it, law provides the architecture in which business is conducted.

Whereas law has always been a key element in business success, its importance accelerated in the last half of the twentieth century. Chayes, Greenwald, and Wing, in a *Harvard Business Review* article published in 1983,[16] referred to the "growth in the scope, nature, and complexity of government regulation" and the "equally rapid rise in consumer, shareholder, employee, and competitor litigation" in concluding that managers need "to include legal advice as an essential element of business planning and decision making."

More recently, the global dimension of business has enhanced the role of law in business decision making. The first question an investor should raise when considering an investment in another country is this: "Does this country have a rule of law or, instead, will the company be subject to the arbitrary whims of government officials?"

This question became especially important after market systems developed in former Communist countries. As George Melloan observed, writing in the *Wall Street Journal*, a market system cannot be established in an emerging economy "without first creating a legal system that protects the right of all individuals to hold, buy or sell property and without corresponding legal protections for the contracts through which those transactions are conducted."[17]

Once you decide that your target country follows the rule of law, you must then understand what the law requires. As Carolyn Hotchkiss (Professor Emeritus and former Dean at Babson College) has observed:

> Law provides the ground rules for international trade and investment in goods, services and technology. An understanding of the ground rules for that trade and investment allows managers to compete successfully

> in the most competitive global markets. A working understanding of the international legal environment allows managers to make judgments about the political and business risk of doing business in countries around the world.[18]

Echoing this observation, Jere Morehead, President of the University of Georgia (and Meigs Professor of Legal Studies in the Terry College of Business), has emphasized the importance of international business law courses in business schools.[19] And a survey of business leaders presented at a conference on the Internationalization of US Education in the twenty-first Century concluded that the two most important international skills that companies seek in their professional staff and line managers are an appreciation for cross-cultural differences and an understanding of legal/government requirements.[20]

Surveys of senior executives highlight the importance of the Law Pillar. For example, sessions on law ranked third (behind only Organization Behavior and Finance) in terms of value according to more than nine hundred senior managers attending general, industry, and functional executive programs at the University of Michigan.[21]

This high ranking of law is not surprising given the considerable amount of time business leaders spend on legal issues. Although studies over the years have concluded that leaders spend a high percentage of their time on legal matters, prominent management scholar Henry Mintzberg published the most telling research in his *Harvard Business Review* classic "The Manager's Job: Folklore and Fact."[22] In this article, Mintzberg describes the four roles that managers play as decision-makers: entrepreneur, resource allocator, disturbance handler, and negotiator.

Mintzberg concludes that managers act as *entrepreneurs* when trying to improve the business and adapt it to a changing environment. They act as *resource allocators* in making budgeting decisions, authorizing projects, and designing the organizational structure. Both of these roles are replete with legal issues relating to new product development, marketing plans, department reorganization, mergers and acquisitions, and so on.

Law becomes even more important when managers play their other two roles. Mintzberg notes that as *disturbance handlers*, managers must respond involuntarily when "pressures of a situation are too severe to be ignored—a strike looms, a major customer has gone bankrupt, or a supplier reneges on a contract. . . ."

The manager's role as a *negotiator* is equally important. In Mintzberg's words, "Managers spend considerable time in negotiations: the president of the football team works out a contract with the holdout superstar; the corporation president leads the company's contingent to negotiate a new strike issue; the foreman argues a grievance problem to its conclusion with the shop steward." These negotiations are filled with legal issues because, to cite a familiar adage, negotiation takes place within the shadow of the law.

In addition to these four roles that require them to become legal decision-makers, managers are legal communicators. They must be prepared to discuss legal matters with all company stakeholders—notably investors (and their representatives, the Board of Directors), creditors, customers, employees, suppliers, and government regulators.

Managers' decisional and communication roles increase as they move up the ranks. It is no surprise that they spend considerable time with their lawyers. As the CEO of United States Steel Corporation put it, "The CEO and the GC [General Counsel] must have the kind of relationship in which they're able to practically finish each other's sentences."[23]

The Law Pillar's importance extends beyond its impact on managers in large companies. For example, entrepreneurs starting a business must make decisions regarding

- the legal form of their business,
- government regulations that govern how they develop and market their products and services,
- liability risks in manufacturing and selling their products,
- protection of their intellectual property,
- the nature of their contracts with customers and suppliers,
- legal considerations relating to financing the business, and
- the law that governs hiring employees.

It is no surprise that legendary entrepreneur David Packard, cofounder of Hewlett-Packard, concluded that business law and management accounting were the most valuable courses he took at Stanford's Graduate School of Business.[24]

The Ethics Pillar

In broad terms, ethics focuses on determining whether conduct is right or wrong and "prescribes what humans ought to do in terms of rights, obligations, benefits

to society, fairness, or specific virtues."[25] According to the *Stanford Encyclopedia of Philosophy*, when applied to business, ethics is a discipline that focuses on the "moral features of commercial activity."

The Ethics Pillar is especially important because unethical conduct by one company can harm a broad swath of stakeholders, as illustrated by the emissions scandal involving Volkswagen (VW) that erupted in late 2015. At the time, VW was the world's leader in car sales. Shortly after United States government regulators announced that VW had cheated on air pollution tests, VW CEO Martin Winterkorn stated that he was "deeply sorry that we have broken the trust of our customers and the public." The head of VW in the United States put it more bluntly: "Our company was dishonest [with the regulators]. . . . We have totally screwed up."[26]

In addition to its obvious impact on the company, the scandal had a ripple effect on many stakeholders. The following Reuters headlines, printed in the months following Winterkorn's announcement, reveal the impact not only on VW's leaders and shareholders but also on Germany, the local community, government regulators, employees, the diesel industry, suppliers, and customers.

- Shareholders: "VW Shares Plunge on Emissions Scandal"
- Germany: "Volkswagen Scandal Threatens 'Made in Germany' Image"
- Community: "Diesel Scandal Casts Gloom Over VW's Home Town"
- Regulators: "VW Scandal Exposes Cozy Ties Between Industry and Berlin"
- Company Leaders: "Former VW Boss Investigated for Fraud"
- Employees: "VW Halts Hiring at Financing Arm After Emissions Scandal"
- Industry: "VW Rivals Risk Bigger Blow as Emissions Scandal Hits Diesel"
- Suppliers: "Car Parts Maker Says VW Suppliers Should Not Pay for Scandal"
- Customers: "Volkswagen Diesel Owners in US Face Lost Value and Limbo"

Not mentioned in these headlines is the potential health hazard to the public resulting from the company's violation of environmental regulations. The United

States government alleged that VW violated the Clean Air Act. The company faced potential fines of over $90 billion, which did not include fines from non-US regulators or damages from lawsuits filed by customers.

An editorial in the *Financial Times* titled "Bankers Not Only Ones Pushing Ethical Boundaries" discussed problems in the banking industry in recent years, such as guilty pleas and settlements by banks charged with rigging foreign exchange and LIBOR rates.[27] (These cases involved Barclays, Citicorp, Deutsche Bank, JP Morgan Chase, the Royal Bank of Scotland, and other banks that paid billions of dollars in fines and settlements.) The editorial then observed that in other industries "companies around the world are pushing ethical boundaries," citing a $2 billion accounting scandal at Toshiba and General Motors' $900 million settlement with United States regulators for covering up its faulty ignition switches that resulted in more than one hundred deaths.

The examples in the editorial dramatically illustrate the consequences of improper conduct, but the headline referring to "pushing ethical boundaries" illustrates a popular misconception that the problems fall entirely within the realm of the Ethics Pillar. All of the cases mentioned in the editorial, along with the VW scandal, involved violations of the law and illustrate the need for business leaders to understand both the Law Pillar and the Ethics Pillar. Writing in *The New York Times*, Robert Prentice (Ed & Molly Smith Professor of Business Law at the McCombs School of Business, University of Texas) observed that scandals such as Enron, WorldCom, and ImClone involved serious ethical lapses, but they also occurred "because their participants had an insufficient knowledge of, appreciation for and, yes, fear of the law."[28]

The fear of the law that Prentice mentions is justified, considering legal penalties that have both civil and criminal dimensions. Claims against BP for the Deepwater Horizon oil spill illustrate both types of consequences. BP agreed to settle government claims for $18.7 billion. This settlement did not include an earlier $4 billion paid to settle a criminal investigation, an estimated $10.3 billion to settle several civil cases, and an undetermined amount the company would need to settle future civil cases (around three thousand such cases).[29]

But it is not enough for a company to understand and comply with the Law Pillar alone, and that is where the Ethics Pillar becomes important. The late author Rushworth Kidder, in his book *How Good People Make Tough Choices*, suggests that "decision making is driven by our core values, morals and integrity" and involves decisions that are either a clear choice between "right" and "wrong" or determinations that are more nuanced because the decision-maker is caught between a "right" and another "right."

Companies and their leaders make decisions that fall into the clear choice category all the time; for example, it has been argued that VW knew that its programming of vehicles to "fool" the emissions tests was a "wrong," yet it took this action anyway—possibly because the company lacked an appreciation for or fear of the law, as described by Prentice.[30]

Much more difficult for companies are decisions that are clearly legal but ethically questionable. Is it acceptable to test unknown products on animals with the goal of protecting humans who will use those products in the future? Is it ethical for a pharmaceutical company to set high prices on a patented drug to increase profits and cover the cost of drug development, even if that reduces affordability for some of the people who need it? Kidder believes that without legal compliance, you can "never arrive at a genuinely ethical mindset. But neither will you get there by compliance alone." The toughest choices are choosing between options that are all on the "right" side of the law.

This difficulty of achieving a "genuinely ethical mindset" is illustrated in the following case—*POM Wonderful LLC v. Coca-Cola Company*—where the juice maker POM Wonderful brought suit against soft drink manufacturer and competitor Coca-Cola for misleading labeling. With questionable strategies being applied by both companies, many ethical considerations are raised by this litigation.

STRATEGY LAW ETHICS	***Three Pillars Case: It's Not the Real Thing***

Citation: *POM Wonderful LLC v. Coca-Cola Co.*, 166 F.Supp.3d 1085 (C.D. Cal. 2016)

Juice products, especially those containing pomegranate juice, have become popular among consumers who believe these products have associated health benefits. POM Wonderful, a manufacturer whose product lines include juice, juice blends, teas, concentrates, and extracts, brought a claim against competitor Coca-Cola for false/misleading advertising related to one of the latter's beverages. POM also made similar unsuccessful claims against other competitors, including Ocean Spray Cranberries, Inc. (in 2010) and Tropicana Products, Inc. (in 2011). In this decision by the US District Court of Central California, Judge Otero finds that POM Wonderful might have had "unclean hands" in its infringement action. This case illustrates—with regard to the companies on both sides of the issue—that although a strategy may be legal, it's important to consider the ethics of strategic decisions.

ORDER GRANTING IN PART AND DENYING IN PART PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT [DOCKET NO. 498]

HONORABLE S. JAMES OTERO, UNITED STATES DISTRICT JUDGE

POM initiated the instant action against Coca-Cola on September 22, 2008, asserting three causes of action associated with Coca-Cola's sales of "Minute Maid® Enhanced Pomegranate Blueberry Flavored 100% Juice Blend" ("the Juice"). . . . POM's . . . claim centers on allegations that Coca-Cola has made false and/or misleading statements as to the pomegranate and blueberry juice content in the Juice product. POM alleges that consumers will believe the main ingredients in Coca-Cola's Juice product are pomegranate and blueberry juice, when in fact pomegranate juice ranks third and blueberry juice ranks fifth, by volume.

. . . POM further alleges that it has "invested millions of dollars in researching the nutritional qualities and health benefits of pomegranate juice, an investment that continues to this day," and further alleges that "[a] key element of P[OM's] marketing campaign has been its concentration on the health benefits associated with pomegranates and pomegranate juice. . . ." According to POM, this "investment of millions of dollars to research and promote the nutritional qualities and health benefits associated with pomegranate juice" enabled POM to "largely create the burgeoning market for genuine pomegranate juice that exists today."

. . . POM identifies Coca-Cola . . . as one of several "[u]nscrupulous competitors [that] have set out to cash in on [POM's] success" and to profit from the fact that, "[d]ue to POM's marketing efforts and funding of research, . . . many consumers now associate pomegranate juice with certain nutritional qualities and health benefits." POM claims that Coca-Cola's Juice label contains many misleading elements not required by federal or state regulation, by, for example, naming the Juice "Pomegranate Blueberry" and juxtaposing this brand name with a picture of a pomegranate and other fruits when in fact the Juice is primarily composed of cheaper apple and grape juices. As a result, POM alleges that Coca-Cola "wrongfully misleads and deceives consumers, and tricks them into believing that they are getting a similar product [to POM's] (i.e., all natural pomegranate blueberry juice with all of its associated health benefits) for a lower price, when in fact they are getting a very different product primarily containing apple juice and grape juice."

Coca-Cola filed its Answer . . . on September 30, 2009, in which it asserts a number of affirmative defenses. At issue in the instant Motion is the thirty-forth affirmative defense, in which Coca-Cola alleges that "P[OM]'s claims against

[Coca-Cola] are barred, in whole or in part, due to unclean hands." In support of this affirmative defense, Coca-Cola offers the following:

> Plaintiff has engaged in naming, labeling, marketing and advertising conduct designed to deceive consumers about its products. For instance, Plaintiff describes its Pomegranate Blueberry juice product as Pomegranate Blueberry 100% Juice, yet at the time it filed its Complaint, Plaintiff's product contained other ingredients, including plum, pineapple, apple, and blackberry juices from concentrates and natural flavors. In addition, Plaintiff's name, label, advertisements, website, and promotions of Plaintiff's pomegranate juice products—including its 100% pomegranate juice product and its 100% juice blend products, such as its Pomegranate Blueberry 100% Juice product—are designed to give consumers the false impression that these juices are fresh-squeezed, and not "from concentrate." In addition, Plaintiff alleges that it "largely created the burgeoning market for genuine pomegranate juice," by educating the public about health claims through its advertisements and/or promotions. Many of Plaintiff's health claims are not supported by any substantial scientific evidence. Indeed, by Plaintiff's own admission, many of its advertising claims constitute mere "puffery." Thus, Plaintiff is seeking to capitalize in this case on the fruits of its own misconduct in the form of misleading labeling and advertising.

Thus, Coca-Cola's unclean hands defense alleges three distinct forms of misconduct: (1) that POM's juice product contained ingredients other than pomegranate and blueberry notwithstanding being labeled "Pomegranate Blueberry 100% Juice" ("ingredient claim"); (2) that POM gave the false impression that its juices were "fresh-squeezed" rather than "from concentrate" (" 'from concentrate' claim"); and (3) that POM's health claims about its pomegranate products are "not supported by any substantial scientific evidence" ("health advertisement claim").

. . . Coca-Cola first argues that a finding by the Federal Trade Commission ("FTC") that POM violated the Federal Trade Commission Act ("FTC Act") by making false and misleading claims about the health benefits of several of POM's pomegranate products is sufficient, standing alone, to demonstrate that POM engaged in inequitable conduct. . . . On January 10, 2013, the FTC issued an opinion ("FTC Opinion") in which it found that POM and its officers violated Sections 5(a) and 12 of the FTC Act by disseminating advertising and promotional materials representing that consumption of certain doses of pomegranate juice

products treats, prevent, or reduces the risk of heart disease, prostate cancer, or erectile dysfunction ("ED") without having a reasonable basis to substantiate these claims. . . . Coca-Cola contends that these "are precisely the type of statutory violations that renders a party's hands unclean," and POM "should not be permitted to recover on the theory that, but for Coca-Cola's sales of the Juice, P[OM]'s fraud would have been even more successful than it was."

. . . Coca-Cola seeks to offer at trial evidence that POM engaged in inequitable conduct by advertising the results of studies regarding the purported health benefits of pomegranate consumption when POM knew that these and related studies reached inconclusive, statistically insignificant, or even negative results. For example, Coca-Cola points to advertisements by POM claiming that pomegranate and pomegranate juice consumption (1) reduces the risk of heart disease; (2) prevents men from "dying of prostate cancer"; and (3) improved erections in men. Coca-Cola has also supplied evidence that studies relied on and referenced in these advertisements (1) reached inconclusive results; (2) were undermined by other research that POM forestalled; (3) relied on improper premises, methods, and indicators; (4) were known by POM employees to be statistically insignificant; and (5) were determined by independent authorities, including the United States government, at an early stage to be unsubstantiated. This evidence tends to show that POM knowingly relied upon inconclusive, discredited, or simply false studies in its health advertisements to consumers, and is sufficient to create a genuine issue whether POM engaged in inequitable conduct.

. . . [T]he Court finds that Coca-Cola has introduced evidence sufficient to create a genuine issue as to whether POM's conduct is inequitable. . . . Thus, the Court DENIES POM's Motion as to pertains to Coca-Cola's health advertisement claim.

IT IS SO ORDERED.

THREE PILLARS CASE QUESTIONS

(1) Describe the concern that POM Wonderful has with the Coca-Cola product. If this claim of misleading labeling proves to be false, would Coca-Cola's conduct still be unethical?

(2) What is the defense of "unclean hands" (https://en.wikipedia.org/wiki/Clean_hands)? Describe the basis of Coca-Cola's unclean hands defense against POM Wonderful. When an unclean hands defense is successful, then any judgment against

the defendant is typically reduced or eliminated. What do you think is the legal principle behind the unclean hands defense?

(3) This is not the first time that POM Wonderful has brought the same allegation of deceptive labeling against a competitor. In a number of the previous cases, California juries found that the competitor labels were not misleading, and the defendants prevailed. In another case, the defendant company was found liable. Additionally, POM has itself been cited by the FTC for false and misleading advertising claims/labels. Some analysts have suggested that POM brings these suits to antagonize competing food and beverage industry manufacturers and distract from its own transgressions. If true, is this a viable strategy to promote the company?

(4) Imagine that POM Wonderful sues small and startup companies for mislabeling, even though the company knows that it will likely lose the case. Why do you think POM would adopt such a strategy? Is the strategy ethical?

(5) In March 2016, a jury found that POM Wonderful did not prove by a preponderance of the evidence that the label on Coca-Cola's juice product misled a substantial portion of consumers. Instead of engaging in litigation with competitors or making unsubstantiated claims about its own products, what is a legal and ethical strategy that POM Wonderful can apply to compete against other juice products on the market?

The decision making process becomes more focused, effective, and advantageous when managers strategize within the dimensions of law and ethics. In Chapter 2, we look at some challenges with aligning the three pillars and at the relative importance of each pillar—strategy, law, and ethics—in the model's application to decision making.

KEY TAKEAWAYS

This book focuses on the three pillars that provide the foundation for decisions in business, leadership, and everyday life: strategy, law, and ethics. In order to make sound, responsible business decisions, you should consider the following:

1. **The Strategy Pillar.** You should contemplate the questions: *what is our value creation goal, and how do we intend to achieve it?* In order to research the law and evaluate the ethics of accomplishing your business goal, you must first develop a strategy that outlines your objectives. A well-designed strategy is ground zero for moving forward.

2. **The Law Pillar.** In a business setting, law represents the "rules of the game"—the framework for business operations and decision

making. Once you have decided on a strategy to accomplish your goal, the next step is to evaluate the legality of your design. What you discover in your due diligence investigation of legal concerns will allow you to refine and adjust your strategy, ultimately creating value for your business within a legal framework.

3. **The Ethics Pillar.** Some businesses believe that as long as they abide by the law, they do not need to be concerned with ethics. However, a business that keeps ethics at the forefront of its decision making will benefit from the ability to recruit and retain top employees and customers, and it will create value that will attract investors and maintain a respectable, highly-regarded profile in the business community.

STRATEGY
LAW ***Three Pillars Decision: Last Trip to Disney World***
ETHICS

In this analysis, a major recreation industry player needs to carefully consider some of the questionable benefits of its popularity with the public.

According to the *Wall Street Journal* (WSJ), the famous amusement park Walt Disney World (WDW) is a relished location for families of the dearly departed to spread the ashes of cremated friends and relatives. The WSJ describes the smuggling in of cremated human remains ("cremains") in pill bottles or plastic bags and the depositing of them in favorite park locations: *Pirates of the Caribbean*, *It's a Small World*, and—most popular by far—the *Haunted Mansion*. When such an incident occurs, it interrupts ride operations and involves an environmentally safe cleanup by Disney employees using vacuums with high-efficiency filters.

VALUE GOAL: Respectfully diminish and/or prevent the depositing of human cremains within attractions at WDW Park.

STRATEGY: Develop and implement a plan to reduce/prevent the depositing of cremains at WDW Park.

LAW: Research the law related to the depositing of cremated human remains in public and private places in the state of Florida, where WDW is located. How does this research affect or alter the strategy you developed?

ETHICS: Apply ethics to your strategy by working through these four steps of ethical decision making: (1) describe the ethical dilemma, (2) identify the stakeholders involved, (3) analyze options (including how each group of stakeholders will be affected), and (4) make a decision based on your analysis.

After examining ethical issues associated with the strategy, determine whether any modifications should be made.

৯*Check for law research materials in the Appendix: Legal Resources for Business Decisions*

STRATEGY LAW ETHICS	***Three Pillars Decision: Reservations of the Heart***

In the situation described below, the hospitality industry wrestles with a decision that could save lives but also may result in significant civil liability if not properly implemented and monitored.

"Each year, more than 250,000 Americans die from sudden cardiac arrest."[31] A technological advance—the "automated external defibrillator" or "AED"—has been promoted as a life-saving device that may be used by non-medical personnel to treat a person whose heart has stopped beating. The AED device "guides the user through the process by audible or visual prompts without requiring any discretion or judgment."[32] According to the American Heart Association, use of the AED could potentially save at least twenty thousand lives annually.

Some state governments require AED placement in health and fitness centers, schools, swimming pools, daycare centers, dental offices, and places of public assembly.[33] There are, however, locations that have resisted the addition of AEDs, such as hotels and resort centers. Hotel operators have expressed concerns about being sued for logistical failures: failing to have enough units, failing to place units in the proper locations, and failing to properly maintain units. Their fears may not be unfounded; according to the US Food and Drug Administration, there have been forty-five thousand reports of AED devices failing or malfunctioning (primarily due to lack of proper maintenance) since 2005 and eighty-eight manufacturer recalls.[34] However, advocates of adding AEDs to all public locations argue that, with the widespread adoption of the devices, hotels that fail to add the life-saving technology will likely experience greater liability risk for *not* installing this option.

VALUE GOAL: To add the potential life-saving technology of AEDs within the hospitality industry.

STRATEGY: Select a US state and develop a strategy to add AEDs to hotels within that state.

LAW: Research the AED law of the state you selected. How does this research affect or alter the strategy you developed? Refine your strategy to align with the law.৯

ETHICS: Hotels may incur liability whether they decide to add AEDs or continue to resist this option. Because of this dichotomy, apply ethics to your strategy of adding AEDs to hotels and be sure to include the option of doing nothing (no addition of AEDs). In your analysis, work through these four steps of ethical decision making: (1) describe the ethical dilemma, (2) identify the stakeholders involved, (3) analyze options (including how each group of stakeholders will be affected), and (4) make a decision based on your analysis. After examining ethical issues associated with both strategies, determine what the best course of action would be: (1) Add AEDs or (2) Do not add AEDs.

ꕥ*Check for law research materials in the Appendix: Legal Resources for Business Decisions*

STRATEGY
LAW **_Three Pillars Decision: "Fair and Square" Strategy_**
ETHICS

The scenario described below is a cautionary tale for companies that try to compete by employing strategies that fail to incorporate the pillars of Law and Ethics into their decision making.

In 2012, California consumer Cynthia Spann filed a class-action lawsuit against retail giant J.C. Penney, alleging that the company tricked her into thinking she was getting good deals on falsely advertised "sale" merchandise. Spann claimed in her complaint that:

> [d]uring at least the last four years, J.C. Penney has misrepresented the existence, nature and amount of price discounts by purporting to offer specific dollar discounts from expressly referenced former retail prices, which are misrepresented as "original" retail prices. These purported discounts are false, however, because the referenced former retail prices are fabricated and do not represent J.C. Penney's true "original" prices.[35]

Spann's experience focused on being induced to spend more than $200 on items with fake discounts, which she would not have otherwise spent if she knew the truth behind the merchandise pricing. Customer complaints suggest the strategy used by the retailer involved artificially inflating prices, then deceiving the buyer by taking what appeared to be deep discounts off those prices.

Also in the year 2012, J.C. Penney supposedly halted the fake sales scheme in favor of CEO Ron Johnson's "Fair and Square" strategy, which offered items at "everyday low prices." The approach failed miserably, however—loyal shoppers accustomed to the heavy discounting of sales were confused by the simplified pricing. According to a J.C. Penney spokesperson, "while our prices continue to represent a tremendous value every day, we now understand that customers are

motivated by promotions and prefer to receive discounts through sales and coupons applied at the register."[36]

In 2013, J.C. Penney ousted CEO Johnson and apparently went back to its standard pricing practice, which included what had been characterized as "fake prices." Penney's isn't the only company engaged in this deception; retailers Jos. A. Bank and Kohl's have also been sued for listing prices that were allegedly "misleading, inaccurate and deceptive marketing."[37]

VALUE GOAL: Provide a pricing strategy that both satisfies consumers and protects profits.

STRATEGY: Develop and implement a plan to effectively address consumer pricing expectations.

LAW: Access the Federal Trade Commission's (FTC) "Advertising FAQ's: A Guide for Small Business" and determine how the FTC determines if an ad is deceptive. Compare these rules to your strategy and make any adjustments to be sure your plans comport with the law.↔

ETHICS: Apply ethics to your strategy by working through these four steps of ethical decision making: (1) describe the ethical dilemma, (2) identify the stakeholders involved, (3) analyze options (including how each group of stakeholders will be affected), and (4) make a decision based on your analysis. After examining ethical issues associated with the strategy, determine whether any modifications should be made.

↔*Check for law research materials in the Appendix: Legal Resources for Business Decisions*

STRATEGY
LAW **Three Pillars Decision: "Nor Any Drop to Drink. . ."**[38]
ETHICS

This decision making scenario examines formulating an ethical strategy when danger is an unavoidable element of business operations.

In 2007, twenty-nine-year-old Dave Buschow died of thirst during a wilderness survival course exercise in Utah. Although Dave's guides who accompanied him had emergency water supplies available, they withheld that resource because the focus of the twenty-eight-day program was to push "past those false limits your mind has set for your body."[39] Participants in the course could drink water only from natural sources on the land and couldn't carry anything to drink with them. After walking for approximately ten hours in one-hundred-degree heat, Dave collapsed and could not be revived. The medical examiner cited the cause of death

as dehydration and an electrolyte imbalance. Administrators at the course's school—Boulder Outdoor Survival School (BOSS)—maintained that Dave signed liability waivers and expressly assumed the risk of serious injury or death prior to participating. They also indicated that they believed Dave failed to read the course materials, may have withheld health information, and may have also eaten too much prior to beginning the course.[40]

VALUE GOAL: To provide challenging, rigorous survival training while maintaining safety for participants.

STRATEGY: Develop a strategy for a survival-training program that tests the mental and physical limits of participants but also provides protection against serious injury or death.

LAW: Research the law related to engaging in high-risk activities, liability waivers, and negligence. What is the legal responsibility for providers of a risky survival course such as the one designed by BOSS? How does this research affect or alter the strategy you developed? If necessary, refine your strategy to align with the law.➢

ETHICS: There is a concern in this case about finding a balance between the intent of the program and the safety of participants. In examining this situation, apply ethics to your strategy by working through these four steps of ethical decision making: (1) describe the ethical dilemma, (2) identify the stakeholders involved, (3) analyze options (including how each group of stakeholders will be affected), and (4) make a decision based on your analysis. After examining ethical issues associated with the strategy, determine whether any modifications should be made.

➢*Check for law research materials in the Appendix: Legal Resources for Business Decisions*

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