**Alternate Case Problem Answers**

# *Chapter 2*

**Business Ethics**

**2-1A. *Consumer welfare***

The court hearing the case was not convinced by the father’s arguments. Rather, the court held that certain risks, such as falling off a jungle gym, are so obvious that manu­facturers need not warn of them. In its decision, the court applied the age-old common-sense principle: “If you fall, you might get hurt.”

Today’s manufacturers are plagued by product liability suits, many of which strain the limits of one’s legal imagination. There is, after all, some­thing called common sense, and most courts agree that consumers should ex­pect to incur certain risks when they use particular products. For example, if a consumer is cut by a sharp knife, the manufacturer should not be held respon­sible for that injury because the risk was obvi­ous and inherent in the nature of the product. Similarly (one would think), manufac­turers of playground equip­ment should not have to bear responsibility for injuries sus­tained by children who fall off such equipment, providing the equipment itself is not faulty. But many consumers view the matter otherwise, and in recent years, a number of cases—including the *Cozzi* case—have come before the courts in which plain­tiffs al­lege that manufacturers of playground equipment should be held liable for injuries sus­tained by children while playing on the equipment.

**2-2A. *Duty to consumers***

The state trial court held that although Terry’s use of the lighter was an unintended use, Bic should have known that harm caused by a child’s use of its product was a fore­seeable risk. Because Bic failed to design its product in such a way as to avoid this risk, it did not exercise reasonable care and was therefore liable for Terry’s injuries. The court stated that because lighters such as those manufactured by Bic “are commonly used and kept about the home, it is reasonably foreseeable that children will have access to them and will try to use them.” In response to Bic’s argument under the *Restatement (Second) of Torts,* the court held that New York law is broader than that set forth in the *Restatement*. In New York, manufacturers have a duty to design a product so that it avoids an unrea­sonable risk of harm to anyone who is likely to be exposed to danger when the product is being used either as intended or in unintended but foreseeable ways. In response to Bic’s claim that the risks associated with its lighter were “open and obvious,” which in some situations is a defense to a claim of negligence, the court held that in New York that doc­trine “is simply another factor that is considered in de­termining the reasonable care ex­ercised by the parties.”

**2-3A.** ***Employment relationships***

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

**2-4A.** ***Ethical conduct***

The court enjoined the defendants, for a period of three years, “from disclosing, using or selling any of [Elm City’s] confidential customer information, trade secrets, procedures, technical data or know‑how relating to the products, processes, methods, research and development plans, equipment or business operations of [Elm City].” The court also awarded Elm City $461,239 in compensatory damages, $300,000 in punitive damages, and $100,000 in attorney’s fees. The defendants’ appeal went to the Connecticut Supreme Court, which upheld the injunction and the damages. The court emphasized that “Federico used confidential business information that he was duty bound, by both statute and the ethics of his profession, to keep confidential. He cannot do so and then hide behind professedignorance that the information he used improperly is part of Elm City’s trade secret.” The court concluded that “Federico should have known that he was using information that was a trade secret and that he was duty bound to keep confiden­tial.” The court added that Federico was “on a course for Elm City’s demise rather than to enter into fair competition.” For example, the choice of location for Lomar was closer to the suppliers than Elm City’s location and would “chok[e] off” Elm City’s supplies. Federico would be “choking off further the distribution of Elm City’s life lines by getting the three major customers of Elm City’s product.” The court also noted the animosity between Federico and the Weinsteins when Federico resigned.

**2-5A.** ***Consumer welfare***

On the defendants’ motions, the court issued two summary judgment orders, effectively dismissing the case. The court reasoned in part that riding unrestrained in the bed of a pickup truck is “an open and obvious danger as a matter of law, and the manufacturer of a pickup truck is not under a duty to warn potential passengers and users of [this] obvi­ous danger.” The plaintiffs appealed to the Hawaii Supreme Court, which affirmed the judgment of the lower court. The state supreme court held that “the dangers of riding unrestrained in an open cargo bed of a pickup truck are obvious and generally known to the ordinary user and that therefore Isuzu had no duty to warn potential passengers of those dangers.” The court explained that “it should be readily apparent and patently obvious to a passenger who chooses to ride in the bed of a pickup truck that he or she is completely unrestrained and unprotected from being ejected from the bed in an accident.”

**2-6A.** ***Ethical conduct***

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

**2-7A. *Ethical conduct***

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

**2-8A. *Ethical conduct***

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

**2-9A. *Ethical conduct***

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

**2-10A.** **A Question of Ethics**

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

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