BSMS 315

Organizational Ethics

Rockford College
Bachelor of Science in Management Studies

Adult Learner Guide
Five Week Course

Instructor: Stephen Hicks, Ph.D.
Office: Center for Ethics and Entrepreneurship
Burpee Center, second floor
Phone: 815.384.5181
SHicks@Rockford.edu
www.StephenHicks.org

Rockford College
5050 East State Street
Rockford, Illinois 61108
www.Rockford.edu

All course materials are protected by U.S. copyright laws.
Unauthorized sales, reproduction, or transcription of this material is strictly prohibited.

© 2009 Rockford College unless otherwise noted.

Organizational Ethics by Stephen Hicks

Rockford College
5050 East State Street
Rockford, Illinois 61108
Phone: 815.226.4050
www.Rockford.edu

Table of Contents

Course Description 4

Learning Objectives 4

Instructor Information 5

Textbooks 5

Evaluation and Grading 5

Class Schedule 6

Detailed Weekly Assignments
- Week 1 6
- Week 2 6
- Week 3 7
- Week 4 7
- Week 5 8
- Post-course Week 8

Appendix: Cases and Readings
- Manufacture and Regulation of Laetrile 10
- F.C.C.'s "Fairness Doctrine" 17
- Notes on ABC New Special, *Greed* 25
- Venture Capital for Rubbernex 27
- Accountant's Small-time Insider Trading 34
- Quotations on Money 42
- Case Analysis Checklist 43

* * *

Organizational Ethics

BSMS 315
Rockford College
Bachelor of Science in Management Studies

Course Description

The purpose of the study of ethics is to develop a set of moral principles to guide individual and social action.

In our culture, vigorous debate exists about what ethical principles should guide our actions. Consequently, vigorous debate exists about the morality of various individual and organizational purposes and practices:

- What core values and virtues should individuals embody?
- What is the value of organizations?
- What core values and virtues should organizations embody?
- How free should individuals and organizations be?
- What should be the scope of government regulation?
- Who should set the terms of production, consumption, and trade?
- How should prices be established?
- What counts as a fair trade?
- Who should control more abstract values such as information?

In this course we will integrate theoretical debates over ethical principles with controversies over classic and contemporary organizational actions.

Learning Objectives

Understanding general moral principles.

Understanding the three-way debate over general moral principles.

Developing an analysis of a particular case.

Applying general moral principles to particular cases.

Understanding how different moral principles generate different and competing solutions to particular cases.

Weighing the pros and cons of different moral solutions to particular cases.

Instructor

Stephen Hicks, Ph.D.

Office: Scarborough 119
5050 East State Street
Rockford, Illinois 61108
Phone: 815.226.4078
SHicks@Rockford.edu
www.StephenHicks.org

Textbooks

David R. Henderson, editor. *The Concise Encyclopedia of Economics* [CEE]. Available online for free at http://www.econlib.org/LIBRARY/CEE.html.

Stephen Hicks, editor. *Organizational Ethics* booklet. [OE]

Evaluation and Grading

Theory Reading Five-point Summaries …………. 30
Participation ……………………………..…….. 20
Case Decision Write-ups …………………………... 20
Final Case Study Assignment ……..…………..…. 30
Total ………... 100

Class Schedule

Week 1: Thursday, November 12, 2009, 6-10 p.m.
Week 2: Thursday, November 19, 2009, 6-10 p.m.
Week 3: Thursday, December 5, 2009, 6-10 p.m.
Week 4: Thursday, December 12, 2009, 6-10 p.m.
Week 5: Thursday, December 19, 2009, 6-10 p.m.
Week 6: Post-course Assignment week.

Detailed Weekly Assignments

Week One (Thursday, November 12, 2009, 6-10 p.m.)

Theme: The Ethics of Individualism or the Ethics of Collectivism?

Theory Readings (To be read in preparation for our first class meeting):

- Robert Hessen, "Capitalism" [CEE: http://www.econlib.org/library/Enc/Capitalism.html]
- Robert Heilbroner, "Socialism" [CEE: http://www.econlib.org/library/Enc/Socialism.html]

In-class writing from memory:

- Five-point summaries of Hessen and Heilbroner (to be prepared by each student ahead of our first class meeting)

Classic case: "Manufacture and Regulation of Laetrile" [OE]

Post-class writing:

- Case decision for Laetrile
- Length: 1000 words

Week Two (Thursday, November 19, 2009, 6-10 p.m.)

Theme: The Ethics of Private Property or the Ethics of Communalism?

Theory Readings: Garrett Hardin, "The Tragedy of the Commons" [CEE: http://www.econlib.org/library/Enc/TragedyoftheCommons.html]

Classic case: "The F.C.C.'s Fairness Doctrine" [OE]

Video: ABC News Special, "Greed"

In-class writing:

- Five-point summary of Hardin

Post-class writing:

- Case decision for "Fairness Doctrine"

Week Three (Thursday, December 5, 2009, 6-10 p.m.)

Theme: The Ethics of Trade and Pricing

Theory Readings: Linda Gorman, "Minimum Wages" [CEE: http://www.econlib.org/library/Enc/MinimumWages.html]

Classic case: Walter Block, "Rent Control" [CEE: http://www.econlib.org/library/Enc/RentControl.html]

In-class writing:

- Five-point summary of "Minimum Wages"

Post-class writing:

- Case decision for "Rent Control"

Week Four (Thursday, December 12, 2009, 6-10 p.m.)

Theme: The Ethics of Intellectual Property and Employment

Theory Readings:

- Stanley Lebergott, "Wages and Working Conditions" [CEE: http://www.econlib.org/library/Enc/WagesandWorkingConditions.html] and
- David Henderson, "Patents" [CEE: http://www.econlib.org/library/Enc/Patents.html]

Classic case: "Venture Capital for Rubbernex" [OE]

In-class writing:

- Five point summary of Lebergott
- Five-point summary of Henderson

Post-class writing:

- Case decision for "Rubbernex"

Week Five (Thursday, December 19, 2009, 6-10 p.m.)

Theme: The Ethics of Financial Markets

Theory Readings: Stanislav Dolgopolov, "Insider Trading" [CEE: http://www.econlib.org/library/Enc/InsiderTrading.html]

Classic case: "An Accountant's Small-Time Insider Trading" [OE]

In-class writing:

- Five-point summary of Dolgopolov

Post-course Week

Post-class writing:

- Case decision for "Accountant's Small-Time Insider Trading" [OE]

Length: 2000-2500 words.

Due: Thursday, January 7, 2010, 6 p.m.

* * *

Manufacture and Regulation of Laetrile

By Tom Beauchamp

> It has been estimated that consumers waste $500 million a year on medical quackery and another $500 million annually on some "health foods" which have no beneficial effect. Unnecessary deaths, injuries and financial loss can be expected to continue unti1 the law requires adequate testing for safety and efficacy of products and devices before they are made available to consumers. (President John F. Kennedy in a message to Congress)

> Let me choose the way I want to die. It is not your prerogative to tell me how. (Glenn Rutherford, cancer patient and Laetrile supporter at FDA hearing)

These quotations express the essence of an acrimonious conflict that raged over the better part of the 1970s in the scientific and popular press, in courtrooms and hearing rooms, in prestigious research institutions, and among drug manufacturers. This debate emerged over the regulation, manufacturing, and marketing of Laetrile, a drug said to be a cure for cancer by its supporters but denounced as worthless by much of the scientific community.

The U.S. Food and Drug Administration (FDA) has a responsibility to determine both the *safety* and the *efficacy* of a drug before allowing it to be marketed in the United States. The FDA's responsibility for drug licensing dates from the passage of the 1906 Pure Food and Drug Act, which primarily addressed safety abuses among patent medicine purveyors. In 1962 new laws were passed (partly in response to the Thalidomide tragedy involving malformed fetuses) that required the FDA to assess a drug's efficacy as well as its safety before the drug could be approved for marketing.

The FDA examined Laetrile for safety and found no significant problems. However, the FDA could not find evidence of the drug's effectiveness and became convinced that Laetrile was worthless for

the treatment of cancer. Consequently the drug was banned from the U.S. market.

Laetrile supporters reacted with fury to the drug ban. Cancer victims demanded the right to use it. Over 20 state legislatures that opposed the FDA's decision legalized it for intrastate marketing and consumption. Others felt the FDA was denying the American people their Constitutional right to freedom of choice. Many argued that since the drug had not been proven unsafe, people should be allowed to use it pending further tests. But many in the medical and scientific communities opposed this laissez-faire attitude. They argued that patients were drawn toward an inexpensive, painless cure for their disease but failed to realize its ineffectiveness. Critics claimed that numerous deaths had resulted from Laetrile use and that some of these people could have been helped by legitimate alternative forms of treatment.

The debate's ferocity was new, but Laetrile was not. According to Dr. Charles Moertel of the Mayo Clinic, "Amygdalin had many centuries of use for medical purposes. Usually administered in the form of bitter almonds, it was a common ingredient of herbal prescriptions for a variety of illnesses, and by liberal interpretation of ancient pharmacopeias one might conclude that it was used for the treatment of cancer." German physicians briefly used amygdalin in cancer treatment in 1892, but they discarded the extract as ineffective and toxic.

Modem proponents of Laetrile therapy attribute the beginning of the Laetrile movement to Ernst Krebs, who began experimenting with the extract of apricot pits in the 1920s, and to his son, Ernst Krebs, Jr., who refined the extract to produce Laetrile in 1949 for use in the treatment of disorders of intestinal fermentation cancer. Since then pro-Laetrile researchers have experimented with a variety of methods and techniques for using Laetrile in cancer treatment, and they claim that Laetrile is in fact effective. According to Krebs, Laetrile is effective because cyanide, which is an active ingredient, attacks the cancerous cells while an enzyme called rhodanese protects the normal cells.

Initially Krebs's supporters claimed that Laetrile not only cured or controlled existing cancers but could also prevent cancers from

forming. They based their claims of Laetrile's efficacy primarily on patients' case histories (some published in a volume called *Laetrile Case Histories*) and on personal testimonials of "cured" cancer patients. However, many in the medical and scientific communities were not impressed with this form of proof. They considered the reported case histories too sketchy and the follow-up times too short to support the claims. Moreover, few patients took Laetrile without first undergoing more traditional forms of cancer therapy. Under these conditions it is virtually impossible to determine which treatment or treatments should receive credit for improvements. Also, the natural history of cancer is not totally understood, and spontaneous remissions can and do occur.

In 1962 the FDA charged Krebs with violating the Federal Food, Drug and Cosmetic Act, on grounds that he could not prove his drug's effectiveness. In 1963 Laetrile was banned because it was not found to be an effective treatment of cancer or any other health problem. Since then, Laetrile proponents have revised their claims. They no longer proclaim Laetrile an independent cure for cancer instead emphasizing its role in the prevention and control of the disease. Laetrile supporters also maintain that the standards of proof for Laetrile research have been higher than for other cancer drugs and that pro-Laetrile results have been obtained but suppressed.

The controversy surrounding Laetrile turned largely on the drug's efficacy and on one's right to *manufacture*, *market*, and *purchase* the product. During the 1970s the FDA suffered criticisms that it was a paternalistic agency after it attempted to ban the manufacturing and marketing of the popular artificial sweetener saccharin. The Laetrile problem immediately followed this unpopular FDA policy. By mid-1977 FDA head Donald Kennedy said his agency found increasing evidence of Laetrile's inefficacy. However, criticism of the FDA was also increasing and efforts were mounted either to allow free choice of the drug or to test for efficacy in a public trial using human subjects. Some state legislatures and judges called the FDA's findings into question. Some states had legalized its manufacture and sale, and some courts had criticized the FDA record and policies. Even prestigious physicians and newspapers such as *The New York Times* endorsed the right of individuals to choose to use a possibly inefficacious drug.

Responding to the demands for a Laetrile efficacy trial with human subjects the National Cancer Institute sponsored a 1981 clinical trial with 178 terminal cancer patients. The trial results dispelled any lingering doubts in the medical and scientific communities over Laetrile's alleged ability to destroy cancer cells Of the 178 trial subjects, only one demonstrated a partial positive response to Laetrile treatment. His gastric carcinoma showed a 10-week retardation period. However the cancer progressed, and the patient died 37 weeks after Laetrile therapy. In their conclusion, the trial doctors commented, "No substantive benefit was observed in the terms of cure, improvement or stabilization of cancer." According to the study, several patients displayed symptoms of cyanide toxicity and blood cyanide levels approaching the lethal range. The report concluded Amygdalin (Laetrile) is a toxic drug that is not effective as a cancer treatment." In response, Laetrile manufacturers sued the NCI in three lawsuits, claiming the study had drastically reduced demand for Laetrile, thereby inflicting financial damage on the manufacturers. All three suits were dismissed in the courts.

According to proregulation partisans, it is desirable and necessary to protect uneducated risk takers who are vulnerable to unsubstantiated medicinal claims: "The absolute freedom to choose an effective drug is properly surrendered in exchange for the freedom from danger to each person's health and well-being from the sale and use of worthless drugs." From this perspective, regulation is not irreconcilable with freedom of choice. If a regulation promotes situations under which more informed and deliberative choices are made, it does not constrict freedom; and a choice cannot be free if the product is a fraud.

By contrast, freedom-of-choice advocates claim that the simple restriction of Laetrile violates the individual's right to autonomous choice and the manufacturers' rights to market a product. Supporters of this view resent the characterization of cancer patients as people who are incapable of making rational or free decisions because of the stress of illness. They believe that most of these individuals are able to make well-founded personal decisions and should be allowed to do so.

The economic implications of banning Laetrile have also introduced a significant controversy. Each side has accused the other of economic exploitation of cancer victims. Laetrile proponents say that traditional cancer treatments represent an enormous and profitable industry and claim that a cost savings for patients would be achieved if Laetrile were legally marketed in the United States. They note that the American Cancer Society estimated that as early as 1972 the direct costs of cancer treatment totaled over $3 billion (for hospital care nursing home care, physicians' and nurses' fees, drugs and other treatments, and research). By comparison, Laetrile supporters claim that legalized Laetrile would cost a fraction of conventional cancer therapies.

Laetrile has been primarily manufactured and marketed in Mexico. In one study it was estimated that in 1977 alone, approximately 7,000 patients were treated in two Mexican clinics at an average cost of $350 per day. The United States represents a large potential market for a legalized, over-the-counter Laetrile However, due to FDA restrictions, one December neither import amygdalin from foreign countries nor ship it across state lines. Although the FDA does not control *intrastate* commerce, it would not be profitable for any one state to manufacture Laetrile in all its stages—that is, from the farming of apricot trees to the laboratory synthesis of the finished drug. Furthermore, the FDA has issued an import alert ban on amygdalin and all corresponding brand names, including Laetrile and vitamin B-17. The FDA refuses to permit importation of Laetrile on the grounds that "it appears to be a new drug without an effective new drug application (NDA)." The FDA also classifies the Laetrile issue as a health fraud case. As a senior scientist at the AMA commented, "People took Laetrile, ignored other, more conventional cancer treatment, and died." Although NDAs for Laetrile have been submitted to the FDA, none has been approved. Consequently, the FDA currently proscribes all importation and interstate transportation and marketing of amygdalin under any brand name.

However, one December still obtain amygdalin quickly and easily within the United States. VitaChem International/Genesis West in Redwood City, California, offers 50 tablets of "Laevalin, a naturally occurring amygdalin" for $47.50. Mexican-based Vita Inc. will ship 100 Laetrile tablets to a United States address for $65.00. To

circumvent FDA regulations, U.S. Laetrile marketers have changed the brand name but continue to market amygdalin openly, in violation of the FDA import and interstate commerce ban.

The courts as well as the press have provided the arena for the conflict over the rights of a patient to choose a treatment and the rights of manufacturers to market a product. Although it was not the intent of Congress to impose such restrictions on choice, the patient's choice is in fact restricted by the 1962 drug amendments. Because these amendments restrict the market to industry-tested and FDA-approved products, treatment by and manufacturing of alternatives are inevitably constricted.

A series of lawsuits have challenged the FDA restrictions, and a number of states have passed laws legalizing its use. In early 1977 U.S. District Court Judge Luther Bohanon (U.S. District Court for the Western District of Oklahoma) issued a ruling permitting Laetrile's importation under a physician's affidavit for terminally ill cancer patients. Although overturned by an appeals court in December 1986. Bohanon's ruling allowed Laetrile treatment for terminal patients. Despite the opportunity to convince the FDA of the drug's efficacy, Laetrile proponents did not obtain an NDA approval for amygdalin. The judicial and legislative challenges are not, however, without opponents. Lawyer William Curran, for instance, has deplored the action of certain courts in allowing the use of Laetrile for the terminally ill:

> It is understandable that judges have had trouble dealing objectively with the legal pleas of plaintiffs who are dying a painful death and whose only wish is to indulge in a harmless, although ineffective, gesture of hope. The courts have tried to dispense mercy. Their error has been in abandoning the protection of law for these patients.

As the arguments have developed, the issues of choice and fraudulent representation by business have moved to the forefront. Franz Inglefinger, the distinguished former editor of the *New England Journal of Medicine* and himself a cancer victim, was convinced that Laetrile was useless. In 1977 he wrote, "I would not take Laetrile myself under any circumstances. If any member of my family had cancer, I

would counsel them against it. If I were still in practice, I would not recommend it to my patients." On the other hand, he said, "Perhaps there are some situations in which rational medical science should yield and make some concessions. If any patient had what I thought was hopelessly advanced cancer, and if he asked for Laetrile, I should like to be able to give the substance to him to assuage his mental anguish, just as I would give him morphine to relieve his physical suffering." Inglefinger did not view truthful marketing of the drug as involving a fraudulent mis-representation.

In December 1987 a Laetrile bill was introduced into the U.S. House of Representatives. H.R. 651 provided that the controversial efficacy requirements of the Food, Drug, and Cosmetics Act would not be applied to Laetrile if a patient were under a physician's care (see Exhibit 1). The bill's sponsor, Rep. Bill Goodling (R-PA) asserted that "the legislation does not state that Laetrile is a cure for pain or a pain reducer." The bill died in the Health and Environment Subcommittee of the House Energy and Commerce Committee.

The National Institutes of Health and most other health care institutions still discourage the use of Laetrile, preferring conventional methods of cancer treatment. The National Cancer Institute's official policy is to encourage conventional methods with the explanation that testing has always shown "evidence of Laetrile's failure as a cancer treatment." The American Cancer Society holds the position that "Laetrile is not effective in the prevention or treatment of cancer in human beings." Despite the medical evidence and the FDA's past efforts to restrict the drug's marketing, one December still today purchase amygdalin by dialing a toll-free number.

Exhibit 1

H.R. 651: To provide that the effectiveness requirements of the Federal Food, Drug, and Cosmetic Act shall not apply to Laetrile in certain cases, be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That in the administration of section 505 of the Federal Food, Drug, and Cosmetic Act, the effectiveness requirement of such section shall not be applicable to Laetrile when used under the direction of a physician for the treatment of pain.

The FCC's Fairness Doctrine

By Tom L. Beauchamp

(Revised by John Cuddihy, Joanne L. Jurmu, and Anna Pinedo)

Government intervention in the publication and dissemination of news is inconsistent with the notion of a free press. However, the government has a responsibility to ensure fairness in the dissemination of information on matters of community interest. These two obligations often conflict. Until recently, a U.S. government mechanism of media accountability known as the Fairness Doctrine existed. The doctrine attempted to mediate between broadcasters' First Amendment rights and those of the public by requiring broadcasters to provide balanced coverage of important public issues.

The Fairness Doctrine originated in congressional and Federal Communications Commission (FCC) legislation. The FCC's 1949 "Report on Editorializing by Broadcasters" outlined the doctrine and stressed the importance of the development, through broadcasting, of an informed public opinion in a democracy. It affirmed the "right of the public in a free society to be informed and to have presented to it for acceptance or rejection the different attitudes and viewpoints concerning these vital and often controversial issues." In 1959 Congress amended the Communications Act of 1934 to impose, in section 315(a), a statutory "obligation upon [broadcasters] to operate in the public interest and to afford reasonable opportunity for the discussion of conflicting views on issues of public importance."

The Fairness Doctrine did not require broadcasters to give equal time to contrasting views. However, if "during the presentation of views on a controversial issue, an attack [was] made upon the honesty, character, integrity, or like personal qualities of an identified person or group," that person or group had to be given an opportunity to respond on the air. The broadcasting company had to bear all presentation costs.

The policy was traditionally confined to broadcast rather than print media, based on a principle of scarce resource allocation. There is a relative scarcity of broadcasting possibilities, because the number of people who want to broadcast exceeds the number of available broadcast licenses. The government allocates this limited resource through a licensing system, designed to protect the public interest through the enforcement of various regulations.

In 1969 the U.S. Supreme Court held the Fairness Doctrine to be constitutional and consistent with the First Amendment's intent in *Red Lion Broadcasting Co. v. Federal Communications Commission*. The Court ruled that the scarcity of available frequencies justifies the imposition of a government regulatory system intended to ensure that broadcasters, as fiduciaries, act in the public interest. The Court declared the public's First Amendment rights to hear differing viewpoints "paramount" to broadcasters' rights. Justice Byron White expressed the Court's opinion as follows:

> Where there are substantially more individuals who want to broadcast than there are frequencies to allocate, it is idle to posit an unabridgeable First Amendment right to broadcast comparable to the right of every individual to speak, write or publish. ...A license permits broadcasting, but the licensee has no constitutional right to be the one who holds the license or to monopolize a radio frequency to the exclusion of his fellow citizens. There is nothing in the First Amendment which prevents the Government from requiring a licensee to share his frequency with others and to conduct himself as a proxy or fiduciary with obligations to present those views and voices which are representative of his community and which would otherwise, by necessity, be barred from the airwaves.

The Court reaffirmed the scarcity of the radio airwaves and the responsibility of broadcasters as public trustees in subsequent cases. Similar reasoning served to justify the Fairness Doctrine's application to cable programming.

The Fairness Doctrine was neither strictly enforced nor widely applied. From December 1980 through August 1987, the FCC received over 50,000 com-plaints of alleged Fairness Doctrine violations. The

FCC dismissed the vast majority of the charges. The Fairness Doctrine was primarily invoked to restrict virulent racism and other use of the airwaves to intimidate and attack persons and institutions. The FCC also used the doctrine in 1967 to require broadcasters to give significant time to antismoking messages. It was almost never used to enforce accountability for claims made in documentaries, no matter how hard-hitting or speculative. Although the National Association of Broadcasters (NAB) has reported several cases in which documentaries were accused of violating the Fairness Doctrine, the FCC upheld only one complaint, later overturned in federal court.

The doctrine was usually applied to ensure that the licensed station owners' political preferences would not control the presentation of candidates for public office. However, these regulations were also loosened over the years. For example, the FCC held that any station endorsing or criticizing a candidate on the air had to give the opposing or criticized candidate air time to respond. In 1983 FCC Chairman Mark Fowler revised the commission's policy on televised political debates. He announced that broadcasters could schedule political debates with the candidates of their choice without being required to provide air time to excluded candidates. Broadcasters could cover debates as bona fide news events without having to make time available to those who did not participate.

THE CURRENT LEGAL SITUATION

The Fairness Doctrine has come under fire from both sides of the political spectrum. Conservatives oppose it as an expendable form of government intervention, while some liberals support it as a means of intimidating or even silencing journalists. In December 1981 the FCC recommended that the Fairness Doctrine be repealed. The commission issued a detailed study of the doctrine in 1985. It concluded that the doctrine was "an unnecessary and detrimental regulatory mechanism [that] disserves the public interest." The FCC did not at that point repeal the doctrine because it believed that Congress had already codified it. However a December 1986 ruling by the U.S. Court of Appeals held that the Fairness Doctrine was not a statutory requirement. According to the ruling, written by Judge Robert Bork and supported by then Appeals Court Judge Antonin Scalia, Congress had merely ratified the doctrine in amending section 315(a) of the 1934

Communications Act. The decision permitted the FCC to modify or to abolish the doctrine. The commission then did abolish the doctrine's chief measures in August 1987 claiming that they violated First Amendment rights and stifled controversial programming.

The court of appeals ruling spurred controversy in Congress, where some members have consistently voiced support for the doctrine. There have been several legislative proposals to codify the doctrine and make it an explicit requirement of the Communications Act. Rep. John Dingell (D-MI), chairman of the House Committee on Energy and Commerce introduced an amendment to the Communications Act that would "require expressly that licensees of broadcast stations present discussion of conflicting views on issues of public importance." President Reagan vetoed the measure, and Congress lacked the two-thirds majority needed to override the veto. In February 1987 Sen. Ernest Hollings (D-SC) chairman of the Senate Commerce Committee, deftly steered a bill through the committee that would have restored the Fairness Doctrine. Although Hollings argued vigorously for the bill, congressional deficit-reduction negotiations eliminated it. Still more recent bills introduced by Senator Hollings and Representative Dingell have either failed to clear their respective committees or died on chamber floors.

THE CURRENT DEBATE

On August 4, 1987, the FCC voted unanimously to eliminate the Fairness Doctrine In a letter to Representative Dingell, then FCC Chairman Dennis Patrick emphasized that although the FCC had abolished the doctrine's major clauses, several of the doctrine's regulations remained in force: the political editorial rule, the personal attack rule, the Zapple Doctrine, and the "application of the Fairness Doctrine to ballot issues."

As stated by the FCC, "The rules on political editorials and personal attacks do not forbid the broadcast of either. Instead, they require broadcasters who carry such editorials or attacks to offer the persons adversely affected by them a chance to state their side of the case in person or through a spokesman." The political editorial clause currently mandates that TV and radio stations offer political candidates whose opponents have been endorsed by the involved

station "a reasonable opportunity to respond" on air to the endorsement. The FCC requires that the opposing candidate be furnished with an editorial transcript within 24 hours of a broadcast. If a station broadcasts a political editorial within three days of the election, the station must provide the transcript and a response-time offer prior to the editorial's airing.

Personal attacks also require response time. However, attacks "occurring during uses by legally qualified candidates" are not covered by the Fairness Doctrine. Attacks made on "foreign groups or foreign public figures" are also immune from the doctrine's "personal attack" claims.

Like the political editorial clause, the Zapple Doctrine also involves political campaigning. Should a TV or radio station run an advertisement during a formal campaign period in which political supporters endorse a candidate, an opponent's supporters have the right to a reasonable opportunity to respond. The Zapple Doctrine December only apply to legally qualified candidates during formal campaign periods. The restrictions "reflect the intent of Congress to confine special treatment of political discussion to distinct, identifiable periods."

The ballot-issue exception requires broadcasters to permit opposing sides equal air time to discuss and advertise for or against ballot propositions. However, "The [Federal Communications] Commission will not intervene in cases alleging false and misleading statements regarding controversial issues of public importance."

Although these clauses remain in force, an FCC employee declared that these exceptions "are not vigorously enforced" and have not seen frequent use in recent years. Overall, the FCC has moved away from even the spirit of the Fairness Doctrine, firm in the belief that the doctrine stifled rather than promoted discussion and debate on public issues.

Doctrine opponents have challenged the Supreme Court's *Red Lion* decision, claiming that it is based on the mistaken premise of airwaves scarcity and need for improved communication of information, which are no longer valid. From this perspective, the Fairness Doctrine is

now an unfair restraint on free market trade; technological advances since the *Red Lion* case have eliminated the former scarcity. The 1985 FCC report noted a dramatic increase to more than 10,000 radio and television broadcasting stations, a 400 percent growth since 1949. Commercial broadcasters opposed to the doctrine point out that in many cities listeners and viewers can pick up dozens of radio and television stations and have access to only one significant newspaper. The FCC also observed that the growth of cable television, satellite television, and new telecommunications services offer an almost unlimited number of broadcast options.

The 1985 FCC report noted that the "Fairness Doctrine in operation thwarts the laudatory purpose it is designed to promote. Instead of furthering the discussion of public issues, the fairness doctrine inhibits broadcasters from presenting controversial issues of public importance." Broadcasters some-times hesitate to air controversial materials for fear that they will be forced to use expensive air time to present another side of the issue. For some broadcasters, the loss of advertising time alone prevents them from making room in their broadcast schedule for these materials. For example, there December be as many as 15 candidates running in a presidential primary, which makes the provision of equal time burdensome for many stations.

Doctrine supporters claim that the relative scarcity of usable airwaves persists. The "scarcity of frequencies should not be measured by the number of stations allowed to broadcast, but by the number of individuals or groups who wish to use the facilities, or would use them if they were more readily available." They point to the economic value of government licenses as a measure of the relative demand. Independent VHF licenses have sold for as much as $700 million in New York. Also, the number of stations has not increased in isolation, but in proportion to the nation's population growth. The broadcast medium continues to be more inaccessible to the private citizen than the print medium because the government must allocate the use of airwaves. Finally, the increase in stations does not necessarily correspond to any local increase in availability of diverse views on issues.

The Fairness Doctrine has been the only significant mechanism of control. The House Committee on Energy and Commerce Report on

the Fairness Doctrine points out that "numerous case histories demonstrate that the Fairness Doctrine promotes carriage of views that would otherwise not be available to the American public." Former FCC Chairman Charles Ferris testified before the Subcommittee on Telecommunications and Finance that "in 1979, during [his] watch, the Commission explicitly found that the Fairness Doctrine enhanced, not reduced, speech." The congressional committee questioned the authority of the 1985 FCC report because it relied solely on broadcasters' accounts of the doctrine's effects.

Opponents argue that the Fairness Doctrine violates constitutional principles by allowing the government to intervene and to define how freedom of expression is to be used and practiced. The doctrine, they say, provides a dangerous potential for government abuse. They point to the FCC's statement that federal law permits government agencies to file Fairness Doctrine complaints against the media. This ruling (in July 1985) resulted in a complaint filed by the CIA charging that ABC's "World News Tonight" had three times distorted the news in broadcasting allegations that the CIA had tried to arrange the assassination of Ronald Rewald, a Honolulu businessman who was under indictment for several crimes. These CIA complaints would reverse past precedents and require greater accountability of the media to the government.

Fairness Doctrine supporters face an uphill battle in the judiciary and Congress. A Media Action Project (a DC public interest law firm) employee said that when the Supreme Court declined in 1989 to review the 1986 DC Court of Appeals ruling, a legal review of the case became "extremely difficult." If the firm decides to re-file a Fairness Doctrine case, it will certainly "seek a more sympathetic court."

Legislative attempts to codify the Fairness Doctrine appear equally unlikely. Although Congressman Dingell and Senator Hollings have repeatedly introduced bills in Congress to resurrect the doctrine, they have all failed. A House legislative aide maintains that "hearings on [Representative Dingell's bill] aren't even likely to be held in this congressional session." Although chairs of powerful House and Senate committees, neither Dingell nor Hollings has yet managed to convince their colleagues to codify the Fairness Doctrine. Furthermore, the executive branch publicly supports the doctrine's

abolition. If Congress did attempt to override a presidential veto of any doctrine measure, it probably could not muster the two-thirds support needed for legislative approval.

U.S. citizens continue to be wary of government intervention in the private sector. But the Fairness Doctrine has, until recently, been considered a justified exception. Although it is a measure that often intrudes upon broadcasters' freedoms, the doctrine was traditionally designed to protect the individual's moral and political right to the presentation of differing views on important issues.

* * *

Greed

John Stossel, ABC News Special (1999)

Theme: What is “greed”?

- Introduction at Vanderbilt mansion. Financier Milken, hotel magnate Helmsley, dictators Marcos and Duvalier, evangelist Bakker.
- Ted Turner: private property and competition are good.
- Contrast rich business person and rich sports figure or actor. Why are rich business people often vilified while rich actors or athletes aren’t?
- Compare art, sports, etc. Greedy to create, greedy to win, greedy to learn.
- Psychologist Julian Edney money-in-bowl experiment: Greed means short-range self-interested grasping?
- Are rich people “Robber Barons”?

Theme: Zero-sum or win-win?

- Philosopher David Kelley: Zero-sum is a child’s view. In fact, producers create wealth, and the pie gets bigger. Most of the 19th century entrepreneurs started with nothing. They didn’t steal: they innovated and produced things people voluntarily traded for.
- Example: Bill Gates got rich by creating value for trade. He persuaded customers. Win-win.
- Contrast example: Baby Doc and other government dictators get rich by taking from others by force. They created no value. Zero-sum.
- Example: buy a quart of milk at convenience store. Both parties say “Thank you.”
- Cheaters? E.g., solar-powered clothes drier. Rarely get rich.
- Vanderbilt’s achievement in ship transportation and Rockefeller’s achievement in oil: lower prices and higher quality. Luxuries become standard fare. Win-win.
- Complaints about Vanderbilt and Rockefeller mostly from competitors who weren’t as productive. Lobbied the government for controls on V and R.

Theme: Motivation of greed versus selflessness and helping others

- Example: Red Cross non-profit lifeguards versus Jeff Ellis’s for-profit lifeguard company.
- Ellis’s lifeguards: Better service, innovations, and lower price.
- Complacence of the established non-profit.
- Walter Williams: contrast results of caring versus results of self interest: grocery store, computers, FedEx, schools, post office, trash, police services
- Profit motive as additional motive to serve others’ needs.

Theme: Cooperation and self interest.

- Supermarket and steak. Iowa ranch. Propane, packaging, trucking, and the hundreds of other functions involved in getting the steak from Iowa to New York. Do all of those people work hard and efficiently because they care about you, or do they work hard out of self interest?
- Revisit bowl-in-money experiment: self interest and the profit motive leads people to learn how to cooperate.

Theme: Education and business education

- Example: Steve Mariotti as high school teacher at a traditionally weak school.
- What motivates the students? Prepare for business: see money-making possibilities, entrepreneurial ideas.
- Former students who are now successful: sports store owner, hot dog stands, music business.

- Kelley: Capitalism is the great equalizer: The poor need capitalism most. They need the opportunities that capitalism generates. They need the freedom from stifling regulations.

Theme: Executive pay and inequality

- Workers lost jobs because of high executive salaries? Aren't large inequalities and disparities unseemly? Should we put limits on profits and salaries?
- Excerpt from movie, "Wall Street." Hollywood villains.
- Example: T. J. Rodgers and Cypress Semiconductor: started a one-man operation and was in debt and created a $1.5 billion company. "I earned it." "I created value." "I am a good guy." "The world is better off when I make a buck."
- Michael Eisner's take home pay. Under Eisner's tenure as CEO, Disney's worth went from $2 billion to $53 billion. Eisner received one-half billion dollars (equals about one percent).
- Ben and Jerry's ice cream: CEO pay experiment. Pay CEO only six times as much as line worker. Had to fire and hire another CEO at ten times. Same thing again.
- Union rally on Wall Street: Union leader John Sweeney. Ever turn down a raise?
- Counter-examples. CEOs who are paid much even when their companies are doing poorly.

Theme: "Giving back"—Philanthropy and charity

- Vanderbilt University
- Turner: billionaire Warren Buffet is a Scrooge because he doesn't give more of his money away.
- Rodgers: Turner is saying something stupid: Business professionals are good at making money, and their making money helps those less well off by creating jobs. So to help others most, we should encourage successful businessmen invest their money rather than give it away.
- Kelley: making money is harder than giving away. He respects Turner more for his building CNN than he does for his donating money to the UN. Business is more humane than charity: it treats people as self-supporting instead of treating them as helpless mouths that need a handout.
- Who did more for the world: Michael Milken or Mother Teresa? Both helped people, but Milken helped more people and he helped them become self-supporting rather than remain charity cases. Teresa suffered and was selfless; Milken got rich and was self-interested. But suffering is not the point; the point is to create value.

Summary:

- Greed as good *versus* greed as evil
- Self interest *versus* selflessness
- Private property *versus* public
- Competition *versus* regulation
- Win-win *versus* zero-sum
- Liberty as primary *versus* equality as primary
- Productivity *versus* charity

Venture Capital for Rubbernex

By Tom Beauchamp

On a Saturday morning in November 1987, five good friends met in the basement of John Kleinig's house near Palo Alto, California. They saw each other frequently because they carpooled to work at the Globe Coating Company, one of the world's largest manufacturers of fine paints and varnishes. Globe had consistently surpassed other manufacturers in the development of several new products and had the industry's finest research staff. The five commuters and friends were all members of this exceptionally capable research staff, although only two were research scientists. The other three handled administration and computer records.

Kleinig was Globe's research division manager, a position he had obtained five years ago after 15 years of working with the company. He also was the clear leader of this group. Each of the other four had more than 10 years of experience with the company. They all believed Kleinig was the person most responsible for making their research division the best in the world. These five men knew virtually everything about research, administration, secret formulas, the competition, suppliers, and the general industry. Along with 13 other key people in the division, these five men had helped develop several products vital for Globe's leading position.

During their commutes, the five had ample opportunity to criticize their peers and to discuss the cumbersome and slow operation of Globe. Over a period of several months they gradually became convinced that they could conduct more advanced research on new coatings in upcoming years than their employer.

Therefore, they met on this Saturday morning to put the final touches on a business plan for which they hoped to find funding. Kleinig and another group member, Jimmy Liang, had already drafted and discussed a tentative plan.

Their idea for a new business venture centered on the strategy of constructing a plant to manufacture "thin film" coatings. These coatings are new products pioneered and marketed by Globe, which

devoted 10 years of research to the development of three forms of the coating. The film coating is so thin that it is invisible to the eye and allows various forms of electrical and adhesive contact as though no coating existed. Yet it provides all the protection of traditional clear coatings. The technology has a marvelous potential for application, from oak floors to computer parts, and yet it slashed production costs as compared with standard polyurethane coatings by 32 percent. It is the most innovative new product in the coating industry.

Between July and the end of August 1987, a friend of Kleinig's, Jay Ewing, critiqued the evolving business plan numerous times and helped Kleinig develop contacts with several venture capitalists. He also arranged for a meeting with the Los Angeles specialty law firm of Lion and Lion to provide legal counsel.

In early September Kleinig met with various venture capitalists, and a September 9, 1987, meeting proved to be the decisive one. Kleinig hit it off beautifully with a representative of a large East Coast venture capitalist, HH Ventures of Philadelphia. This representative was already convinced that thin coating promised major technological innovations in the paint and varnish industry and that the five men represented the epitome of coating knowledge. Their discussion of personnel and business plans lasted approximately two and a half hours, and both admired each other's integrity and capability by the end of the meeting. Between September 10 and 18, Kleinig and HH representatives placed 15 evening phone calls to cement the basis for an agreement between HH and what was to be Rubbernex Industries.

On September 19, 1987, Kleinig resigned from Globe. Nearing an agreement with HH Ventures, he felt that he could no longer in good conscience remain a loyal Globe employee. The other four group members did not resign at this point, since they were not holding direct discussions with HH. At his "exit interview" with his supervisor and a Globe lawyer, Kleinig encountered a hostile and intimidating environment. Globe told him in straightforward terms that if he were to put his skills to work with another company by utilizing Globe trade secrets, he would face a massive lawsuit. His supervisor told him that Globe was seriously concerned that its trade secrets and confidential business information would be misappropriated. Kleinig was asked to sign a letter that enumerated 168 broadly worded trade secrets that he could not transmit or use. He

refused to sign it but assured Globe that there would be no misappropriation. His supervisors nonetheless continued to focus heavily on moral and legal questions about trade secrets.

By the conclusion of the exit interview, those present had negotiated the following tentative arrangement: In advance of taking a new job or developing any product, Kleinig would consult with his ex-supervisor at Globe to ensure that there would be no trade secret violations. He also would submit a plan to show that any market he wished to explore would not conflict with already established Globe markets. The interview participants discussed neither the nature of trade secrets nor trade secrets specific to thin film technology.

In a December 21, 1987 meeting, Kleinig, three HH representatives, and lawyers representing both signed a tentative agreement to fund Rubbernex. The contract gave Rubbernex funding for one month to allow for further development of the business plan. HH had one month to evaluate its position with the choice of dropping its interest at the month's end or trying to reach a final agreement for major funding. The agreement included an offer of further financing after one month conditional on what is called due diligence in the venture capital industry (and elsewhere). In this context, due diligence means, in part, that HH has obligations of due care when money is given to assist in a business startup. It is a standard of proper care that requires an investigator to competently and thoroughly investigate a proposal's business viability as well as to protect against violations of the rights of all affected parties.

The December 21 meeting involved lengthy discussions about Kleinig's exit interview, about Globe's concerns for its trade secrets, and about HH's need for assurances that no trade secrets problem existed. Kleinig reassured them that he could "build thin film coatings using many different alternative chemicals and processes" and that Globe should have no basis for concern by the time Rubbernex developed the new processes. The next day, Jimmy Liang and the group's chief scientist, Jack Kemp, resigned from Globe. One week later the final two group members resigned. Globe officials told all four during their exit interviews that the company was considering a suit against Kleinig to protect its trade secrets and warned all that if they joined him, they faced the same suit. Globe officials told all four that company officials could prove Kleinig had conspired with other

individuals to steal Globe's secrets as early as nine months before leaving the company. These officials would not, however, specify the trade secrets when requested by Kemp to do so.

Whether this package called a *tentative agreement* between venture capitalist HH and the five entrepreneurs would be rewritten and result in a new manufacturing company rested in the hands of Henry Hardy, the man whose massive personal fortune constitutes the venture capital that fuels HH. He had at first decided not to fund Rubbernex, based on his lawyer's explicit concern that Globe's threat of a lawsuit was not an idle one. But Mr. Hardy had left open the possibility that Globe could be mollified or that the trade secrets problem could be otherwise dispatched in an honest and forthright manner.

Mr. Hardy had personally taken charge of HH's due diligence review, which he usually leaves to subordinate officers. He first hired the best firm in New York to do reference checks on the entrepreneurs. These consultants were asked to examine both professional credentials and former or existing employment contracts. Mr. Hardy next commissioned a thorough review of the legal questions surrounding trade secrets by a specialist law firm. He also hired 12 outside consultants at American universities to review the feasibility of the entrepreneurs' scientific claims and asked in each case for an evaluation of whether the venture could be successfully launched without using Globe's trade secrets. He then requested a thorough review of the company's financial and legal position by his in-house lawyer and three of his program directors.

Furthermore, Mr. Hardy examined the enterprise's business viability by having two of his trusted consultants check the Rubbernex proposal. He commissioned a review by a Wall Street security analyst of the coating industry and held discussions with two other venture capitalists who had in the past been involved with trade secrets issues. He also asked for an appraisal by Kleinig of whether he would need further direct hires from Globe to fulfill his plan's staffing requirements.

Mr. Hardy then attempted to contact Globe executives to ask them to review the Rubbernex business plan for possible trade secrets problems. Following the course sketched out during Kleinig's exit interview, Mr. Hardy's proposal to Globe invited company engineers

and chemists to spend time in any future Rubbernex manufacturing facility for observational purposes to ensure that there were no trade secrets violations. He was prepared to divulge any formulas used for thin film coatings and allow a neutral inspector to examine Rubbernex's formulas by comparison to Globe's to see if there were any violations. In their reply, Globe lawyers issued a warning that the technology of thin film coatings was proprietary to Globe and that if any venture capital was forthcoming from HH, Mr. Hardy would personally be named in a lawsuit.

This response angered Mr. Hardy. He felt that, whereas he had offered numerous concessions to Globe to ensure that there were no moral or legal violations, Globe had taken a hostile position of non-negotiation solely to prevent potential competition. At about this time, Mr. Hardy's internal and external legal advisers submitted reports that stating that with enough chemical and engineering ingenuity and sufficient venture capital to buy expensive new West German machinery, the potential existed to introduce modifications to claim a new product rather than a mere clone of the Globe product. However, his advisers judged it necessary to qualify their reports with roughly the following statement: "I cannot ensure that there will be no violation of trade secrets unless I am able to examine the trade secrets, and law and ethics prohibits me from doing so."

HH Venture's due diligence standards had consistently equaled or surpassed those of any business competitor, and Mr. Hardy could not imagine a more thorough review than he had done. But this was his first foray into the territory of a trade secrets problem, and he was perplexed by the fact that there is no way to examine whether a trade secrets violation is likely to occur. He remained uncertain of both how much ingenuity the entrepreneurs have (although in the past they have not lacked for a wealth of new ideas) and what the trade secrets are that cannot be utilized. He now realized that his consultants could not recognize the exploitation of a Globe trade secret by the entrepreneurs. Each consultant said the potential existed for the entrepreneurs to make thin film coatings through, as one recent court opinion put it, "skillful variations of general processes known to the particular trade," but no one could say for sure whether the potential would be actualized.

Mr. Hardy's legal consultants had supplied him with the standard legal definition and analysis of trade secrets, which his consultant report-sheet summarized as follows:

A trade secret consists of any formula, device, pattern, or compilation of information used in business that gives one an opportunity to obtain advantage over competitors who do not know or use it. It is not a secret of any sort, but a process or device for continuous use in the operation of the business. An exact definition of trade secrets is not possible, but there are factors that can be considered in determining whether something is a trade secret: general knowledge, employee knowledge, the adequacy of protective guarding, the value of the information, the amount of money expended in development of the secret, and ease of acquisition or duplication. An employee in possession of confidential information that could damage the economic interests of an employer if disclosed is under an obligation of confidentiality that remains in force when the employee leaves the firm and takes employment elsewhere. However, under common law it is not a breach of any obligation owed to an employer to plan for a new competitive venture while still employed, even though the employee has an opportunity to observe (what will later be) a competitor s secrets, and even though the employee December leave with a wealth of experience in and knowledge about the competitor's processes, products, research, and financial matters.

Mr. Hardy saw that this legal definition makes a sharp distinction between a company that *owns* a formula, device, or process that has been *disclosed* in confidence to one or more employees, and a company whose formula has been developed by those employees while employed at the company. In some of the more innovative industries, employees are typically instrumental in creating or advancing a formula, device, or process through their own ingenuity and skills. The greater the extent of an employee's role in creating or otherwise improving the confidential information or property, the greater the employee's apparent claim to a right to use it elsewhere, and the less an employer's right to claim sole possession. Mr. Hardy believes that the entrepreneurs who came to him for funding were, and still are, in this latter circumstance.

It therefore seemed unfair to the entrepreneurs to keep them from starting Rubbernex simply because their former employer was intimidating them. As Mr. Hardy sees it, these employees have several types of obligations to Globe: contractual obligations based on their employment contracts; a responsibility to avoid conflicts of interest such as remaining employed by the firm that will become a competitor of the firm being planned; and a duty to ensure that the new venture will use independently developed competitive technologies, thus avoiding violations of trade secrets, patents, and proprietary designs.

Although there is some disagreement and ambiguity, Mr. Hardy's reference checks and technical consultants said that these conditions have been at least minimally satisfied in this case. They all emphasized that the law of trade secrets is amorphous, conceptually muddy, and formed from a number of different areas of law in a patchwork manner. The law attempts to foster innovation and progress without leaving firms the victims of faithless employees or placing employees in a situation of servitude. An employer has a right to his or her intellectual property, but the employee also has a right to seek gainful employment that requires the application of his or her knowledge and abilities. If employees could be prevented by intimidation from moving from one firm to another, technological growth and diffusion could be stifled.

Mr. Hardy agreed with this argument and conclusion. He favored funding the entrepreneurs although he sensed that two lengthy lawsuits were now a virtual certainty, one against the former Globe employees for misappropriation of trade secrets and the second against HH Ventures for a failure of due care. Mr. Hardy denied the latter charge because it implied that he performed an inadequate due diligence review prior to an investment. He considered this charge to be groundless.

* * *

An Accountant's Small-Time Insider Trading

By Tom L. Beauchamp

Donald Davidson is a young accountant who recently went into practice for himself. He literally placed a CPA shingle on a mantel post outside a basement office that he rented in a reconstructed part of downtown Frederick, Maryland. He chose this location because of its extremely low overhead, which was about all he could afford as he got his practice underway. He had only two clients in Frederick, but Washington, DC, with its inexhaustible need for accountants, is only 40 miles away. Donald had made a number of contacts in Washington during a brief previous job with an accounting firm. Donald's father is a lawyer/accountant with a solid practice in Washington and is positioned to send some business Donald's way. In fact his father has already sent him one important client, Mr. Warner Wolff, the president of a medium-sized bank in the Maryland suburbs of Washington, First National Bank of Beltsville. Donald had been doing the president's personal accounts—his income taxes and two Keogh Pension Accounts the president had amassed for himself and his wife through a consulting business managed by his wife. Donald has often talked with Mr. Wolff about the bank's plans and programs, and he hopes there would be some contract work to be done for the bank in the future.

One day while going over the books on the pension accounts, Donald noticed that Mr. Wolff had sold the entire diversified portfolio of stocks in his wife's pension account, which traded for a value of just over $249,000. Mr. Wolff had then bought $248,982 of stock in the First National Bank of Beltsville for his wife's pension account. Upon seeing these trades, Donald jokingly commented to Mr. Wolff that he must have supreme confidence in his managerial abilities to put all of his wife's pension money in the stock of his own bank.

Mr. Wolff, a sober and forthright person, took Donald's comment as a serious inquiry into the reason for the trades and gave a serious

answer: “Although it won't be announced for three months and is top secret,” he said, “we have signed a merger agreement with the largest bank in Maryland, and our stock price should rise dramatically on the announcement date.” Donald was surprised at being let in on the secret, but he presumed that Mr. Wolff took the disclosure to be protected by normal accountant/client confidentiality. He thought nothing more of it and concluded his work on the records.

However, on the drive home he began to mull over his client’s timely purchase and quickly saw that the same opportunity presented itself to him. He had no cash and only an IRA (individual retirement account) worth $10,000 at this stage of his young career, but the bank certificate of deposit in which he had invested his IRA was coming due in three weeks, and so he needed to reinvest this money anyway. Why not, he thought, put all $10,000 in the stock of the First National Bank of Beltsville?

As a student at the Wharton School, Donald had studied insider trading and the regulations governing it issued by the Securities and Exchange Commission. He vaguely remembered that the principle behind the SEC regulations is that it is illegal to trade on nonpublic, financially useful information that has been misappropriated or secured by a breach of fiduciary duty. Donald felt a need to bone up on his rusty understanding. He took off the shelves a textbook he had studied as a graduate student and read the following description:

> The practice of insider trading has long been banned in the United States. The Securities and Exchange Commission (SEC) has actively sought rules against such trading since the enactment of the Securities Exchange Act of 1934. Under the terms of this law, a trader is forbidden to use information obtained on the inside to buy or sell securities or to pass the information on to others so that they December benefit. In the important precedent case of *S.E.C. v. Texas Gulf Sulphur*, a court held, “Anyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or [if] he chooses not to, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed.”

Insider trading has proven difficult to define. An inside trader is someone who trades in the stock of a corporation based upon material nonpublic information he has obtained by virtue of his relationship with the corporation. Some believe that the information should be relevant to the price and to the purchase of the stock. For example, one might have confidential information that could not be disclosed and yet would not likely affect the stock's price even if it were known. The SEC has said that the nonpublic information must be misappropriated by the trader, but a definition of the term misappropriate has likewise proven difficult.

There is considerable moral ambiguity surrounding insider trading. The SEC believes that the insider trading laws serve a moral purpose: preserving the fairness and integrity of the nation's securities market. Investors who have nonpublic inside information are thought to be unfairly advantaged. The underlying principles of these laws are that all investors in a free market should have equal access to relevant information, that securities markets must operate on faith and trust, and that insider trading undermines public confidence in the marketplace. The United States Supreme Court has stressed a different moral purpose. The Court has held that an inside trader is one who violates a fiduciary duty to retain confidential information; insider trading is, therefore, like stealing, from an employer. Insider trading is also believed to obstruct the market in capital information.

Other authorities do not consider insider trading unfair. Several scholars have argued that permitting insider trades would make the securities market more efficient. The activity of the traders would be spotted and the market would respond more quickly to essential information. Ben R. Murphy, a partner in a merchant banking firm in Dallas, argues as follows: "My theory is that if we didn't have [insider trading laws] the market would eventually discount all the leaks and rumors and become more efficient. People would have to take a risk on believing the rumors or not." It is noteworthy that over $50 billion of securities trades daily on American exchanges, and no one is prepared to argue that even as much as 1 percent involves insider trading or any form of illegal transactions.

Jonathan Macey, Professor of Law at Emory University, has argued that a person who locates undervalued shares in a company

> through inside information can provide a valuable service to the market by the discovery, whether insider trading occurs or not. But in order to encourage such discovery the person or institution must be allowed to profit. This is basically what stock analysts do; they all try to get information not yet public before their rivals do in order to reward clients who pay for their activities. The amateur investing public has no chance against such professional knowledge and can only hope that the market price already reflects insider information. Macey concludes that "a complete ban on trading by those with confidential information about a company would be disastrous to the efficiency of the capital markets. If such a rule were enforced, nobody would have an incentive to engage in a search for undervalued firms, stock prices would not accurately reflect company values, and, perhaps worst of all, investment capital would not flow to its most highly valued users. Thus, we would all be better off if the SEC would de-escalate its war on insider trading."

Donald realized that the laws regulating insider trading were often inconsistent. There were no federal securities laws explicitly prohibiting insider trading as such. The laws had developed gradually from SEC and judicial decisions. Donald could see that the term *misappropriated* was too vague to be meaningful, except in a highly subjective way from case to case. He did not think that he would be engaging in a breach of fiduciary duty by trading in the bank stock, because he had no relevant fiduciary duty. As he saw it, he had a fiduciary duty not to disclose the secret revealed by his client, but he did not intend to disclose anything. In his judgment, he no more obtained the information through a breach of fiduciary duty than does a bartender who overhears information at the bar about a merger of two companies. Donald asked himself, what fiduciary duty could I possibly have not to buy this stock?

Moreover, Donald also knew that the Justice Department had traditionally construed insider trading to apply exclusively to an insider with a fiduciary duty to a corporation not to the use of confidential information obtained in their relation-ship. He could not see that he had any corporate connection. Such insiders were almost always Wall Street professionals. He also knew that in one of the few cases to reach the U.S. Supreme Court, the Court had dismissed charges of insider trading against a printer who had traded stocks

based on the reading of confidential information he had been given to print. The Court held that the printer had no legal obligation not to use the confidential information. Donald saw himself as in much the same situation as the printer.

Donald had read about the insider trading cases that had made the headlines in recent months. In fact, his current copy of *Business Week* magazine had a cover story dealing with the recent history of insider trading. He reached for the article and began reading the historical parts about two notorious insider trading scandals, both of which had previously escaped his attention. The first case involved a reporter, R. Foster Winans of *The Wall Street Journal*, who had taken advantage of his position as a reporter for personal financial gain (not very effectively) and had also helped his friends and associates gain financially (very effectively). The Winans case was not easy for Wall Street to dismiss, but Winans was an outsider looking in. The excesses of a juvenile journalist did not seem to directly attack the staid atmosphere of the Wall Street investment firms on which Winans reported.

However, shortly after Winans dealings, a more consequential case erupted. Dennis Levine, a managing director who specialized in mergers and acquisitions at Drexel Burnham Lambert, was arrested for allegedly trading the securities of 54 companies (including major companies such as Nabisco and McGraw-Edison) on insider information in order to earn over $12.6 million. Levine was one of Wall Street's most successful figures and had taken home $3 million in salary and bonuses during the previous year. He had also just pulled off a major deal by advising Pantry Pride in its takeover of Revlon.

Levine's walk on the wrong side of Wall Street evidently began on a trip to the Bahamas in 1980, where he deposited $170,000 at secret branches of a Swiss bank. Using code names, he ultimately set up two dummy Panamanian corporations that traded through the Bahamian bank. On or about March 22, 1984, Levine bought 75,000 shares of Jewell Companies. He sold them on June 5, 1984. In 1985 he bought 145,000 shares of American Natural Resources Company on February 14 and sold them March 4. The continuous pattern of such trading netted Levine the $12.6 million in a short period of time. The SEC

launched an investigation after noting a pattern of suspiciously well-timed stock trading at the Swiss Bank's U.S. trading accounts.

The Levine conviction reinforced a view that is strongly held at the SEC: Insider trading is rampant on Wall Street. Repeatedly the stock of a takeover target will jump in price immediately before a takeover offer is announced to the public. For example, just before Levine's arrest. General Electric acquired RCA. Immediately prior to the announcement the stock had jumped a dramatic 16 points. The SEC's massive investigation made it clear that the agency is dedicated to major policing efforts in the attempt to contain insider trading. Since Levine's arrest, several other famous Wall Street figures had been arrested and successfully prosecuted.

The SEC discovered that insider trading was not confined to corporate insiders, but that many Wall Street outsiders were actively involved. In reporting on the Winans case, *Business Week* pointed out that

> Executives do it. Bankers do it. Accountants, secretaries, and messengers do it. And so do printers, cabdrivers, waiters, housewives, hairdressers—and mistresses. Some do it on their own. Others work in rings with connections as far away as Switzerland and Hong Kong. But they all work the shadowy side of Wall Street by trading on inside information to make money in the stock market.

The SEC and the Congress have been working together to crack down on insider trading. They recently took a hard look at the role played by accountants when insider trading by institutional investors occurs in markets for high-yield bonds. Usually the trading occurs after consultation with attorneys or accountants a few days before favorable information is released about companies that had formerly been considered in financial difficulty. The preferred accountants are often those who sit on creditors' committees of companies undergoing bankruptcy proceedings. Nonetheless, ambiguities and inconsistencies in the laws regulating insider trading have prevented effective enforcement, and prosecutors have often had difficulty in convicting offenders, especially in bond markets where insider trading is less clearly delineated than in stock markets. Donald read, in *The Wall*

Street Journal, that government prosecutions for insider trading also might now be delayed for as much as a year, pending a new Supreme Court decision expected to set a precedent for the courts.

Both the SEC and the Congress have also been considering statutory definitions of insider trading. The congressional legislation introduced by senators from Michigan and New York and the SEC proposal would both toughen penalties on insider trading. The proposals would define it as the "possession of material, nonpublic information" obtained "wrongfully, whether knowingly or recklessly." The information is obtained wrongfully "only if it has been obtained by, or its use would constitute, directly or indirectly, theft, conversion, misappropriation or a breach of any fiduciary, contractual, employment, personal or other relationship of trust and confidence." The prohibition would apply, according to the SEC proposal, to anyone with a "regular nexus to the operation of the nation's securities markets."

Donald could see that he had obtained his information in confidence, but, again, he could not see that he was violating that confidence or that he had either directly or indirectly stolen his information. Although the new congressional definition was disquieting to him, Donald was buoyed to read a quotation taken from the leading investment journal. *Barron's*, which maintained that the SEC is "riding roughshod over due process of law," drying up the free flow of information and harming the interest of those it is sworn to protect. In discussing the Winans case, the *Barron's* article adamantly insisted that Winans had done no legal wrong and that the SEC had twisted the idea of "misappropriation" of information to the breaking point in getting a conviction of Winans. Winans's only wrong, said *Barron's*, was the moral wrong of violating *The Wall Street Journal*'s rules of ethics. But this was clearly just a matter of journalism ethics, not business ethics, as far as Donald could see.

Donald had been around accounting long enough to know that government rules, especially Internal Revenue Service rules, had multiple interpretations and borderline case situations. He recognized that he might be in a borderline situation morally, but he could not see that he would be violating any clear legal principle by purchasing the bank stock. After considerable thought, he decided that he would buy

the stock in three weeks, unless he saw new reasons not to do so. However, he felt uneasy with his decision. He was not worried about the law, although any new laws were likely to be more restrictive. Donald’s two deepest concerns were about his IRA and his integrity.

* * *

Quotations on Money

“No one can earn a million dollars honestly.” (William Jennings Bryan)

“The rich are the scum of the earth in every country.” (G. K. Chesterton)

“Behind every great fortune there is a crime.” (Balzac)

“The love of money is the root of all evil.” (I Timothy 6:8-10)

“The lack of money is the root of all evil.” (Mark Twain)

“The universal regard for money is the one hopeful fact in our civilization, the one sound spot in our social conscience. Money is the most important thing in the world. It represents health, strength, honour, generosity, and beauty as conspicuously and undeniably as the want of it represents illness, weakness, disgrace, meanness and ugliness. Not the least of its virtues is that it destroys base people as certainly as it fortifies and dignifies noble people.” (George Bernard Shaw, *Major Barbara*)

“If a man runs after money, he’s money-mad, if he keeps it, he’s a capitalist; if he spends it, he’s a playboy; if he doesn't get it, he’s a ne'er-do-well; if he doesn't try to get it, he lacks ambition. If he gets it without working for it, he’s a parasite; and if he accumulates it after a lifetime of hard work, people call him a fool who never got anything out of life.” (Vic Oliver)

“A neighbor not long ago told me that her husband was one of eighteen nephews and nieces of a man who at his death had left a trust that gave each of them, when they turned twenty-one, an annual income of $60,000 each. Apart from her husband, who went on to medical school, not one of these legatees finished college. The result of their uncle’s generous benefaction was to breed a set of drug addicts, full-time beach bums, ne'er-do-wells, and other human disasters.” (Joseph Epstein, “Money is Funny,” p. 311)

“It is a socialist idea that making profits it a vice; I consider the real vice is making losses.” (Winston Churchill)

“Economic efficiency consists in making things that are worth more than they cost.” (J. M. Clark)

Martin Luther: “There is on earth no greater enemy of man, after the Devil, than a gripe-money and usurer, for he wants to be God over all men ... . Usury is a great, huge monster, like a werewolf ... And since we break on the wheel and behead highwaymen, murderers, and housebreakers, how much more ought we to break on the wheel and kill ... hunt down, curse, and behead all usurers!”

“There is no money in poetry, but then there is no poetry in money, either.” (Robert Graves)

“Why doesn’t someone write a poem on money? Nobody does any-thing but abuse it. There’s hardly a good word for money to be found in literature. The poets and writers have been needy devils and thought to brave out their beggary by pretending to despise it.” (John Jay Chapman)

But please do not think that I am not fond of banks,
Because I think they deserve our appreciation and thanks,
Because they perform a valuable public service ie in eliminating
  the jackasses who go around saying that health and happiness are
  everything and money isn't essential,
Because as soon as they have to borrow some unimportant money
  to maintain their health and happiness they starve to death so they
  can't go around any more sneering at good old money, which is
  nothing short of providential.
(Ogden Nash, “Bankers are just like anybody else, except richer”)

* * *

Case analysis checklist

1. Key background facts about the product/service and situation.

2. Identification of the parties involved.

3. Pro argument:
   - Party 1's rights and responsibilities
   - Party 2's rights and responsibilities
   - Party 3's rights and responsibilities

4. Con argument:
   - Party 1's rights and responsibilities
   - Party 2's rights and responsibilities
   - Party 3's rights and responsibilities

5. My conclusion.

6. My arguments for my conclusion.

7. My counter-argument to the conclusion opposed to mine.