3

CLASSIC BUSINESS ETHICS DILEMMAS
WHEN DOING THE RIGHT THING DOES NOT MAXIMIZE PROFITS

3.1 Now that we have discussed what ethics does, and what business does, in the first two chapters, we can begin exploring the business ethics controversies that arise when the goal of profit maximization clashes with the goal of doing the right thing. We will explore these conflicts through four of the most central cases in the business ethics canon: (1) the Ford Pinto; (2) Walmart; (3) B.P.; and (4) Enron.

3.2 In the Pinto case, Ford executives decided whether to fix a dangerous flaw in a popular car (doing right by their consumers) when paying off consumers injured by the flaw would be less expensive (maximizing profits). In the Walmart case, the business decided whether to pay employees a living wage (doing right by their employees) while requiring backbreaking, degrading work (maximizing profits). The B.P. case covers the 2010 oil spill in the Gulf of Mexico, in which the company decided whether to protect the environment (doing right by the community) when it was cheaper not to (maximizing profits). In the Enron case, the business risked its ability to continue as a business (doing right by the shareholders) when it decided whether to engage in accounting improprieties (for the sake of maximizing profits).

3.3 These cases develop the view of business and ethics set forth in the first two chapters and serve as paradigms for the 20 cases that will be covered in Part III (Chapters 7–11).

This is Business Ethics: An Introduction, First Edition. Tobey Scharding.

Doing Right by Consumers: The Ford Pinto Case

The Pinto was just the kind of car that would be popular with young people: 3.4
cute, small, fun to drive, inexpensive. Manufactured by the Ford Motor Company from 1971–1980, it was designed to please the consumer. And it did just this, until a serious defect was revealed in the fuel tank engineering. When rear-ended, even at low speeds, the car's gas tank could rupture. If the fuel leaked, if there was a spark, the car could explode: killing or maiming the car's occupants.

Design flaws sometimes occur in manufacturing. A flawed product is 3.5
not necessarily unethical. What elevated the Pinto fuel tank flaw from an engineering error to a full-blown business ethics scandal was the way the company responded to the problem. One issue with Ford's response is what the company decided to do: after learning of the defect, it allegedly decided to sell the cars anyway. Another issue is the reason why Ford made its decision: allegedly, because it was cheaper to sell the defective vehicles than to fix them. That is, it was cheaper *even when* the "cost" of human life was assessed and included in the company's cost-benefit analysis. Putting profits before human lives is the root of the ethical scandal in the Ford Pinto case.

Sidebar Exercise

Think back to the cases of college ethics in Chapter 1, where we analyzed what information we would need to know in order to determine whether an action was ethically right or wrong. What do we need to know in this case in order to evaluate whether what Ford did was ethically wrong?

This textbook is going to introduce some information about the Pinto 3.6
case. But one important piece of information about this case is that we do not know all of the details about Ford's business decision-making. The company has refused to reveal many relevant details about the case to the public. Refusing to share information could suggest that the information incriminates Ford—but it need not. The company may decline to reveal all of the facts about the case because some of those facts would reveal

its *trade secrets*, compromising Ford's ability to compete with other car manufacturers.

3.7 Let us begin, though, with what we do know. The most natural starting point is the "Pinto Product Objectives," which we can think of as the business model for the Ford Pinto. This list was created by a Ford manager, Lee Iacocca. Iacocca was so closely involved with the Pinto's design that the vehicle is sometimes called "Lee's Car."

1. The Ford Pinto is a "true" subcompact in terms of both its size and its weight. The Ford Pinto weighs less than 2,000 pounds.
2. The Ford Pinto is low cost in terms of initial price, gas usage, and reliability. It costs less than 2,000 dollars.
3. The Ford Pinto is a superior product in terms of comfort, features, handling, and performance. It is a fun car to drive and a fun car in which to ride.

The first thing that many people note about this business model is that there is no mention of "safety." Iacocca was well known for believing that "safety doesn't sell." His main concerns were moving Pintos off of the lots and increasing revenue for the Ford corporation. This list reflects those concerns.

Sidebar Exercise

Is it ethically wrong that the Pinto business model does not include safety as an objective? Think about your own preference in cars. What is most important to you? How important is safety? How unsafe a car would you be willing to buy if it had the other features that are important to you?

3.8 On the topic of safety, we should try to put ourselves into the position of Ford executives in the 1970s. Nowadays, car consumers are used to having a variety of well-functioning and (relatively) safe cars to choose from, at various price ranges. Cars in the 1970s were much less reliable, however. Have you ever seen a car at the edge of the highway with its hood open and smoke pouring out? We hardly ever see this now but overheating and other problems used to be common experiences for drivers. In the 1970s,

the government did not regulate the car industry as closely as it does today and safety requirements were much laxer. In fact, it was during the same time that the Pinto scandal was playing out that safety regulations were being standardized for the first time. So things that seem obvious to us about car safety might not have appeared so clear to Ford executives.

We should not make too much of this point, however. Yes, there are 3.9
significant differences in the automobile industry between the 1970s and the 2010s. Yes, customers have variable preferences: some prefer safer cars, others prefer cars with better performance, others prefer cars with a "cute" or "sexy" appearance. Even taking these two points into account, though, most people would presumably reject a car that was seriously unsafe.

And that was precisely the problem with the Ford Pinto. It was seriously 3.10
unsafe. The fuel system's precarious location next to the bumper meant that the gas tank could rupture when the car was rear-ended, even at speeds as low as 20 miles per hour. If the tank ruptured and there was a fuel leak, the car could ignite: killing or injuring the inhabitants. Everyone could die as a result of a routine, minor accident, the kind that happens every day.

And, indeed, such routine, minor accidents—producing horrifying 3.11
deaths—occurred throughout the 1970s. One of the most infamous incidents occurred in 1978, when a 1973 Pinto carrying three teenage girls was struck from behind and ignited. The young driver and her passengers were all incinerated. One of the experts who testified at the trial, Byron Bloch, called the fuel tank design a "catastrophic blunder." Drawing on his expertise in automobile engineering and industrial design, Bloch testified that, "Ford made an extremely irresponsible decision when they placed such a weak tank in such a ridiculous location in such a soft rear end. It's almost designed to blow up—premeditated." Bloch testified that it would have been safer to place the fuel tank in front of the rear axle, where it would be less likely to rupture if the car were rear-ended.

In a 1977 article, "Pinto Madness," published in *Mother Jones* magazine, 3.12
an unnamed Ford engineer addressed the issue of the gas tank design and placement. That engineer admitted that the gas tank was flawed from a safety perspective but emphasized that it had other merits. In particular, he emphasized that the Pinto tank created more trunk space in the car, which was an area in which the Pinto sought to be competitive.

In the face of mounting deaths, though, concerns about trunk space 3.13
appear frivolous. Hundreds of people had died or been injured in fiery crashes by the late 1970s. At this time, Ford had access to several strategies for making the cars safer. First, it could have reinforced the rear axle, improved the bumper, and provided additional support for the tank. Making

these changes would have cost $15 per vehicle. They would have made the fuel tank able to withstand a 34–38 mile-per-hour rear-impact crash.

3.14 In addition to the axle reinforcement, bumper improvement, and tank support, Ford could have added a bladder at a cost of about $5 per vehicle. Making these changes—at a cost of $20 total per vehicle—would have allowed the fuel tank to withstand a 40–45 miles-per-hour rear impact. If the tank had been located over the rear axle and surrounded with a protective barrier, at a cost of approximately $10 per vehicle, it would have been safe in a rear impact at 50 miles per hour or more.

3.15 Why did Ford decide not to make any of these changes? As with any decision, it is difficult to figure out, from the outside, why other people decided to act as they did. We can ask them, and take their word for it. Alternatively, we can construct a theory about why we believe that they acted as they did and try to argue for that theory. In the case of the Pinto disaster, both strategies have been attempted. When Lee Iacocca was asked about the design choices, he explained that he did not know that the design would have the deadly consequences that it ended up having.

3.16 When looking more broadly at how the Ford Motor Company tended to make decisions during this time, however, another possibility emerges. This possibility is offered in the *Mother Jones* article. In the 1950s and 1960s, a person who had an important influence on the Ford Motor Company was Robert McNamara. McNamara was the first person who was not a member of the Ford family to serve as the president of that company. He subsequently served as Secretary of Defense in the Kennedy administration. Trained as an accountant, McNamara was a strong proponent of cost-benefit analysis (CBA), the decision-making strategy discussed in Chapter 2. Based on McNamara's influence on the Ford Company, many people have inferred that the company decided to keep selling the Pinto, rather than performing one of the other actions, listed above, because continuing to sell the defective car was favored by CBA.

3.17 As noted above, CBA has obvious value in business decision-making. In particular, it is highly effective at maximizing the bottom line. Problems with the decision-making strategy arise, though, when it is applied to decisions concerning human life. The most serious of these problems is that analysts must place a dollar value on human life. For Ford, that value was $200,000. A non-fatal burn was valued at $67,000. (Adjusted for inflation, that is over $1 million per life and around $400,000 for a non-fatal burn in contemporary dollars.)

3.18 A memo that Ford created using CBA to assess whether the car industry as a whole should use a safer gas tank has been made public. In that memo,

Ford estimates the human "cost" of the riskier tank, industry-wide, per year, at 180 lives and 180 burns. Industry-wide, 12.5 million vehicles that caused these kinds of injuries (cars and "light trucks") were sold. That means that, industry-wide, the costs of burn deaths and injuries is projected to be $49.5 million but the cost of selling safer cars (assuming that the safer car costs $11 more to manufacture) is $137 million.

These industry-wide costs and benefits, though, do not settle the question of what Ford ought to do from a CBA standpoint. To figure that out, we will have to make some assumptions. First, we can plausibly estimate that the Pinto had a sales volume of 300,000 vehicles per year. (This figure is based on a 2003 article by Robert Sherefkin in *Automotive News*, in which the author notes that Pinto sales in 1971 were 328,275 in the United States.). According to Ford Vice President Herbert L. Misch, there were 12 fatalities in all Pinto accidents in 1975 that involved fires. We know from the memo that Ford assumes that burn deaths and injuries are the same number. So, assume that Ford is deciding whether to install the safety devices discussed above (costing $10, $15, or $20) for the next operating year (say, 1976). It anticipates 12 deaths and 12 burns per year. 3.19

Estimated CBA: 3.20

- ($200,000 per death × 12 projected deaths) + ($67,000 per burn × 120 projected burns) = approximately *$3 million* per year.
- $15.00 × 300,000 Pintos per year (estimated) = *$4.5 million* to make the car safe at 34–38 mile-per-hour rear-impact collisions.
- $20.00 × 300,000 Pintos per year (estimated) = *$6 million* to make the car safe at 40–45 mile-per-hour rear-impact collisions.
- $10.00 × 300,000 Pintos per year (estimated) = *$3 million* to make the car safe at 50 mile-per-hour rear-impact collisions.

Because the bottom line is the same to fix the car as to pay for injuries, these figures do not make a compelling case for either alternative (in terms of CBA). Combined with Ford's $200 million investment in Pinto production with the defective cars, though, we can grasp how the bottom line might have influenced Ford to keep the defective cars in place. We do not have the information about costs of retooling Pinto assembly lines and improving the car's design. It does seem plausible, though, that these costs would have been greater than compensating survivors and the families of the deceased. Ford's decision to keep selling the unmodified Pintos suggests that, in this case, the bottom line trumped concerns about loss of human life.

Sidebar Exercise

What would the DM recommend that Ford do in this case? What would ShareT recommend? How about StakeT? Raise an objection against each decision-making strategy's recommendation. Then, consider how someone who supported the decision-making theory would respond to your objection.

Doing Right by Employees: The Walmart Case

3.21 In the Pinto case, we examined a conflict between shareholders and customers. In the Walmart case, we will look at a conflict between shareholders and employees. Walmart is one of the biggest companies in the world. In 2014, it had more than $250 billion in revenue (in the U.S. alone), more than 10,000 stores around the world, and two million employees worldwide. It was founded by Sam Walton in 1962. Walton's aim was to sell products at the lowest possible prices. He thought of his stores as serving consumers' interests. Although earning little profit on each item sold, Walmart sold more products than any of its competitors. In this sense, its business model served shareholders' interests as well. This can be seen in the immense wealth of Walmart's owners. Sam Walton was the richest person in the United States from 1982–88. Since his death in 1992, Walton family members have maintained ownership of more than 50 percent of Walmart stock. A 2011 *Forbes* magazine article profiled the Waltons as the richest family in the world, with a combined net worth of $93 billion.

3.22 The interests that may have seemed to have received short shrift in the Walmart business model are those of employees. In addition to paying employees very low wages, often without benefits like health care and retirement savings, Walmart has been accused of wage-and-hour violations, race- and gender-based discrimination, and maintaining a stressful, oppressive workplace. These claims were set forth in a series of employee interviews included in the 2005 documentary, *Walmart: The High Cost of Low Price*. We will examine each of the claims in turn.

3.23 According to the documentary, full-time Walmart employees (who work 28 hours/week) earn less than $12,000/year. Many employees can't afford to live on their own. One worker reported that "I can't afford to pay $75 a

month for the medical coverage but because I earn such low income I am eligible for Medicaid." The documentary reported that Walmart's low wages and inadequate benefits cost taxpayers $1.5 billion via government-provided welfare, food stamps, and Medicaid.

3.24 Workers also claim that store managers violate the Fair Labor Standards Act (FLSA), which requires employers to pay non-managerial employees one-and-a-half times their regular wage for any hours more than 40 per week. Walmart managers, however, are required not only to keep their expenses low but actually to lower expenses every month. Many managers say that the only way to do this is through payroll. Thus, they say: "No overtime whatsoever." Because most workers are desperate to keep their jobs, if there are two hours of work left to do but a worker has only half-an-hour left on his or her shift, the worker must do the remaining work unpaid.

3.25 Other workers allege race- and gender-based discrimination. At one store, there was only one female worker, who claimed that she was made to clean the bathroom in addition to her sales responsibilities. At another store, an African-American woman applied for an assistant manager training program. A manager told her, "There's no place for people like you in management." The woman retorted, "What do you mean: that I'm black or that I'm a woman?" The manager replied, "Well, two out of two isn't bad." At a third store, African-American employees found nooses hanging in an employee break area. Nooses, which recall the era of lynching in the Southern United States after the Civil War, are a frequent means by which racist employees harass their African-American co-workers.

3.26 In addition to these workplace violations, the documentary shows that Walmart has actively discouraged union participation. Unions allow employees to join forces and bargain collectively, which can allow them to be more successful in their negotiations with corporate management. One of the issues about which unions often negotiate are the workplace violations discussed above. As portrayed in the 2005 documentary, Walmart is one of the most aggressively anti-union companies in the United States.

3.27 More recently, Walmart workers have made renewed efforts to unionize, or otherwise organize, their fellow employees. OUR Walmart ("Organization United for Respect at Walmart) was formed in 2011 by a Walmart employee, Cindy Murray. By 2012, it had gained over 4,000 members. OUR Walmart members say they do not seek legal recognition as a union or collective bargaining rights. OUR Walmart members say they simply want to make Walmart a better place to work and shop.

3.28 OUR Walmart held protests at about 1,000 stores on the Friday after Thanksgiving (the busiest day of the year for retailers, also known as "Black Friday") in 2012, seeking (1) full-time jobs with predictable schedules rather than part-time work with hours that can change every three weeks; (2) wages that can provide their families with a decent life; and (3) respect. Despite the organization's success in attracting attention to the Black Friday strikes, less than one-tenth of 1 percent of the company's U.S. workforce participated.

3.29 Walmart has always been opposed to unions. David Tovar, a Walmart spokesman, says the company is proud of the jobs it offers, that its benefits are affordable and comprehensive, and that there are plenty of opportunities for associates to advance: "The suggestion that the issues OUR Walmart is raising are widespread or representative of any sizable number of associates is ludicrous." The issue continues to develop.

Sidebar Exercise

What would the DM recommend that Walmart do in this case? What would ShareT recommend? How about StakeT? Raise an objection against each decision-making strategy's recommendation. Then, consider how someone who supported the decision-making theory would respond to your objection.

Doing Right by the Community: The B.P. Case

3.30 The next case study involves a conflict between shareholders and communities concerning environmental protection. The corporation under examination here is British Petroleum (B.P.). The ethical controversy occurred in April 2010, when an oil rig, the Deepwater Horizon, exploded and sank in the Gulf of Mexico. Eleven people were killed in the wreck; hundreds more were injured. The explosion also damaged an oil well, the Macondo Prospect, owned by B.P., which gushed oil into the Gulf of Mexico for almost three months, discharging at least 134 million barrels of oil. The Macondo was a deep-sea well, designed to drill oil from 23 million-year-old sediment located 13,000 feet below the bottom of the sea. Underwater oil drilling is always risky. The frigid waters and intense pressures of deep-sea

wells increase those risks. One of the Deepwater Horizon workers who was killed had described the Macondo to his wife as "the well from hell." Tragically, B.P.'s cost-cutting business activities appeared to have contributed to the well's rupture.

Sidebar Exercise

Think back again to the cases of college ethics in Chapter 1, where we analyzed what information we would need to know in order to determine whether an action was ethically right or wrong. What do we need to know in this case in order to evaluate whether what B.P. did was ethically wrong?

The well gushed oil, natural gas, and toxic sludge for almost three 3.31
months, discharging at least 134 million barrels into the Gulf of Mexico. This was the largest oil spill in history, and one of the most damaging. The most seriously affected areas were along the Louisiana shoreline and Florida panhandle. The oil damaged marine and wetlands habitats, along with beaches used for tourism. It contaminated estuaries from which human food is fished.

The U.S. government investigated the spill. One former B.P. executive, 3.32
Kevin Lacy, testified that he had quit B.P. shortly before the Macondo disaster because he felt that B.P.'s cost-saving strategies compromised its safety. Lacy contributed to a study of the well following the damage that rated the well's complexity on a five-point scale. Lacy and his co-authors found that the Macondo rated more than three on this scale.

Ultimately, the government cited weaknesses in the construction of the 3.33
well, especially shoddy cement, as causes of the rupture. In its report on the Macondo disaster, the U.S. Chemical Safety Board blamed flaws in a cement barrier designed to protect the well from high pressure below the sea floor for the disaster. The inadvertent release of this pressure led to the blowout, which precipitated the explosion, fire, and oil spill.

The government also criticized B.P. for providing inadequate safety 3.34
monitoring and security for the well. B.P. was forced to pay high penalties and submit to safety and ethics monitoring by the Environmental Protection Agency. Three months after the spill, it had lost over a third of its market value, worth about $70 billion.

3.35 Following the spill, *Harvard Business Review* reported that the company failed to acknowledge the extent of the damage for which it was responsible. For example, CEO Tony Hayward called the spill "relatively tiny" in the context of a "very big ocean." Moreover, the company failed to take the most rapid means of cleaning up the mess, resulting in further damages.

Sidebar Exercise

What would the DM recommend that B.P. do in constructing the Macondo Prospect oil well in terms of materials, safety monitoring, and security? What would ShareT recommend? How about StakeT? Raise an objection against each decision-making strategy's recommendation. Then, consider how someone who supported the decision-making theory would respond to your objection.

Doing Right by Shareholders: The Enron Case

3.36 Our final paradigm case study involves a conflict between the firm's business activities and the firm itself. It focuses on the (now defunct) Enron Corporation, whose extensive use of aggressive business practices to accelerate earnings led to overinflated claims about profits. Eventually, the exaggerated profit claims led to the bankruptcy of the company.

Sidebar Exercise

Think back again to the cases of college ethics in Chapter 1, where we analyzed what information we would need to know in order to determine whether an action was ethically right or wrong. What do we need to know in this case in order to evaluate whether what Enron did was ethically wrong?

3.37 Some key events to be examined include: the employment practice of rank-and-yank, the firm's use of mark-to-market accounting, and the firm's creation of Special Purpose Entities (SPEs). Key players are CEO Ken Lay,

Chief Operating Officer (COO) Jeff Skilling, and Chief Financial Officer (CFO) Andrew Fastow.

Let us begin by setting out Enron's corporate identity. The business was founded in 1985 by Ken Lay as an American energy firm. Using aggressive tactics, the company grew rapidly, becoming the most successful energy company in the world by the late 1990s. Part of the fast growth also had to do with political events in the 1990s such as the deregulation of energy. Prior to deregulation, the federal government had controlled the cost of energy in order to make it affordable for low-income Americans. After the government stopped regulating the price of energy, Enron could sell energy at higher prices. Jeff Skilling, a Harvard Business School protégé, was brought in as COO, with Andrew Fastow completing the triumvirate as CFO. Ken Lay was a consummate entrepreneur and identified strongly with his company. Similar to French King Louis XIV's famous proclamation that "L'état, c'est moi" ("I am the state"), Lay was known for claiming that: "I am Enron." 3.38

Sidebar Exercise

How could StakeT, ShareT, and the DM evaluate Lay's claim?

One of the ways that Lay ensured adherence to his vision for the firm was through an employment practice colloquially known as *rank-and-yank*. In this practice, employees were graded each year from 1–5 based on their performance during the foregoing year (that's the *rank* part). The bottom 15 percent were terminated, regardless of how good their performance was (the *yank*). Lay conceived of this practice as direct feedback from him about how each employee was contributing to the company's objectives. 3.39

Another way that Lay advanced his vision of the firm was through his requirement that the firm use *mark-to-market accounting*. Mark-to-market accounting is a form of record-keeping in which a price is assigned to a product before the profits are actually realized, based on the product's current *market value*. This can be useful in registering products that are difficult to price, such as real estate or other assets whose value can vary. It can be dangerous, though, in the sense that it makes the company responsible for profits that are not yet secured. 3.40

Sidebar Exercise

Is mark-to-market accounting dishonest? Is dishonesty unethical? How do StakeT, ShareT, and the DM evaluate the decision to use mark-to-market accounting?

3.41 Lay and Skilling preferred mark-to-market over other kinds of accounting because mark-to-market allowed them to record potential profits on the day the deal was signed. This accorded with their belief that the person who had the idea for a new product was entitled to all of the profits associated with that product. According to the 2005 documentary, *Enron: The Smartest Guys in the Room*, Skilling believed that the idea was everything and you should be able to book the profits right away; otherwise, the profits would be gained by some "lesser man" for the ideas of a "greater man." Using mark-to-market placed Enron in a potentially precarious position, though, if the company realized less profit from its initiatives than it anticipated. The practice also left the firm's accounting open to manipulation—in the sense that accountants might have to try to produce the missing profits from some other source.

Sidebar Exercise

Does Ken lay have a good character? Does Jeff Skilling have a good character? Why or why not? Can StakeT, ShareT, and the DM capture this aspect of the case?

3.42 Problems of this nature occurred in two of their business transactions: involving the Dabhol Power Station and Blockbuster. The Dabhol Power Station was constructed in the early 1990s in the state of Maharashtra in India, after Skilling observed that the rapidly developing nation was in need of greater energy production in order to power its development. The problem was that at the time the power station was built, the local population was unable to afford the power it was to provide. For a while, Enron collected 4.67 rupees for each unit of power from the state of Maharashtra;

because Maharashtra collected only 1.89 rupees from its customers for the same amount of power, though, the situation was unsustainable. Enron ended up realizing almost nothing from the $3 billion project.

The Blockbuster deal of the early 2000s, in turn, was intended to deliver 3.43
Blockbuster's video content on demand to consumers at home via streaming on Enron's fiber-optics network. In retrospect, the idea seems quite prescient. Netflix and other companies later went on to significant success in delivering on-demand video content. The Enron-Blockbuster deal broke down, though, when the parties were unable to reach agreement about key issues.

One final business venture was the creation of *special purpose entities* 3.44
(SPEs), or shell companies that a business creates to serve narrow purposes that differ from the business's main purpose. Like mark-to-market accounting, SPEs have legitimate business uses but are open to manipulation. In the late 1990s, Enron used a series of SPEs to hide the debt created by failed deals like Dabhol Power Station and Blockbuster—which were marked in Enron's ledger as profitable.

Enron's downfall began in March, 2001, when a journalist, Bethany 3.45
McLean published an article, "Is Enron Overpriced?" in *Fortune* magazine. She questioned how Enron could maintain its high stock value, which was then 55 times its earnings. The company rapidly declined as information about its corrupt accounting practices were made public. Lay sold hundreds of millions of dollars worth of Enron shares 15–30 minutes before the information that Enron was collapsing went public on November 28, 2001. Enron's other stockholders—including employees who had their pensions in Enron stock—lost everything.

Sidebar Exercise

What would the DM recommend that Enron do in this case? What would ShareT recommend? How about StakeT? Raise an objection against each decision-making strategy's recommendation. Then, consider how someone who supported the decision-making theory would respond to your objection. Can your objections be adequately addressed? Or do they suggest more serious problems with the decision-making strategies?

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