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Corporate Social Responsibility and Energy

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"If there is one thing I have been impressed with over the last decades, it is that when the environmental community defines a number one priority, something happens. Not always something good—but something."[1]

—**Dr. Kenneth L. Lay, Chairman, Enron Corporation, June 1997**

INTRODUCTION

Capitalism took the fall for Enron. Yet it is largely forgotten that this company had been a favorite of the environmental Left and an advocate/practitioner of the trendy notion of *corporate social responsibility* (CSR). Nonetheless, when the company collapsed in December 2001, Enron and its once-iconic chairman Ken Lay suddenly became Exhibit A against the teachings of Adam Smith, Ayn Rand, Milton Friedman, and other proponents of self-interest and voluntary exchange.

"The ideal of the unregulated market is flawed," proclaimed business ethicist Marjorie Kelly in her Enron interpretation, "and it's time we said goodbye to the invisible hand."[2] Princeton economist Paul Krugman predicted in the *New York Times* that the demise of Enron—an event that was bigger than 9-11 in his view—would sour society against free-market capitalism.[3]

Robert Kuttner took the argument a step further in *Business Week*:

> For three decades now, the dominant strain of economics from the University of Chicago has been teaching gullible undergraduates and journalists that there is no such

thing as the public interest. Efficient outcomes are just the aggregation of selfish private interests, and government's main job is to get out of the way. Well, after Enron, these theorists should learn some other useful trade.[4]

These critics got it backwards. Enron was not a free-market company but a politically dependent one, the type of enterprise that capitalist intellectuals had warned against time and again. Ken Lay was not a nuts-and-bolts business executive trained in engineering, accounting, or finance, as are most market-oriented CEOs. Lay was a Ph.D. economist with years in government (the last two stops as a regulator) whose niche became running public-utility regulated assets. In his 17 years at Enron, Lay milked the political system to benefit a variety of his profit centers, including energy trading. His efforts were enabled by mandatory access to competitor transmission systems ("infrastructure socialism," as two analysts put it[5]), and taxpayer-backed loans for international infrastructure development. The scale and scope of Enron's political activities, in fact, is unprecedented.

On the environmental front, Enron practiced so-called *sustainable development* by sounding the alarm over man-made greenhouse-gas emissions beginning in 1988. The firm:

- Supported Clinton/Gore's 1993 proposal for a Btu tax,
- Aggressively invested in solar power in 1994,
- Jump-started the ailing U.S. wind industry with the purchase of Zond Corporation in 1996,
- Spearheaded the effort behind what became the nation's most strict renewable energy mandate (in Texas in 1999), and
- Lobbied the Bush/Cheney administration (unsuccessfully) to regulate CO_2 emissions.

Enron received a climate-protection award from the Environmental Protection Agency (EPA) and a corporate-conscience award from the Council on Economic Priorities for its efforts. The company advanced the interventionist agenda of the President's Council on Sustainable Development; the Business Council for Sustainable Energy; the Pew Center on Global Climate Change; and the Heinz Center for Science, Economics, and the Environment, as well as sponsoring Earth Day events in Texas, California, and Oregon. Ken Lay's Enron was pointing the way to a sustainable-energy future—or so it was thought.[6]

And then there were the regulatory reforms that Enron could not land. In the 1980s, Lay's company failed to persuade lawmakers to enact a sizable oil tariff to reduce interfuel competition to the company's natural gas operations. Enron also fell short in its 13-year drive to persuade the federal government to regulate greenhouse-gas emissions, particularly carbon dioxide (CO_2), an intervention which promised profit opportunities in a variety of the company's divisions. Still, as an ex-Greenpeace official observed, Enron was "the company most responsible for sparking off the greenhouse civil war in the hydrocarbon business."[7]

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OVERLOOKING ENRON'S CSR EFFORTS

The full story of Enron's greener-than-thou energy environmentalism remains to be told. Corporate Social Responsibility proponents and the environmental Left chose to ignore this aspect of Enron's history. A tome on Enron's sins spearheaded by a group of Houston business and law professors, for example, makes nary a mention of Enron Renewable Energy Corporation and the company's multifaceted efforts to promote greenhouse gas regulation.[8] Nowhere is this omission more evident than in "The Enron Story and Environmental Policy" by Victor Flatt, the A. L. O'Quinn Chair in Environmental Law at the University of Houston Law Center.

Flatt's essay begins promisingly: "There are many aspects of the Enron saga that would give pause to someone who thinks about the environment and its problems."[9] But then his 20-page review inexplicably ignores Enron's energy model in its many shades of green. It focuses, instead, on one aspect of the company's desired regulatory regime—the trading of carbon dioxide under a national cap-and-trade program. (Flatt is critical of this proposal.)

Yet Enron's environmentalism should give pause to climate alarmists and to those who advocate government-engineered energy transformation in the name of promoting "sustainable" energy. Enron was certainly no angel for the cause of energy sustainability. The "green" energy crusade that Enron in some ways fathered is much more about corporate welfare than true energy sustainability. Inferior (high-cost) energy production penalizes lower-income consumers the most and poses a quandary for an estimated 1.6 billion who need modern forms of energy.[10] The "solution" of government intervention should be balanced against the "problem" of free markets ("government failure" versus "market failure").

And if "wealthier is healthier" for people and the environment, wealth-reducing energy policies will have unintended ecological consequences as well. The energy crusade of neo-Malthusianism should be reconsidered in its parts and as a whole in any post-Enron stock-taking.

CLIMATE ALARMISM AT ENRON

ENRON LIVES and thrives today in one important respect. The current debate over energy sustainability, a pillar of the modern CSR movement, is linked to Enron's marketing strategies. Coal, oil, and natural gas emissions have been linked to global climate change through an enhanced greenhouse effect. Alarm over anthropogenic (man-made) global warming has created a political movement to mandate reductions of fossil-fuel emissions through supply-side substitutions of low-carbon energy (natural gas) or no-carbon energy (wind, solar), and through demand-side increases in energy efficiency and conservation.

Beginning in the late 1980s, global warming became a bread-and-butter issue for Ken Lay, Enron's leader and new visionary of the natural gas industry. At the beginning it was methane versus coal and fuel oil in electric generation. Enron in the 1990s became a full-fledged "green" company with its investments in solar power, wind power, energy-efficiency services, and environmental services. Enron, in fact, could claim to be the world's "green" leader in energy.

No U.S.-based company sounded the alarm over climate change more than Enron. What John Browne did as head of the international energy major BP, Ken Lay did in the United States, working with interest groups and political leaders to push the energy industry and public toward CO_2 regulation. Lay had his reasons for pushing global warming alarmism. In fact, he had seven — this many company profit centers, all of which stood to gain from government restrictions on carbon emissions:

- Natural gas production (relative to oil and coal),
- Natural gas transmission (relative to oil and coal),
- Natural gas-fired electric generation (relative to oil and coal),
- Energy outsourcing (a/k/a energy efficiency) services,
- Renewable energy generation (wind and solar),
- CO_2 emissions trading (joining company trading in sulfur dioxide and nitrogen oxide), and
- Environmental outsourcing (a/k/a environmental services).

Enron's natural gas activities were core and profitable (and "win, win" economically and environmentally, in their important applications). But the last four areas were problematic from the start and never profitable, even though each received special government favor. In retrospect, almost no amount of government subsidy would have been enough to make these nascent businesses profitable.

But there was always hope. In late 1997, an elated Enron climate lobbyist reported that a climate-change accord had been reached in Kyoto, Japan, among 38 Annex 1 countries (the developed world) to reduce their collective greenhouse gas emissions 5.2 percent by 2008–12, compared to 1990 base levels. The United States, itself committed to a 7 percent decrease (at least in principle), would need new waves of government intervention to reduce its emissions, which meant more subsidies and new mandates for politically correct renewable energies (wind and solar, not hydropower) and energy conservation programs.

Thus, Enron's John Palmisano excitedly reported from Kyoto:

> If implemented [the Kyoto Protocol] will do more to promote Enron's business than will almost any other regulatory initiative outside of restructuring of the [electricity] and natural gas industries in Europe and the United States.... The endorsement of emissions trading was another victory for us.... This agreement will be good for Enron stock!![11]

Palmisano believed it was time to turn deeds into dollars. "Enron now has excellent credentials with many 'green' interests including

Greenpeace, WWF [World Wildlife Fund], NRDC [Natural Resources Defense Council], GermanWatch, The US Climate Action Network, the European Climate Action Network, Ozone Action, WRI [World Resources Institute], and Worldwatch [Institute]," he wrote, adding, "This position should be increasingly cultivated and capitalized on (monetized)."[12]

Enron was popular at Kyoto. Palmisano spoke on panels and received an award from the Climate Institute on behalf of Ken Lay and Enron.[13] And the praise continued. Worldwatch Institute's *State of the World 1998* identified Lay's company as a key player in a coming "energy revolution." The authors explained: "Enron, originally a large Texas-based natural gas company, has made a strong move in the renewables field with its acquisition of Zond, the largest wind power company in the United States, and its [50%] investment in Solarex, the second largest U. S. manufacturer of photovoltaic cells."[14]

While closely associated with both Bush Administrations, Lay was ideologically closer to another political figure on the issue of climate change. In a talk to the American Bar Association in 2000, Lay said, "In *Earth in the Balance*, Senator Al Gore stated: 'Higher taxes on fossil fuels ... is one of the logical first steps in changing our policies in a manner consistent with a more responsible approach to the environment.' I agree."[15]

ENRON'S CSR-DRIVEN BUSINESS PLAN

IN THE FALL OF 2001, Ken Lay's words set the tone for what would be Enron's last Environmental, Health, and Safety Management Conference:

> We believe that incorporating environmental and social considerations into the way we manage risk, govern our projects, and develop products and services will help us maintain our competitive advantage. As we move forward, we will leverage our intellectual capital and innovative capabilities to promote sustainable business practices around the world.[16]

At this meeting, Enron's CSR task force listed its "Accomplishments to Date,"[17] which are reproduced verbatim below:

- Secured board oversight of social/environmental performance
- Expressed support for Universal Declaration of Human Rights

- Completed corporate responsibility task force
- Developed and pilot-tested human rights audit
- Developed security and human rights guidelines
- Established formal partnerships with WBCSD [World Business Council on Sustainable Development], IBLF [International Business Leaders Forum], and CI [Conservation International]
- Identified language to strengthen code of ethics
- Providing project support—Calypso, Transredes, Dabhol and Cuiabá
- Responding to stakeholder concerns on an ongoing basis

The goals for 2002 included:[18]

- Formally adopt Ceres [Coalition for Environmentally Responsible Economics] Principles
- Complete indigenous peoples' policy
- Specify social/environmental expectations in formal relationships with vendors and contractors
- Review results of stakeholder survey and develop strategy to address outcome
- Create awareness of social/environmental trends among [Enron's] origination and investment groups
- Add corporate responsibility performance attribute to PRC [Performance Review Committee] process
- Present task force recommendations to Dr. Lay and senior management

Make no mistake—Enron was *trying* to practice CSR in order to monetize its "green" energy model. This had been Lay's strategy for a decade with natural gas and internationally with Enron Global Affairs' 1999 launch of the Social and Environmental Responsibility Program.

But Enron's CSR initiatives came to a screeching halt in December 2001, along with all of the company's other discretionary activities. The company was out of money and out of time. But the ship went down with its green lights on.

"I have never known much good done by those who affected to trade for the public good," Adam Smith cautioned in *The Wealth of Nations* in 1776. "It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it."[19] Milton Friedman reached the same conclusion in his influential 1970 essay on the social responsibility of business.[20]

On close inspection, Enron was trying to have its cake and eat it too. The company was building oil-fired power plants internationally and erecting (sans press releases) a profitable coal subsidiary.

This created internal tension, but Enron then-president Jeff Skilling assuaged the concerns of one of his defensive coal executives back in 1997 with the words: "Mike, we are a green energy company, but the green stands for money."[21]

Still, with $300 million (and counting) invested in coal properties,[22] and the imminent prospect of becoming the world's leading coal trader, coming on top of a decision to sell the solar division to BP, Enron's head of European government affairs warned in 1999, "Our position as a 'green' company is getting thin."[23]

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It was "not easy being green" in other ways, too. Environmentalists lambasted Enron for building energy projects in pristine areas, even wind turbines in southern California. Wind (when blowing) was mostly backing out natural gas, the cleanest of the fossil fuels, which reduced the bang for the environmental buck and created a financial subtraction for gas-giant Enron.

"GREEN" ENERGY GAMES

ENRON WAS primarily a natural gas company, but Enron stayed silent on the disadvantages of wind (and solar) relative to natural gas in terms of cost and reliability. Wind is a free energy source, but turning wind into electricity is very capital intensive compared to generating electricity with relatively BTU-intensive fossil fuels. Wind power has been propped up by disproportionate tax subsidies, as well as by state-level mandates requiring that utilities buy renewable energy whether or not they want or need it. In particular, the wind-power boom in Texas (#1 in the U.S., #5 in the world[24]) was not about economics. It was about a successful lobbying effort by Enron Wind Corporation and environmental groups in 1997 to include the nation's strictest renewable quota mandate in an electricity restructuring bill. Texas Governor George W. Bush gave Ken Lay a double win on that one.

Solar power was (and still is) several times more expensive even than wind power—and hopelessly uneconomic compared to gas-fired generation as a grid-source of electricity. Yet, in 1994, Enron claimed that its proposed $150 million project could produce solar power "at rates competitive with those of energy generated from oil, gas and coal."[25]

A business-section feature in the *New York Times*, "Solar Power, for Earthly Prices: Enron Plans to Make the Sun Affordable,"[26] reported Enron's pledge to deliver power to the federal government for $0.055 per kilowatt hour, comparable to the average cost of delivered electricity across the nation, from a 100-megawatt solar farm within two years. Enron's solar power rate was unheard of, exceeding even the most optimistic estimates from environmental pressure groups. But the rate was highly contrived, depending on a raft of government subsidies (some already in the law and others requested), as well as questionable assumptions about financing, technology, and delivery schedules—not to mention corporate risk. The rate was also "back-loaded," with compounded annual cost escalations for thirty years.

Still, the quoted rate was taken at face value, as if a new era of solar affordability had suddenly dawned. Two officials from the Clinton Administration's Department of Energy were quoted in the *Times*. "This establishes the benchmark we want and restarts a stalled solar industry," said the head of DOE's photovoltaic section.[27] Deputy Secretary William "Bill" White (later mayor of Houston, and one of Enron's last defenders[28]) stated his intention to try to help make the project economical.[29]

But the smoke-and-mirrors project was too much even for the Clinton Administration. The project languished and quietly died. Nevertheless, it provided a heady PR moment for politically correct Enron.

OVERSELLING ENERGY EFFICIENCY

Turning from the supply side to the demand side, Enron excited environmentalists with Enron Energy Services (EES), known in the trade as an energy service company (ESCO). EES offered energy outsourcing services for large commercial and industrial customers through long-term contracts under which the company and Enron would split the energy-cost savings, at least theoretically. Who could complain about private-sector strategies that saved money and reduced energy usage and emissions at the same time?

EES co-chairman Thomas E. White estimated the customer cost savings at about 20 percent. Ken Lay put the energy-use savings near 10 percent, which inspired some within the company to advocate certifying customers as "Kyoto compliant" (the idea was ultimately rejected).[30]

But these energy savings were only the beginning, according to energy conservationists Amory Lovins and Joseph Romm. They preached in articles, books, and lectures that much more energy savings and much greater greenhouse-gas-emission reductions were profitable so that compliance with the Kyoto Protocol was possible, if not easy.

"ESCOs are DEFINITELY the future," Joe Romm emailed Enron.[31] In his book *Cool Companies* (1999), Romm wrote: "Cool buildings that cut energy use—and hence greenhouse gas emissions—*in half* are increasingly commonplace."[32] He saw massive opportunities for easy savings. "*The entire notion that low-hanging fruit is easily exhausted turns out to be a myth*," Romm wrote (emphasis in the original.)[33]

EES bought two hundred copies of *Cool Companies* to give to existing and potential customers. The respect was mutual. Enron is "a company I greatly respect," Romm emailed.[34]

And then there was Amory Lovins, whose conservationist vision went beyond even that of Romm. "Something like 80% or 90% of the electricity now sold is uncompetitive with electricity-saving technologies," Lovins opined in *Business Week* in 1984.[35] Consequently, he predicted that the demand for electricity in the U.S. would fall (it is 40 percent *higher* today[36]), and new power plants would not be needed (capacity is one-third *higher* today[37]).

Eighteen years later, with EES smoldering in ruins, Lovins estimated that the nation's electricity bill could be cut in half,[38] with energy efficiency leading the way. "That's not a free lunch," Lovins touted. "It's a lunch you're paid to eat."[39]

EES, in fact, was one of Enron's fraud-rife divisions, with the estimated savings in energy and customer costs consisting mainly of speculation and accounting tricks. EES's contracts were liabilities parading as assets. The division was closed as an operating concern upon the parent's bankruptcy filing and had no saleable value to the outside market. The entire ESCO business was in disarray, with market leaders such as PG&E Energy Services and DukeSolutions calling it quits. Saving energy profitably, above and beyond what private companies had been doing prior to outsourcing, was skinny on profits relative to risk, it turned out.

The Romm/Lovins idea of free lunches was highly exaggerated. Free or low-cost compliance with the Kyoto Protocol was little more than a postmodernist dream on both the demand side and the supply side—at least as far as consumer-derived profit and loss was concerned.

Enron's PR pitch from beginning to end was that renewables and step-change efficiency gains were tomorrow's energy. "We've bet on the future, while others have bet on the past," John Palmisano proclaimed in December 1997 from Kyoto, Japan.[40]

But W. S. Jevons in 1865 offered better insight about past and future of energy in his landmark book, *The Coal Question*. He explained how increasing energy efficiency—then in stark evidence—was accompanied by *increasing* overall energy usage and, in fact, was a cause of it. Jevons also explained why renewable energies were unsuitable for the industrial age.[41] He said that burning wood, falling water, and wind did not have the economy and/or reliability to power the machine age, a statement that still holds true today.

The concentrated energy embedded in coal, oil, and natural gas—the sun's work over the ages—was a quantum leap over the dilute, irregular energy flow from the sun. Furthermore, solid fuels are easily stored and transported compared to the politically correct renewables of wind and solar. These intrinsic advantages for carbon-based energies remain in full force today.

WAS ENRON RIGHT ABOUT CLIMATE CHANGE?

Now there is a *new* consensus. Potentially catastrophic climate change, it is said, necessitates a government-led transformation of the U.S. and world energy market to "clean" fuels and step-change energy efficiency. The assertion is that debate is over, and neo-Malthusianism—finally—has grounding in reality. Ken Lay was just ahead of his time. Or so it may appear.

But this is an old song, new verse. The "population bomb" scare of the 1960s has been falsified, as has the running-out-of-resources consensus of the 1970s. In retrospect, a bandwagon effect occurred that was long on emotion and short on proof. And what is now a 40-year alarm continues. The physical science behind climate change is not settled in favor of alarmism—much less is it settled that governments worldwide must mandate a new energy future. Climate models predicting distant pessimistic climate scenarios are problematic. What the Intergovernmental Panel on Climate Change (IPCC) admitted on page 805 of *Climate Change 2007: The Physical Science Basis* should have been stated right up front in the Summary for Policymakers, namely, "The set of available models may share fundamental inadequacies, the effects of which cannot be quantified."[42]

Attempts to stifle open, vigorous debate about climate-change science, economics, and policy by climate catastrophists mirror the arrogance, form-over-substance, and obstinacy problem

In fact, real-world warming has lagged behind that predicted by models, suggesting that climate sensitivity to greenhouse gas forcing is less than thought. Skeptics of climate alarmism and policy activism also argue that the human influence on climate has positive economic and environment effects. Moreover, they warn that policy action against consumer-driven business-as-usual energy markets has significant costs that must be compared to, and discounted against, the alleged future benefits. The IPCC has recently admitted as much, stating:

> Limited and early analytical results from integrated analyses of the cost and benefits of mitigation indicate that these are broadly comparable in magnitude, but do not as yet permit an unambiguous determination of an emissions pathway or stabilization level where benefits exceed costs.[43]

In sum, climate alarmism is very much a debate in its physical, economic, and policy dimensions. The scientific method does not work by emotion, agendas, awards, applause, or even consensus. The fact that virtually everyone *thought* Enron was a great company in the 1990s did not make it one. The fact that doomsayers *thought* that the world was running short of resources in the 1970s did not mean it was true. And just because groups today declare that the climate is in crisis and major government action is necessary does not make that viewpoint true, either. No amount of posturing in the debate will change either the underlying physical reality of climate science or the technological choices dictating economic tradeoffs with energy alternatives and the environment.

Attempts to stifle open, vigorous debate about climate-change science, economics, and policy by climate catastrophists mirror the arrogance, form-over-substance, and obstinacy problem that plagued Enron. Enron's smartest-guys-in-the-room problem is today's fatal-conceit problem (a term F. A. Hayek used against central planning). As the middle ground of the climate debate slowly emerges, more troubling analogies to the Enron mentality may well come to light.

CONCLUSION

ENRON FOOLED many constituencies in its solvent life—and has continued to fool many in its aftermath. Only a few saw the company for what it was. One such analyst was Jerry Taylor of the Cato Institute, who wrote in the *Wall Street Journal* shortly after Enron's demise:

> On balance, Enron was an enemy, not an ally, of free markets. . . . Enron would probably still be a small-time pipeline company were it not for the statist conceit that consumers are better off under the regulatory boot of government than with the invisible hand of the marketplace.[44]

Enron lived, thrived, and perished in and through the mixed economy. Enron's artificial boom and decisive bust had more to do with government regulation and taxpayer subsidization than free markets. Ken Lay's meteoric rise and stunning fall was not the saga of a capitalist wildcatter; they were the tragedy of a political rent-seeker in action, prominently including government intervention sought in the pretext of addressing climate change and promoting "green" energy.

In the name of corporate social responsibility and the public good, Enron sought and received a variety of government-provided advantages. But Ken Lay's company is now seen as the paragon of the public bad. Such unintended consequences offer a vivid case study of the perils of government intervention and the tensions within corporate social responsibility theory. The challenge now is to draw the right lessons from Enron's rise and fall to apply to both energy and climate-change policies.

NOTES

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3. Paul Krugman, "The Great Divide," *New York Times*, 29 January 2002, A21.
4. Robert Kuttner, "Enron: A Powerful Blow to Market Fundamentalists," *BusinessWeek*, 4 February 2002, 20.
5. See Adam Thierer and Wayne Crews, *What's Yours Is Mine: Open Access and the Rise of Infrastructure Socialism* (Washington, D.C.: Cato Institute, 2003).
6. Lay was also a director of Resources for the Future and the American Enterprise Institute, where he pushed the need to price CO_2. Lay was not involved with any libertarian groups, although he occasionally spoke at their conferences when Enron's agenda involved, to some degree, free markets.
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11. John Palmisano, "Implications of the Climate Change Agreement in Kyoto& What Transpired" (Enron memo), December 12, 1997, 1, 3. This memo is reproduced at http://www.politicalcapitalism.org/enron/121297.pdf.
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26. Myerson, D1–D2.
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