

BUSE 201: BUSINESS ORGANIZATION AND MANAGEMENT

Enron and the California Energy Crisis

Case Study Essay

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Ethics Case Study: Enron and the California Energy Crisis

Enron Corporation, founded as a result of the merger of InterNorth and Houston Natural Gas in 1985, was a U.S. based energy and services company based in Houston, TX. The company's main operations were in energy production and transmission lines, but the company also had separate business units in telecommunication, transportation, and various other commodities and services. With the exception of a few months in 2001, Kenneth Lay was Chairman and CEO from 1985 until his resignation from the company in 2002 during the beginnings of what would be termed as the "Enron Scandal." The company filed for Chapter 11 Bankruptcy in December of 2001, and ceased operations in 2004.

During the mid-1990s, Enron became a revolutionary energy company in that fact that they introduced trading energy like commodities on a market. Enron also owned numerous transmission lines in which they could also record a profit on by leasing lines to public utility companies and private groups as well. Because Enron had already been using Mark to Market Accounting, former executive (and CEO for a few months), Jeffrey Skilling began to use a model he called Hypothetical Future Value Accounting, an extreme form of Mark to Market that was estimating and recording future profits that the company had not yet, and in the end, would never realize. To the public, its shareholders and investors, Enron appeared to be a financial success, while in reality, a massive financial breakdown was brewing. The start of the fraudulent account practices occurred in the early 90s with Enron Oil group, actions which Lay encouraged.

While the mess that became the highly publicized Enron Scandal had many integrated parts, the majority having to do with cooking the books, one of those parts was felt by California residents shortly after energy was de-regulated in the state. Traders in the western division of

Enron began finding ways to increase the cost of the power being sold to state agencies. Perhaps the most unethical practice concerning the California energy crisis was when Traders would call the power plants and inform the plant manager or foreman that the demand for power was low (when it in fact was not) and that the plant could go offline for a few hours to do maintenance. The lack of power on the grid stressed the system, and rolling blackouts occurred in California's largest cities. This then created a market demand for electricity, and Enron's traders began rake in millions of dollars in fraudulently inflated electricity costs. These actions would later come under federal investigation.

Inflating the electricity prices in California made Enron's Energy Services division a lot of cash, but at the expense of California residents and public institutions. Those in the lower middle class and those under the poverty levels were not able to afford their electricity bills, not to mention millions in tax dollars the state was spending on electricity for public facilities. Fraudulently inflating the rates by overbooking the transmission lines and shutting down power plants during peak consumption does not meet the principle of long-term self-interest. The decision caused consumers to be upset, and ultimately the energy crisis was covered in the media, and Enron's credibility with end users began to fade.

While Enron did act within the newly established California regulations (or lack thereof), the company also did not meet the principle of utilitarian benefits because the decision made by the traders in the western division did not result in a greater good for society. The rolling blackouts that occurred caused medical emergencies during the summer due the excessive heat, and caused numerous traffic problems and slowed response times of first responders. In essence, the traders' decision caused harm to society. And because the poor were taken advantage of

during the rise in electricity rates, Enron, albeit inadvertently, marginalized lower income households, thereby not meeting the principle of distributive justice.

Stakeholders in Enron's part in the California energy crisis included municipal and state government agencies, household consumers, the company employees, shareholders and investors, which would be the firm's primary stakeholders. Enron's traders led a price-gouging mission on California's public utilities, earning hefty bonuses for themselves and substantial profits for the firm's energy division, but at the expense of the public's safety in some instances, and the public's wallet in all instances of the problem. The greater public was held hostage by a greedy group of traders. The actions of the traders also set the energy division up to fail when the firm would eventually come under investigation, and be the brunt of multiple lawsuits, contributing the firm's eventual bankruptcy filing in December 2001.

Secondary stakeholders, in this case the media and those who analyzed Enron's stock, were also harmed. Before the California energy crisis, and before the firm's bankruptcy filing, Enron was a bit of a media darling, with numerous sources lauding the firm for their innovation and diversification strategy (all of which were big failures, but covered up by creative accounting). Activist groups also began targeting Enron's corporate governance.

Reactions from the top two executives, Kenneth Lay and Jeffrey Skilling, were those of arrogance, denial, and outright lies. Skilling said they were not to blame for the California energy crisis, and they were the "good guys" and "on the side of angels." Kenneth Lay also told employees and shareholders they were "making money not because of California, but in spite of California" as the firm began to spin the energy price and availability problem back into the lap of the state. This is an example of reactive strategy of social responsiveness. During U.S. Senate

investigations, Skilling claimed to not know anything about the conduct of the traders, comments which fell on deaf ears at legal proceeding.

During the legal proceedings of Enron's involvement in the California energy crisis, documents and tapes were uncovered that proved the firm's intentional practices to work the market in such a way to earn profits at the expense of the state and end users. Also during this time, the unethical accounting practices of CFO Andrew Fastow were also the subject of media and federal scrutiny. While Fastow was made the fall-guy for the elaborate schemes, the driving force behind the practices was Enron's top two executives, Lay and Skilling. In the months leading up to the bankruptcy, top executives cached in shares for millions of dollars. Employees, whose retirement accounts were tied in with Enron stock, ended up losing the majority of their retirement savings. Employees were given 30 minutes to clear out their offices at Enron's Houston headquarters on the day the bankruptcy was announced. Both Lay and Skilling were indicted and convicted for fraud charges. Skilling would be the only to serve time. Lay died of a heart-attack before his scheduling sentencing. The assets of Enron were sold, and the company spun-off or sold remaining divisions, and operations officially ceased in 2004.

References

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