

# HOW A CORPORATE CEO VIEWS THE ENVIRONMENT AND THE ECONOMY

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## **Introduction**

Cinergy Corp.<sup>1</sup> has a long-standing commitment to balancing the needs of *all* of its stakeholders, including its environmental constituents. With the 1994 merger of The Cincinnati Gas & Electric Company and PSI Energy in Indiana to form Cinergy, we decided to hold ourselves to high performance standards built around satisfying multiple stakeholders. As a result, our board and management team base their decisions on this multiple-stakeholder approach. This isn't easy, nor is it conventional. In my letter to stakeholders in Cinergy's 1996 annual report, I wrote: "We are willing to make the tough choices, but we are unwilling to accept false tradeoffs... between serving the interests of shareholders and honoring our commitments to our employees, investors, customers, communities and the environment.... Every decision I make as CEO will continue to be based on creating value for all of our stakeholders."

Let me expand on this statement in the context of the three questions posed by the organizers of this Forum.

**1. Can business leaders be expected to achieve serious environmental objectives that may reduce near-term earnings, in the absence of mandatory environmental requirements? Have they adequately explored the ways in which environmental improvements can be profitable?**

In many industries, environmental performance and corporate profits are aligned since any emissions or releases into the environment represent unwanted waste and production inefficiencies, additional costs for permits and compliance assurance, and increased environmental risk. In most situations, reduced emissions or releases translate into more product to sell for less cost. This is a win for both the shareholders and the environment. And it is the way that a great many corporations are showing that investments in environmental improvements can be just as profitable as the firm's other investments.

The issue is far harder where, as the question poses, environmental objectives may reduce near-term earnings. This would seem to be the challenge facing power generators who rely on the combustion of coal to produce power. In my industry, emissions controls cost more than the generating stations themselves and these "bolt on" controls siphon off a significant portion of the power output of the plant. For instance, the wet "scrubber" used to eliminate SO<sub>2</sub> emissions from coal-fired power plants can cost as much as \$200 million per generation unit while taking as much as 2 percent of the unit's output for operation of the device. Obviously, any program to retrofit controls on the portion of the coal fleet that is not fully controlled requires huge capital outlays and negatively impacts the amount of electricity available to be sold.

In addition, the confusing and conflicting environmental regulatory scheme the industry faces makes it difficult to anticipate with the necessary certainty what controls to install at which units. This is why Cinergy has championed the creation of workable, comprehensive multi-emissions legislation that will create simple targets and timetables for power plant emissions reductions.

Finally, there are significant competitive risks associated with acting as a volunteer and ahead of an industry-wide mandate. Again the high capital costs, increased variable costs and, in some cases, loss of operational flexibility associated with major pollution control projects at coal-fired units may negatively impact the units' dispatch and profitability.

So in this industry, the considerable progress we have made has been driven by government programs such as the Clean Air Act. For instance, since 1980, the electric power industry has reduced its air emissions significantly while electricity generation from coal has increased 64 percent. The industry dramatically reduced its rate of emissions of sulfur dioxide (SO<sub>2</sub>) by 50 percent and nitrogen oxide (NOx) by 45 percent. We have also reduced particulate matter (PM10) by over 90 percent. Moreover, because some particulate matter, SO<sub>2</sub> and NOx controls have some mercury reduction co-benefits, our industry has also reduced mercury emissions significantly by almost 40 percent – from 75 tons per year to approximately 48 tons per year. Our industry has accomplished all of this despite a steady climb in electricity demand, a growing economy and without sacrificing the reliability and affordability of the electricity that we produce.

Cinergy itself has invested considerable sums in clean air compliance. Since the early 1990s, we've spent more than \$700 million, primarily to meet the SO<sub>2</sub> and NOx requirements of Title IV of the Clean Air Act. And we just spent another \$200 million to repower an older coal plant in Indiana to natural gas. That's a total of \$900 million. Between 2000 and 2005, we will spend a total of \$800 million on additional pollution control equipment aimed at to meet additional NOx emissions to meet EPA's ozone transport rule.

Going forward, I fully expect that the next round of reductions from coal-fired power plants will be driven by federal legislation that sets environmentally-responsible targets for further progress but provides industry with sufficient time to undertake the retrofits necessary and sufficient flexibility to allow us to craft the lowest cost compliance strategy possible.

The right multi-emission bill will benefit electricity producers, consumers and the environment, by:

- Locking in major emission reductions targets
- Locking in a fixed timeline for those reductions so that planning and implementation of emissions control strategies can begin today
- Coordinating reductions so that utilities are able to use multi-pollutant control technology
- Providing the electric industry with the time necessary to attract capital for the multi-billions of investments that will be needed to meet the new requirements

- Maintaining coal as a generation fuel thereby preserving natural gas reserves for consumers, farmers and businesses
- Providing flexibility through market-based programs such as emissions trading and early reduction credits
- Lowering the bill for consumers

We believe these provisions are found in the “Clear Skies Act,” S. 485, now pending in Congress. This bill would require the most ambitious emissions reductions ever from power plants, ensuring air quality results that are cleaner, sooner, and cheaper. The emissions reductions would be rock solid, due to continuous emissions monitoring and large penalties for non-compliance. The targets and timetables in S. 485 are ambitious and, for many small companies and public power systems, extremely painful. This is especially true for the first phase of this legislation.

To meet the targets of S. 485, we estimate our capital expenditures *for just pollution control equipment* would top \$1.5 billion. And, unfortunately for Cinergy and most other utilities, these costs are not back-loaded. We estimate that more than two-thirds of these expenditures will be necessary by 2010 to meet the first phase of the Clear Skies targets.

This is not to say that Cinergy cannot and will not act without government environmental mandates. For instance, Cinergy recently announced a voluntary commitment to reduce its greenhouse gas (GHG) emissions to a level equivalent to 5 percent below 2000 levels by 2010. This commitment will be supervised by the national environmental group, Environmental Defense, and includes a commitment to provide a full disclosure of GHG emissions during each year leading up to the target. Cinergy has also pledged to spend \$21 million on programs between now and 2010 that will help the company achieve this target.

Cinergy took on this program for several reasons. First, the program responds to concerns from environmental stakeholders while reducing the business risk we face from this issue. Second, we believe there are economic advantages to being an early mover in this area and to increasing the company’s internal capabilities to manage our GHG emissions. Finally, the target we selected allows us to continue to use coal as our primary fuel for our plants, thus preserving U.S. fuel diversity and Cinergy’s ability to deliver affordable, reliable power to its customers.

**2. Many businesses work towards a “triple-bottom-line” of economic, environmental and social improvements. In real business situations, do non-economic goals have equal standing with traditional financial goals?**

Absolutely. This is the cornerstone of a multiple-stakeholder approach that I mentioned at the outset. This is also what the current focus on building, running and managing sustainable businesses is all about. Due to our multiple-stakeholder approach, Cinergy was practicing sustainability well before the word was in vogue. We did this not only out of an ethic that this was the right thing to do, but also out of a conviction that there really is a gain for shareholders when a corporation is viewed by its employees as a good place to work; and when it is viewed by its customers as a good neighbor in the community, and viewed by its regulators as a responsible steward of the environment.

As CEO, my devotion to the financial performance of the company must be unwavering. And I am proud of the financial performance of Cinergy during my tenure. But I am equally proud of the non-economic achievements we have had as well.

### **Social**

Creating jobs and a vibrant economy are cornerstones of successful communities and an important part of a corporation’s social agenda. This is but one of the major reasons Cinergy uses its leading economic development program and our district managers to work closely with our partners in state and local governments to attract new business and industry to our region. Our low rates, reliability and reputation as a company that can get things done have helped Ohio, Kentucky and Indiana successfully market themselves to a number of new promising enterprises.

In addition Cinergy Foundation has contributed \$43 million over the past 12 years (Cinergy, PSI and CG&E) in the communities we serve with an emphasis on education, health, environment and the arts. And, Cinergy was recently recognized by the U.S. Department of Labor for its employee diversity efforts. Also, the company is one of only two Ohio companies, and one of only two utility companies in the U.S., named to Working Mother magazine’s list of the 100-best companies for working mothers for seven consecutive years. Until 2002 and for five years running, Cinergy was the only utility company on the list. We took these steps because they were simply the right thing to do, especially for a business with a multiple stakeholder focus.

We've also been a leader in corporate governance and before it became a major focus with the corporate scandals of the last two years. In 1996, the Cinergy board was one of the first to have a corporate governance committee (then called a nominating committee) and more recently, we were the fourth company in the nation and the first utility company to announce in 2002 that we would expense stock options beginning with the 2003 cycle. We currently rank 8th and we are the only utility in the top 10 companies ranked for excellence in corporate governance by International Shareholder Services. Again, our focus on balancing and weighing the needs of all of our stakeholders was and continues to be the driver of this focus.

### **Environment**

Beyond our voluntary greenhouse gas commitment and environmental investments I discussed in response to Question 1, Cinergy has several other environmental accomplishments:

**Environmental Leadership Pledge:** With a multiple stakeholder focus, we are committed to protecting the environment at all times and being good neighbors in the communities in which our power plants operate. As such we are committed to finding ways to generate electricity in environmentally benign ways.

Before our merger, PSI was the only electric utility to support the amendments to the Clean Air Act. One of the first acts of the new Cinergy Board of Directors back in 1994 was to approve a formal Environmental Leadership Pledge. The pledge has served as the guiding force in making our plants more efficient and our product – electricity generation – less degrading to the environment.

In 2003, our board of directors updated and amended our 1994 pledge to reflect their focus on the principles of running a sustainable business.

## **Cinergy Corp. Environmental Leadership Pledge**

Cinergy and its subsidiaries will be industry leaders in protecting our environment. We will meet or exceed all applicable regulatory requirements. We will conduct our business with respect for the environment, while providing our customers with low cost, reliable and efficient energy services.

### *Corporate Citizenship*

Cinergy accepts the responsibility of reducing the impact of its operations on the air, water and land. Its management will be responsible for complying with all environmental regulations and will include potential environmental impacts in its planning processes. The company will ensure its employees are comprehensively trained in job procedures that protect the environment. The company will encourage employees to understand the environmental significance of their jobs and will reward them for superior environmental performance and innovation.

### *Employee Responsibility*

Our employees will work with respect for and be good stewards of the environment.

### *Open Reporting and Auditing*

We will measure the progress of the company and our employees in meeting this Pledge. We will present an annual environmental performance review to the Cinergy Corp. Board of Directors. We will conduct periodic environmental audits on our facilities and make available to the public an annual report that details our progress toward meeting this Pledge and associated targets.

### *Natural Resources Stewardship*

We will be a responsible steward of the earth's resources and will identify opportunities within and outside the company that will allow us to enhance the natural environment.

### *Pollution Prevention*

We will identify and implement opportunities to reduce our waste streams, beneficially reuse coal ash and other residual products, recycle and improve operating efficiency. We will challenge ourselves to seek new ways to reduce the environmental footprint of our operations and we will help our customers do the same.

*Emergency Preparedness and Response*

We will continually develop and evaluate procedures designed to reduce the risk of releases to the environment. We will routinely update our emergency preparedness and response plans. If an accidental release of a harmful material does occur, we will immediately notify the appropriate authorities and the public and deploy trained and equipped personnel to clean up the site.

*Research and Development*

We will support the research and development of methods and practices to enhance the quality of the environment and conserve natural resources. We will evaluate new technologies to reduce emissions, minimize waste and increase energy efficiency.

*Environmental Advocacy*

- We will be a leader in advocating a progressive environmental public policy.
- We will communicate this Pledge to all our stakeholders and will provide our employees the education, training and resources to implement it effectively.

Dow Jones Sustainability Index: Putting it all together, we believe that this is why this past September, Cinergy was added to the Dow Jones Sustainability Index (DJSI), an international benchmark of corporate commitment to social, economic and environmental responsibility. Cinergy ranks as the #1 sustainable utility in the United States and the #3 utility in the world. And in the context of question #2 above, our challenge and our objective is to continuously improve to remain on the DJSI.

We have never wavered from our stewardship to all of our stakeholders. We believe it is the right thing to do to ensure our continued success and to ensure the best results for our shareholders.

### **3. Is the failure to include certain “external” environmental costs a significant market-pricing failure? And, if so, can it be fixed?**

There used to be considerable concern that United States industrial production created significant environmental damage without consequence. Because that damage was “free,” the enterprise did not need to include any costs associated with avoidance of the harm or remediation when it priced its goods. These costs were external to the functioning of the market and thus represented a market failure.

For the most part, those days are long gone.

Coal-fired power plants, for instance, now face a “telephone book” full of regulations applicable to their operations, from the unloading of the coal to combustion to disposal of the waste. For air pollution, plants must comply with stringent NO<sub>x</sub>, SO<sub>2</sub> and particulates requirements, all of which increase the cost structure of the plant and are therefore reflected in a plant’s dispatch price. As the Clean Air Act continues to be implemented and additional reductions are needed, those costs will be added in as well.

Indeed, cap and trade emissions reductions programs directly turn requirements into perfect market signals by forcing any unit that produces products to secure an allowance equivalent to the emissions it creates. Assuming caps are set at the level currently necessary to protect the environment, the cost of the allowances issued to implement the cap will be treated as a variable cost that the unit must cover if it is to operate. The more emissions a unit has, the more allowances it needs to operate. The unit’s price will directly reflect the cost of its environmental compliance.

Perhaps the only place where significant environmental externalities are not accounted for is in the climate area. However, I would suggest that the problem is not one of economic design but rather political will and technical clarity. Put simply: We know how to make a cap and trade program for CO<sub>2</sub> work, if that is indeed necessary. However, there is no consensus in the United States on whether we need to take that step now, and if so, what level of reductions should be adopted over what time frame. Unless and until we in this country reach some shared vision of the problem and the necessary path forward, we will not be able

to agree on the significance of “climate externalities” or the proper policy response.

Again, Cinergy dealt with this ongoing uncertainty by constructing a voluntary GHG program that builds in a modest carbon signal into our internal economics. This will help ensure that we don’t ignore this “externality.” More importantly, it will force our business down a path where we will be rewarded for behavior that reduces GHG impacts no matter how these reductions are achieved. We expect this program to help Cinergy become a player on energy efficiency, distributed generation, renewables and other carbon-advantaged investments. This points the company’s compass firmly towards a future built on clean energy technologies, the ultimate solution to the carbon issue.

## Endnotes

1. Cincinnati, Ohio-based **Cinergy Corp.** (NYSE:CIN) has a balanced, integrated portfolio consisting of two core businesses: regulated operations and commercial businesses. Its regulated delivery operations in Ohio, Indiana, and Kentucky serve 1.5 million electric customers and about 500,000 gas customers. In addition, its Indiana regulated operations own 7,000 megawatts of generation. Cinergy’s commercial business unit owns 6,300 megawatts of capacity with a profitable balance of stable existing customer portfolios, new customer origination, marketing and trading, and industrial-site cogeneration. The “into Cinergy” power-trading hub is the most liquid trading hub in the nation.