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The Second Battle of the Alamo: The Midnight Connection

Richard D. Cudahy

The tale that follows is frequently called "The Texas Range War" or "The War of the Midnight Connection." But because of its place in the annals of Lone Star patriotism, I prefer to think of it as "The Second Battle of the Alamo." At this second battle, the Texas electric power industry sought to remain clear of federal regulation.

The Second Battle of the Alamo received the concentrated attention of more administrative agencies, courts, legislative committees, attorneys general and other organs of government than any other electric power dispute of which I am aware. It was a somewhat embarrassing bonanza for lawyers. The platoons of brief-cased, horn-rimmed attorneys far outnumbered those of the lean and mean engineering brigade.

Yet at the same time, the conflict involved what would prove to be a watershed for the electric power industry. Specifically, this clash demanded that the industry examine the issue of electrical interconnection between Texas and the rest of the United States, and the transmission of power between the two. The dispute is fascinating not only for what it may teach about the law of electricity but also for what it may suggest about passionate attachments to old (or new) ways of doing business.

The Seeds of a Conflict

The story begins with my then-client, the Central and Southwest Corporation (CSW), which is a registered public utility holding company under the Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79 *et seq.* (PUHCA). CSW owns all the common stock of four vertically integrated operating utilities: Central Power and Light Company (Central Power), headquartered in Corpus Christi in South Texas; West Texas Utilities Company (West Texas), headquartered in Abilene in West Texas; Public Service Company of Oklahoma (Oklahoma Public Service), headquartered in Tulsa, Oklahoma; and Southwestern Electric Power Company (Southwestern), serving Arkansas, Texas and Louisiana and headquartered in Shreveport, Louisiana. The service areas of these companies are indicated on the map on page 58. They generally border the State of Texas on its eastern and northern flank and penetrate it through West Texas down to the Rio Grande River. To-

gether these service areas have the appearance of a giant crescent-shaped gerrymander.

PUHCA was enacted in 1935 to administer what was popularly called the "death sentence" to the public utility holding companies that controlled most of the electric power generation and distribution in the United States during the 1920s. These holding companies generally consisted of a pyramid of heavily leveraged entities ultimately supported by operating public utilities. At each level of the pyramid, the entity involved carried a substantial amount of debt. This powerful leverage, combined with the perceived soundness of the public utility base, made these holding companies peculiarly attractive investments. Consequently, they became very popular and widely held securities during the 1920s; the earning power of the underlying operating utilities, which continued to grow rapidly and predictably in the 1920s, promised a great return. Then came the Depression. The operating income of the underlying utilities faltered and ultimately declined. The leverage that seemed so helpful during profitable years strangled the holding companies as their earning power ebbed.

The result was financial disaster for thousands of stockholders throughout the United States, most of whom thought they had made a conservative investment. The tycoons who conceived and presided over the holding companies became rascals in the eyes of the public. One of these financial giants was Samuel Insull, the one-time secretary for Thomas Edison. Although Insull admittedly had been a highly competent manager of operating utility properties, the collapse of the financial empire he created made him a "wanted" man. He eventually fled to Greece, but that gets us a bit far afield from the present story. Insull's relevance here lies in the creation of CSW. He was the mastermind behind the marriage of the four independent utilities that made up CSW. Although each of these component companies was sound, the question was whether CSW, comprising these four entities, could survive PUHCA's death sentence.

The problem lay in the structure of CSW. In short, it was not electrically integrated. That is, all of the four companies CSW owned could not exchange and share electricity in a purposeful fashion. Two of its companies, Oklahoma Public Service and Southwestern, were interconnected primarily outside of the State of Texas (in the neighboring states of Oklahoma, Arkansas and Louisiana). But its other two companies, Central Power of Corpus Christi and West Texas of Abilene, were in-

Judge Cudahy is a member of the United States Court of Appeals for the Seventh Circuit.

terconnected solely within the state of Texas—with other Texas utility companies. This arrangement left CSW holding two separate systems, cut off from each other and incapable of integration. Although such a setup had been unobjectionable before the Depression, PUHCA—designed to wipe out the holding companies—demanded their integration into a single system as the price of their continuing existence. The death sentence contained in PUHCA could be stayed only if the holding company could justify itself on efficiency grounds as capable of integrated operation.

This legislation generally required the Securities and Exchange Commission (SEC) to break up public utility holding companies into their constituent properties unless they could function as an integrated and more efficient whole. The implications for CSW were clear: It was destined for the scrap heap unless it could attain electrical integration, which required joining each of its four constituent utilities, not only in ultimate ownership (as already had been accomplished) but also in the purposeful exchange of electricity.

Such a task might appear easy enough given common ownership: Could not each of the four companies simply exchange electricity in the interest of efficiency and reliability? A formidable barrier stood in the way of accomplishing this goal: the electric “Alamo.” Faced with the threat of federal regulation in the wake of the 1935 passage of the Federal Power Act, the principal utilities in Texas (including, perhaps, Central Power and West Texas) elected to isolate their properties from interstate commerce. By eschewing transmission across state lines, the Texas utilities retained freedom; this policy of isolation avoided regulation by the newly created Federal Power Commission, whose jurisdiction was limited to utilities operating in interstate commerce.

Freedom from federal regulation was a cherished goal—more so because Texas had no state regulation before the 1970s. So eager were the Texas utilities to maintain traditional Texas independence that they memorialized the policy of isolation into a written agreement, binding themselves to intrastate operation. Eventually, in 1970, the utilities operating exclusively within Texas set up an intrastate power pool, the Electric Reliability Council of Texas (ERCOT). Central Power and West Texas were part of ERCOT. Its other members consisted primarily of Houston Lighting and Power Company (Houston Lighting) and Texas Utilities, together with Brazos Electric Power Cooperative, the Texas Municipal Power Agency, the cities of San Antonio and Austin, and the Lower Colorado River Authority. Texas Utilities was itself a large holding company consisting of Texas Power & Light, Dallas Power & Light and Texas Electric Service Company. Each of these utilities was a company operating solely within Texas; and even though all were interconnected (forming ERCOT), none was connected with any utility operating in whole or part outside Texas.

This bastion of impregnable isolation proved to be the horn of CSW’s dilemma. As becomes apparent, it meant that Oklahoma Public Service (operating exclu-

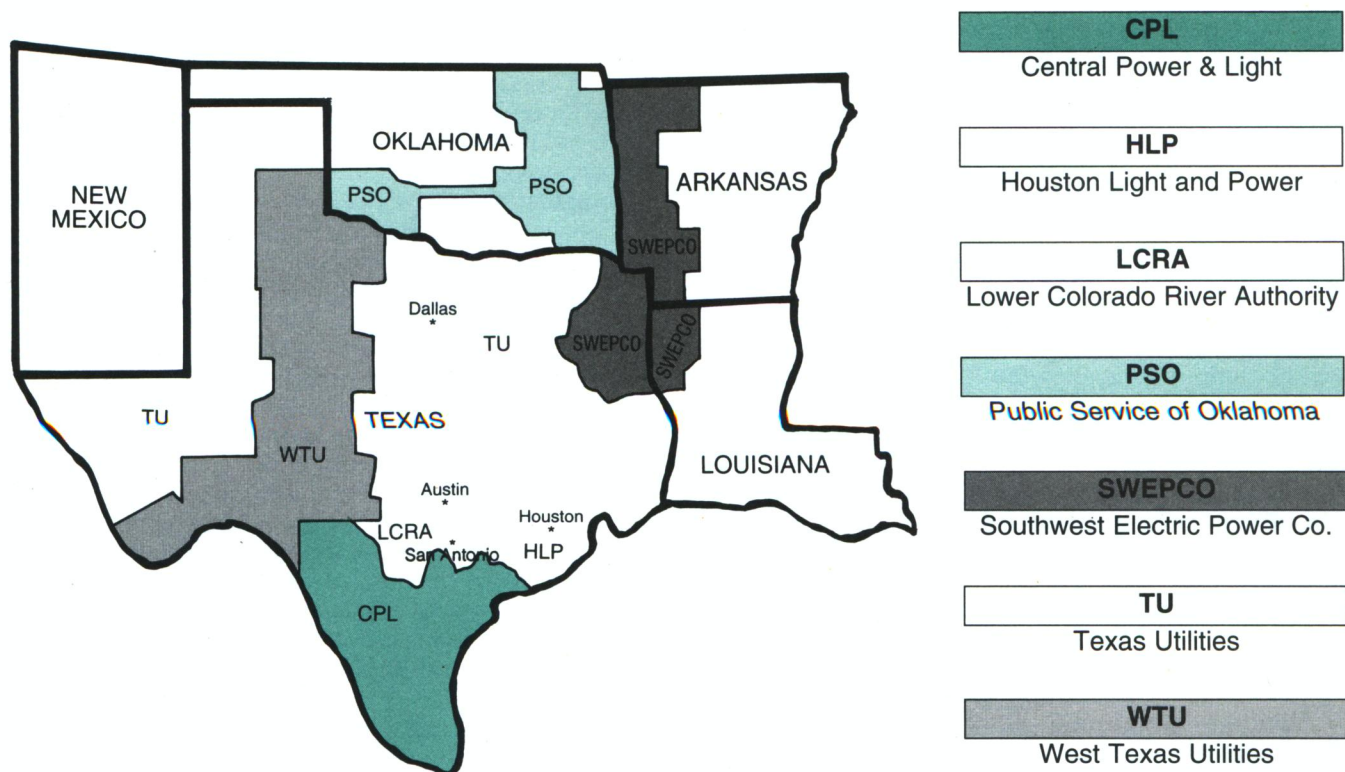
sively in Oklahoma) and Southwestern (operating in Texas, Louisiana and Arkansas) had no connections with Texas’s intrastate utilities—including, much to CSW’s eventual chagrin, West Texas and Central Power. Lest one underestimate the strength of this Texas stronghold, one need only remember the monitoring that periodically occurred at some of the West Texas switches. One Texas Utilities subsidiary installed on its neighbor’s premises various devices (such as a system of power flow relays) to protect against the unauthorized transmission of power over state lines. For the most part, this policy of isolation had never been breached. The only exception, to my knowledge, was necessitated by the exigencies of World War II. The Federal Power Act contains certain emergency provisions authorizing electrical interconnections such as those needed between Texas and the adjoining states. See 16 U.S.C. § 824a(c). But the Act also provides that any such interconnection will not subject an otherwise intrastate utility (like the Texas utilities) to federal jurisdiction. See 16 U.S.C. § 824a(d). The electric interconnections used during the years of the war therefore failed to alter the intrastate nature of most of Texas’s electric power.

Nevertheless, CSW apparently benefited from the fortuity of interconnection necessitated by war. Toward the end of World War II, CSW’s status as a holding company came up for examination before the SEC. CSW was eligible for PUHCA’s death sentence unless it could show the required level of electric integration. Because the investigation was completed in 1945, the Texas intrastate companies were connected across state lines pursuant to the wartime exemption. The SEC consequently found that CSW demonstrated the required degree of electric integration.

Escalating Tensions and Firing the First Shot

This happy state of affairs continued until 1974. Then, Oklahoma attorney Jay Galt filed a motion with the SEC on behalf of a group of municipal and cooperative electric distribution systems served by Oklahoma Public Service. Among other things, the motion asserted that CSW was not in compliance with the integration requirement of the 1935 Act. It suggested, in particular, that two of CSW’s companies (Oklahoma Public Service and Southwestern) were operating synchronously with the Southwest Power Pool (part of the interconnected system covering all of the eastern United States except ERCOT), while the other two companies (West Texas and Central Power) were cut off from Oklahoma Public Service and Southwestern, and operated synchronously with ERCOT. In addition, there were a number of allegations challenging other aspects of CSW’s integration.

CSW responded to the complaint by asserting that it was, in fact, an integrated system. At the same time, however, it commissioned a consulting firm to conduct a study to determine whether the interconnection and integrated operation of its intrastate and interstate portions was advisable (the economic feasibility of integrating all



four companies, of course, turning on their interconnection). CSW invited Texas Utilities and Houston Lighting to participate in the study, but they declined.

The consultants' report indicated that CSW could benefit from considerable operating savings by interconnecting its companies and integrating operations—either as a single CSW unit or by integrating the entire ERCOT (Texas) pool with the Southwest Power Pool. On this basis, CSW attempted to persuade Texas Utilities and Houston Lighting to come aboard the interconnection band wagon. These large and dominant Texas utilities naturally declined. The basis for their distaste for interconnection may be debated. The Texas utilities certainly asserted confidence in the reliability of their own isolated system, but the jurisdictional objection and abhorrence of federal authority, coupled with a sheer distaste at being “manipulated” to accommodate CSW, certainly played a leading role in their refusal. In the meantime, the SEC had undertaken an investigation of the state of integration of CSW's system. Because Texas Utilities and Houston Lighting were opposed to the proposed interconnections between ERCOT and the Southwest Power Pool, they moved to intervene in the proceedings involving CSW. You can sense, at this point, trouble brewing along the Red River. The only question became who would fire the first shot.

Convinced that only bold tactics could break the stalemate, CSW made the first move. On May 3, 1976, West Texas and Central Power filed suit in the United States District Court for the Northern District of Texas against Houston Lighting and a subsidiary of Texas Utilities. They complained, in particular, that these two utilities had conspired to restrict the transmission of

electric energy in interstate commerce in violation of section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1. West Texas and Central Power asked that the other Texas utilities be enjoined from enforcing any written or oral contract provisions prohibiting the flow of electric energy in interstate commerce. See *West Texas Utilities Co. v. Texas Electric Service Co.*, 470 F. Supp. 798 (N.D. Tex. 1979).

Such conventional tactics were insufficient, however. The very next day, before dawn, CSW made an unprecedented move that later came to be known as the “Midnight Connection.” Like commandos operating far behind enemy lines, CSW caused power from deep in the heart of Texas to flow for several hours into interstate commerce. On May 4, 1976, an unknown trooper flipped a switch at the West Texas substation in Vernon, Texas, to send Texas intrastate current surging into an electric load in Altus, Oklahoma via this clandestine connection. Under the simple laws of physics, all the ERCOT utilities thus contributed to the flow into Oklahoma.

While such a clandestine surge of power may seem insignificant, under the controlling Supreme Court cases, the simple transmission of power over interstate lines establishes federal jurisdiction. See *Federal Power Commission v. Florida Power & Light Co.*, 404 U.S. 453, 454 (1972); *Connecticut Light & Power v. Federal Power Commission*, 324 U.S. 515, 529 (1945); *Jersey Central Power & Light Co. v. Federal Power Commission*, 319 U.S. 61 (1943). The Midnight Connection therefore presumably placed the entire state of Texas and all its utilities under federal jurisdiction. These utilities had arguably suffered the irrevocable taint of interstate power.

The Second Battle: Surrender Is Unacceptable

CSW's next move was to apprise the Texas utilities of the breach in their battlements. Consequently, at about eight o'clock the next morning, my partner, Richard Ferguson, telephoned the lawyers for Texas Utilities and Houston Lighting to inform them that their power had been flowing in interstate commerce for several hours.

Their rejoinder was drastic, totally unprecedented, and totally Texan—a bit like Lt. Col. William Barret Travis's defense of the Alamo. About noon, Houston Lighting severed its connections with all the other major Texas utilities. Texas Utilities followed suit about three o'clock that afternoon. Both large utility systems completely disconnected themselves from other systems that operated generally to the west: West Texas, Central Power, Austin, San Antonio and the Lower Colorado River Authority, all of which were being continuously "infected" with interstate power. San Antonio, Austin and Lower Colorado remained connected with Central Power and West Texas of the CSW system. Although we CSW lawyers knew we were dealing with Texans, we were awed by the drastic—and perhaps risky—course that Texas Utilities and Houston Lighting pursued in defense.

Hours before they managed a disconnect, and as interstate power was flowing from Texas into Oklahoma, I filed a petition with the Federal Power Commission (FPC) on behalf of CSW's various utilities, asking that agency to maintain and expand the interconnections between ERCOT and the Southwest Power Pool. *See generally* 16 U.S.C. § 824a. In our view, the simple transmission across state lines effected by the Midnight Connection subjected ERCOT to the FPC's jurisdiction. Accordingly, the FPC had authority to require that interconnection be maintained if we could establish that doing so was in the public interest.

When we established the radial line from West Texas into Oklahoma, we did not engineer the synchronous operation of West Texas and Oklahoma Public Service. Therefore, the interconnection had no perceptible effect upon ERCOT's reliability—or, for that matter, any of the other electrical characteristics of the ERCOT system. In contrast, the disconnections undertaken by Texas Utilities and Houston Lighting deprived them, as well as other ERCOT members, of the reliability of the ERCOT pool.

Consequently, Lower Colorado, one of the disconnected utilities, soon requested that the FPC order Texas Utilities and Houston Lighting to remain interconnected with the CSW utilities. They asserted that severing the interconnections would jeopardize the reliability of service in Texas. West Texas also filed a similar motion requesting that the FPC order the immediate resumption and continuation of the interconnections between Central Power, West Texas, Texas Utilities and Houston Lighting. Additional motions claimed that an emergency situation existed. The motions of the non-CSW parties were not strategic in the interutility conflict, but seemed to be quick reactions to the apparently

drastic changes in the reliability picture.

After CSW's legal *coup de main*, we tensely awaited the FPC's response. We had spent most of our ammunition; all that remained was the formal declaration of victory or defeat. This pronouncement was not long in coming. On July 21, 1976, the FPC issued an order finding that West Texas and Central Power were "public utilities" within the meaning of section 202(e) of the Federal Power Act, 16 U.S.C. § 824(e). Therefore, these utilities were subject to the jurisdiction of the FPC. The FPC also found, however, that Texas Utilities and Houston Lighting were *not* "public utilities" under the Act because they were not in interstate commerce. *See generally* 56 F.P.C. 432 (1976).

The FPC's findings also addressed the risks created by the disconnection of the Texas system. The FPC believed that the bifurcation of ERCOT reduced the capability of the electric systems in Texas to respond to events such as generating plant or transmission line outages. This state of affairs, in the FPC's view, constituted an emergency under section 202(d) of the Federal Power Act, 16 U.S.C. § 824a(c). The FPC therefore authorized Texas Utilities and Houston Lighting to maintain their physical connections with Central Power and West Texas, and the other members of ERCOT. Because this order was issued pursuant to the Federal Power Act's emergency provisions, no jurisdictional consequences would result from interconnection. 16 U.S.C. § 824a(d). The FPC, however, was interested in a possible interconnection between ERCOT and the Southwest Power Pool and therefore instructed its staff to update a 1972 study finding that interconnection would result in substantial savings and the ultimate lowering of otherwise required reserves of energy. The merit of the FPC's decision not to subject Texas Utilities and Houston Lighting to federal jurisdiction on the basis of the Midnight Connection is an interesting issue. The Supreme Court cases governing the subject merely speak in objective electrical flows. *See generally Connecticut Light*, 324 U.S. 515. In the leading authorities, no weight was given to the motives of any of the parties in bringing about interstate electrical flows—whether they were effected surreptitiously or otherwise. In concluding that the major Texas utilities were not subject to federal jurisdiction as a result of the electricity flows, for instance, the FPC had to fall back on an obscure 1965 letter to the Home Light and Power Company of Greeley, Colorado, which was described as a small distribution utility. *See* 56 F.P.C. at 42. (The FPC's order was appealed to the D.C. Circuit, which eventually remanded it for consideration of antitrust and other matters. *See Central Light & Power Co. v. FERC*, 575 F.2d 937 (1978).)

There were certainly those who felt that such an involuntary connection was not a legitimate basis for creating jurisdiction. Commissioner James Watt (later Secretary of the Interior) filed a separate opinion in the CSW case, stating:

The Commission should not condone such blatant attempts as has [sic] occurred here to force jurisdiction upon otherwise non-jurisdictional companies.

56 F.P.C. at 442-43. No doubt this view would encounter considerable sympathy today—when almost everything federal is regarded as pernicious and when escape from federal jurisdiction qualifies as the worthiest of causes. But we contended then, and I continue to believe, that insistence upon a policy of isolation ignores genuine concerns about operating efficiency and reliability.

During and after the filing of the interconnection petition with the FPC, I continued the struggle to have CSW's goals recognized. At the direction of one of CSW's more politically astute directors, I began to contact several members of Congress and senators. My goal was to secure a few minutes of an official's time to plead CSW's view of the interconnection debate. I followed instructions and generally ended up making my case to the member's staff assistant for energy. I remember one incident quite fondly, however, and that involved Congressman Jake Pickle of Austin, Texas. Congressman Pickle took me into his office to listen to my story. I was quite astonished and gratified by his interest and hospitality—despite the fact that I did not appear to be a future source of political benefit to him. But more than that, I remember Congressman Pickle's attitude toward CSW's case; he earnestly sought to understand our complaint and our goal.

Quite aside from Congress, I found that one of my foremost tasks during the interconnection struggle was to explore relationships with other bodies involved in the electric industry whose sympathies might lie with us. Ironically, the rural electric cooperatives and municipal power bodies tended to understand our objective; they generally had long-standing objections to obstacles to the transmission of electric energy. The irony lay in the fact that some of these entities were behind our being hauled before the SEC in the first place. They nevertheless rallied to our side.

Naming names is futile because we received assistance from so many sides. I *had* to get beyond CSW's narrow goal of survival to sell this struggle to the public. Although some would say that it smacked of treason to the investor-owned segment of the industry to seek alliances among its traditional rivals, these "rivals" were those who were familiar with our fight. We sought help from the historic supporters of interconnection and transmission access, and we received it. But support for our cause was hardly limited to traditional rivals. Some of the regulatory agencies of the states bordering Texas were sympathetic. And we also received support from friends in the investor-owned part of the industry as well—those who, though not enthusiastic advocates of forced interconnection and wheeling, agreed that it was time to move on from the isolation of ERCOT.

The Aftermath of War: Legal Fallout Continues

The interconnection battle ultimately spawned a litigator's paradise. In part, this was attributable to the fact that resolution of the dispute between CSW and the Texas utilities would ultimately affect a large number of players in the electric game. But to a much greater degree, these disputes reflected the interest of the entire electric industry in having questions answered about forced interconnection and wheeling.

Perhaps as a result of this broad interest, in December 1978, Tex-La Electric Cooperative (a cooperative operating in Texas and Louisiana and a supporter of interconnection) filed a petition in the Federal Energy Regulatory Commission (FERC, the successor to the Federal Power Commission) requesting that it investigate whether Texas Power and Light (Texas Power), a Texas Utilities subsidiary, was subject to the agency's jurisdiction. Texas Power received power from the federal Denison Dam, under the terms of a contract with Southwestern Power Administration (SPA), a federal agency. The dam is located on the Red River, the interstate boundary between Texas and Oklahoma. Downstream of the dam SPA operates two generating units. The contract between Texas Power and SPA provided that their two systems would be operated to ensure that energy would not flow from the Texas Power system to points outside of Texas or vice versa.

CSW intervened in support of Tex-La's position. It was unclear whether the dam and the related electrical-generating equipment were located partly in Texas and partly in Oklahoma, or entirely in one state. My prior research led me to believe that the boundary between Texas and Oklahoma was fixed by the Treaty of 1819 between the United States and Spain. That treaty recognized the south "cut bank" of the river as the international boundary between the Louisiana Purchase and what was then New Spain (later Mexico). The boundary carried over (presumably) to the states of Texas and Oklahoma.

In *Tex-La*, FERC ruled that Texas Power's utilization of power from the dam did not subject it to FERC's jurisdiction. *Texas Power & Light Co.*, 9 F.E.R.C. ¶ 61,044, *reh'g denied*, 9 F.E.R.C. ¶ 61,344. The agency found, however, that the location of the boundary between Texas and Oklahoma had been brought into dispute and ordered that notice of the dispute be published in the *Federal Register*. *Id.* The State of Texas responded, invoking the Supreme Court's original jurisdiction to determine boundary disputes. The Court eventually ruled that the dam had not

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altered the boundary. *Texas v. Oklahoma*, 457 U.S. 172 (1982). This avenue of attack on the intrastate status of ERCOT therefore turned out to be a dry hole. It was a tribute to the influence of Texas in Washington, however, that the United States had seen fit to arrange things at the Denison Dam to protect ERCOT from contamination by interstate power.

Central Power and West Texas had also filed an antitrust case in Dallas federal court against a Texas Utilities subsidiary (noted earlier as one of the first "shots" fired in the interconnection battle). In addition to antitrust relief, West Texas sought a temporary restraining order preventing the Texas Utilities unit from disconnecting in the event that West Texas commenced interstate service. This request was ultimately denied (and, as we have seen, when West Texas transmitted electricity into Oklahoma, the Texas Utilities' companies disconnected). See generally *West Texas Utilities Co. v. Texas Electric Service Co.*, 470 F. Supp. 835 (N.D. Tex. 1979). The Dallas court eventually decided the merits of the antitrust claim, finding that Texas Electric and Houston Lighting had not engaged in a group boycott or otherwise unreasonably restrained trade by choosing to retain an intrastate character—isolation was a permissible goal under the law. Although the court also found that competition between the parties was nonexistent or *de minimis*, its holding was nevertheless significant and was a distinct setback for CSW because antitrust was one of our major legal weapons.

Antitrust concerns were hardly limited to the federal court, however. The Nuclear Regulatory Commission (NRC) and the Attorney General had not yet ruled on some of the antitrust issues created by the electrical events in Texas. During the 1970s, a number of electric utilities plugged into the mysteries of nuclear power. Houston Lighting, Central Power and the cities of San Antonio and Austin entered into a joint undertaking to develop the South Texas Project, a nuclear plant. Comanche Peak was another nuclear plant undertaken by the Texas Utilities companies. Federal law required electric utilities to obtain licenses from the NRC prior to operating a nuclear-generating facility. See generally 42 U.S.C. §§ 2011 *et seq.* In addition, it authorized the Attorney General to determine whether the activities under the proposed licenses might cause antitrust problems and to order a hearing (which might ultimately result in the NRC's denial or revocation of a license) to address any concerns.

The South Texas Project received antitrust clearance from the Attorney General in 1974 and the utilities were granted a license to construct the plant. An antitrust review never had been requested for Comanche Peak, however, and its license was granted in 1974 without any antitrust analysis. In June 1976, Central Power filed a petition with the NRC asking for an antitrust hearing in connection with South Texas, alleging that there had been a change in circumstances in light of the major electric disconnection that had taken place in Texas after the original antitrust ruling.

After a bit of scheming and wrangling, the Department of Justice (DOJ) became involved in the dispute. DOJ recommended a new antitrust hearing on South

Texas, as well as a reexamination of Comanche Peak's license application. The hawks at DOJ apparently prevailed. The NRC therefore ordered antitrust hearings with respect to both South Texas and Comanche Peak, and numerous publicly owned, cooperative and investor-owned utilities intervened. The hearings were scheduled to start in 1980 and promised to keep the antitrust ball in play, despite the subsequent court decision in Dallas.

Meanwhile, the newly created Public Utility Commission of Texas (PUCT) had been attempting to cope with the most challenging problem ever to face a new agency. As a result of the historic event of May 4, 1976, ERCOT had been operating in a bifurcated mode. Houston Lighting, the Texas Utilities companies, the Texas Municipal Power Pool, and the Brazos Electric Power Cooperatives operated as one synchronous system while Central Power, West Texas, Lower Colorado, the cities of Austin and San Antonio, South Texas Electric Cooperative, Medina Electric Cooperative, and the Public Utility Board of Brownsville, Texas, operated as another. The PUCT first decided that each of these systems should be permitted to operate as it chose. Later, the CSW group decided to alter its mode of operation, specifically, to operate its Texas companies and the utilities connected with them synchronously with the Southwest Power Pool outside of Texas. West Texas thus took the necessary electrical steps to ensure synchronous operation—no mean engineering feat considering the elongated configuration of the two CSW companies in Texas and the entities connected with them. This mode of operation was successfully maintained from August 1976 through May 1977.

In January 1977, however, Houston Lighting and the Texas Utilities companies filed complaints with the PUCT alleging that the synchronous operation of West Texas and the Southwest Power Pool impaired the reliability of service in ERCOT and was in breach of the parties' contract obligations. Houston Lighting and the Texas Utilities companies asked the PUCT to order the reconnection of ERCOT as it existed on May 3, 1976 (the day before the Midnight Connection).

Because I was a former state public utility commissioner, I was selected as the appropriate person to make an oral argument before the Texas Commission—this, despite my obvious upper Midwest accent and the other indicia of my inexperience with the unique mores of the Lone Star State. I thought I managed quite an effective argument, these factors of origin aside, but the commissioners apparently thought otherwise. In short order, they directed the members of ERCOT, including Central Power and West Texas, to interconnect in the original pre-May 4 configuration and to reconstitute the traditional ERCOT (unless the original configuration was later declared illegal). See *Application of Houston Lighting and Power Co. for Reconnection of the Texas Interconnect System*, PUCT Docket No. 14 (July 11, 1977).

This order essentially restored the system to the *status quo ante*. It was as if the battle had never been

(Continued on page 85)

performance has been disappointing. The closely analogous electricity industry provides the most obvious candidate for similar restructuring. By restructuring that industry, we can improve the industry's performance dramatically and reduce the nation's electricity bill by approximately \$24 billion a year. See Black and Pierce, *The Choice Between Markets and Central Planning in Regulating the U.S. Electricity Industry*, 93 COLUM. L. REV. 1339 (1993).

Many of the lessons learned from our history of failure and success in regulating the gas industry can also be useful as we undertake the more challenging task of

restructuring the healthcare sector of the economy. Indeed, the broad lessons are generalizable to virtually all contexts. Effective regulatory reform requires that we avoid imposing price controls on structurally competitive markets and that we create a legal environment in which market forces are allowed to play the maximum possible role in determining the price and quality of goods and services. See Enthoven, *The History and Principles of Managed Competition*, HEALTH AFFAIRS (Supplement 1993) 341 (1993); Enthoven & Singer, *A Single-Payer System in Jackson Hole Clothing*, HEALTH AFFAIRS 81 (Special Issue, Spring (I) 1994).

Midnight Connection

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fought. Aside from the order's impact on morale at CSW, a number of us had a significant legal complaint about it. The order had the clear effect of ordering West Texas *out of* interstate commerce, a result that seems pretty discordant with some of Supreme Court Justice John Marshall's early and fundamental pronouncements about the states' role in interstate commerce. Because the PUCT order raised these serious federal constitutional questions (as well as some state problems), we appealed in both state court and federal court. The state court ruled against us. *Central Power & Light Co. v. Public Utility Commission of Texas*, No. 261,605 (Dist. Ct. Travis County). The federal court dismissed the suit on grounds of abstention. *Central Power & Light Co. v. Public Utility Commission of Texas*, No. A77CA86 (W.D. Tex., May 5, 1978). The United States Court of Appeals for the Fifth Circuit eventually affirmed this abstention decision. *Central Power & Light Co. v. Public Utility Commission*, 592 F.2d 239 (5th Cir. 1979). But in the face of defeat, we refused to give up hope. Help was on the way.

The Congressional Mandate: A Forced Truce (of Sorts)

As these various court and administrative agency proceedings ground on, events in Congress were coming to a head. In 1977 and 1978 the Public Utility Regulatory Policies Act of 1978 (PURPA) was wending its way through Congress. See generally Pub. L. 95-617, 92 Stat. 3117. PURPA would give FERC authority to order interconnection and wheeling (transmission service) in certain circumstances. The jurisdictional limitation of the Federal Power Act (restricting federal jurisdiction to utilities in interstate commerce) was to be removed in favor of a broader grant that would allow FERC to order interconnection any time certain conditions were fulfilled. As amended by PURPA, the Federal Power Act would empower FERC to order an interconnection where it was found that: (1) it was in the public interest; (2) it would encourage overall conservation of energy or capital, optimize the efficiency of the use of facilities and resources, or improve the reliability of any electric system to which the order applies; and (3) it

met the requirements of section 212 of the Federal Power Act, as amended. PURPA further provided that utilities subjected to FERC jurisdiction for the purpose of carrying out an interconnection or wheeling order under the new provisions would not, solely by virtue of such an order, become subject to FERC jurisdiction for any other purpose (such as the review of wholesale rates). Under these provisions, FERC could order Texas Utilities and Houston Lighting to interconnect with the CSW operating companies and, except to comply with the interconnection order, Texas Utilities and Houston Lighting would not thereby become subject to FERC jurisdiction.

The primary public supporters of these new provisions were the publicly and cooperatively owned utilities (and some investor-owned utilities). The Carter administration also favored them. But certainly much of the political impetus—perhaps the decisive force behind the provisions—were the forces seeking the interconnection of ERCOT and the Southwest Power Pool. Agreeing upon appropriate language was a laborious struggle because, aside from the opposition of the major Texas utilities, there were utilities throughout the country that simply did not like compulsory wheeling. Consequently, some of the new provisions contained negotiated language abstruse almost to the point of absurdity. One section, for instance, stated that interconnection or wheeling should not be ordered unless FERC determines that it “is not likely to result in a reasonably ascertainable uncompensated economic loss. . . .” See 16 U.S.C. § 824k(a).

In general, we proponents were happy to compromise on the finer points because, no matter how many conditions were attached, this legislation in almost any form greatly increased the likelihood of interconnections between ERCOT and the outside world, thereby resolving many of CSW's problems. In 1978, PURPA, amending the old Federal Power Act, passed Congress.

CSW filed an application with FERC soon thereafter. In particular, it sought an exemption from the 1977 PUCT orders, which prohibited West Texas from engaging in interstate transmission of electricity. In addition, CSW proposed to construct four synchronous al-

ternating current interconnections between ERCOT and the Southwest Power Pool. Not surprisingly, Houston Lighting, Texas Utilities and numerous other parties moved to intervene, and FERC set CSW's claims under PURPA for investigation. See *Central Power & Light Co.*, 8 F.E.R.C. ¶ 61,065 (1979), *on reh'g*, 9 F.E.R.C. ¶ 61,011 (1979). FERC eventually denied CSW's request for an exemption from the PUCT's order. 9 FERC ¶ 61,011. FERC did, however, definitively reject the PUCT's jurisdictional claim that FERC had no authority to order interconnections and wheeling that would affect ERCOT. *Id.* This ruling vindicated the Supremacy Clause and put matters in a better perspective.

Further support from federal forces was not long in coming. Later in 1979, the United States Department of Energy (DOE) publicly announced that it supported *interstate* electric operations. In particular, the agency issued a comment on the nuclear power situation involving Comanche Peak and South Texas. In a letter to the NRC's Atomic Safety and Licensing Board, DOE stated that intrastate-only operations were not in the public interest because they adversely affected coordinated operations and system reliability in the southwestern United States. DOE further noted that the intrastate operations restricted competition in bulk power markets, increasing the cost of electricity to consumers.

These were unequivocal messages to the Texas combatants: It was time to think about a compromise—and a compromise that involved, no less, a few concessions to federal authority.

The passage of PURPA, together with the various federal pronouncements, was enough to bring the parties to the bargaining table. CSW, Texas Utilities and Houston Lighting began settlement negotiations to resolve the interconnection dispute. Having departed this fascinating controversy for a seat on the federal bench, I was unfortunately unable to witness these landmark events firsthand. Instead, they were committed to the able hands of my partner, David Rosso. These settlements were, in some ways, greater achievements than the events leading up to them.

The parties explored all sorts of arrangements, including direct-current ties, synchronous interconnections, and so on. They finally settled upon a direct-current interconnection because, unlike an alternating current tie, the power flows over a direct-current link could be controlled. This meant that the parties could specify exactly how much power to send in a chosen direction. The parties agreed to other terms as well, notably that the interconnection would not subject ERCOT to federal regulation for other purposes.

Certain contract provisions provided for transmission service to other utilities (and rates governing the

same). CSW was committed to transmission service to small utilities for a period of fifteen years under conditions agreed to by CSW and DOE. These provisions were presumably intended to benefit cooperative and public power entities and to broaden the public benefits of interconnection.

As a result of a series of settlements painstakingly negotiated by Rosso with various utility parties and government agencies, the CSW companies gained the ability to engage in centralized dispatch of all their generating facilities. In light of this development, the SEC issued an order restating its 1945 findings that the CSW system as integrated would continue in effect. Consequently, the SEC terminated its investigation of CSW. Because the agreement also contained provisions applicable to the nuclear plants, the NRC halted its antitrust investigations. Various transmission service rate disputes have arisen among the parties, but all have been resolved satisfactorily.

Remembering the Alamo

Peace was forged, and yet a measure of independence was retained. The question remains: What did all this prove? Is this matter merely a grandiose aberration,

a full employment project for lawyers that stirred up clouds of procedural dust but of little substantive import? Perhaps this was all that was there, although as one of the principal combatants, I would prefer to believe otherwise.

In fact, the experience of one company provided a vehicle for forging changes needed in the law. In the course of making it possible for CSW to present a picture of adequate integration, the law was amended to empower FERC to order mandatory transmission of one entity's electric power over the lines of other electric utilities. The new provisions of PURPA, whose details were very much influenced by the ERCOT controversy, apparently did not prove satisfactory for

general application. They were amended in 1992 and already have been successfully employed to provide competition among utilities and independent electric power-generating units. Thus, the statutory transmission provisions eventually coming out of this controversy are to be ideally employed in search of a goal quite different from the one we sought in Texas: namely, that of providing a system where competition between noncentrally planned generating units will cull out the efficient from the inefficient. This is a very different focus from the concerns motivating the PUHCA, which sought efficiency in large, centrally operated units. But one never knows whether achievements for one purpose will ultimately be employed for different purposes altogether. Despite the unusual circumstances of the isolated ERCOT reliability system in the Southwest, the idea of in-

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tegrating it into a larger power pool was one that was quite orthodox at the time. And the idea that one can combine a competitive bulk-power market with a centrally dispatched power pool is not one that violates a good deal of current competitive thinking. See, e.g., William W. Hogan, *Reshaping the Electricity Industry* (paper prepared for the Federal Energy Bar Conference, Nov. 17, 1994). But, superficially at least, integration and disintegration seem to point in different directions.

The real lesson of the Second Battle of the Alamo is that transmission lines can break through seemingly im-

pregnable political barriers. The battle teaches, as well, the many paths that administrative litigators can pursue to achieve their ends. I know of no other case where the determination and ingenuity of the parties so tellingly rewrote whole chapters in the body of the law. The battle was exhilarating, and it taught us a great deal about the pros and cons of interconnection and wheeling. It also showed us how deep the abhorrence of federal regulation can run. We must remain aware of these feelings since they seem stronger today than ever.

EPAct of 1992

(Continued from page 71)

generation market who are required to purchase power under PURPA while others who can serve the utility's customers are not.

If all generators are to compete on that proverbial "level playing field," laws such as PUHCA and PURPA that impose burdens on some, but not all, generators have no place. The same is true with respect to other laws that assume continuation of the traditional, vertically integrated utility with an exclusive retail franchise over which it can recover the costs of public policy objectives not imposed on other generators. This is true whether those objectives are revenue-raising, low-income assistance, environmental protection or new tech-

nology development. New mechanisms will be required to accomplish these objectives in the electricity industry of the future if competitive distortions are to be avoided.

Whatever the future shape of the electricity industry may be, it is clear that it will not be the same as it was before EPAct. Although many of the changes now occurring in the electricity industry may eventually have happened without EPAct, it seems clear that EPAct has put to rest questions concerning the role of competition in generation even as it opened new fields of inquiry concerning the role of utilities in the electricity industry of the future. For these reasons, the Energy Policy Act of 1992 is landmark energy legislation.

National Energy Act

(Continued from page 68)

for new construction. Initiatives in these areas continue today.

In other areas, the implementation of NECPA proved more problematic. For example, NECPA strengthened the appliance energy-efficiency standards program established under EPCA by requiring energy-efficiency standards for thirteen types of appliances, assuming such standards were economically justified. But in 1982, DOE concluded that the energy standards envisioned under NECPA could not be economically justified. Years of litigation and subsequent action by Congress were required before appliance energy-efficiency standards would be established. In 1987, Congress adopted the National Appliance Energy Conservation Act (NAECA), Pub. L. No. 100-12, 101 Stat. 103 (1987), specifying energy-efficiency standards and proposals for periodic updating of such standards for a variety of major household and commercial appliances. NAECA was amended in 1988, Pub. L. No. 100-357, 102 Stat. 671 (1988), and again in 1992 through the EPAct. Today, efficiency standards have been prescribed for all major categories of consumer products. The standards program is currently regarded as one of the key policy tools for reducing greenhouse-gas emissions.

Lessons

It is easy to describe and understand the objectives of the NEA. Facing an energy crisis of unprecedented proportions, President Carter wanted the United States to regain control of its energy destiny and his administration developed an extensive plan for doing so. It included an aggressive conservation program to reduce energy demand, mandatory conversion from the more scarce oil and gas to domestically abundant fossil fuels, and a vigorous research and development program for renewables.

Congress also recognized the need to control the nation's energy future—the NEA legislation is testimony to that. However, Congress did not embrace all of President Carter's proposals, and as has been shown, many of Carter's more ambitious proposals did not become law.

What is not so easy to describe is whether the legislation accomplished the goals of its drafters. Except in the area of conservation, most of the regulatory initiatives that flowed from the NEA have since proven unworkable or no longer necessary and have been abandoned. For example, the extension of price ceilings to the intrastate natural gas market through the NGPA was an effective mechanism at the time for relieving supply shortages, but is no longer relevant be-