

FROM INSULL TO ENRON: CORPORATE (RE)REGULATION AFTER THE RISE AND FALL OF TWO ENERGY ICONS

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I. INTRODUCTION

For most Americans, the sudden and horrific collapse of the Enron Corporation will go down as the most shocking and significant corporate event of their generation. Yet, remarkably, it is a surprise to many people that the New Deal regulatory framework – which was recently reformed and toughened in response to the Enron debacle – was itself created in the wake of a strikingly similar corporate crash. In late 1931 and early 1932, investors, business executives, and ordinary citizens looked on in horror as Samuel Insull’s grand and seemingly invulnerable electric utility holding company empire foundered without warning and slipped into receivership. This debacle wiped out the holdings of 600,000 shareholders and 500,000 bondholders,¹ most of whom believed that they had entrusted their savings to a safe and secure electric utility enterprise.

As Insull (much like Enron seventy years later) was vilified in the press, candidate Franklin D. Roosevelt seized upon this business disaster to press his case for corporate reform during the 1932 presidential campaign. Though Insull and his crash are today largely forgotten, we are still subject to its regulatory aftermath—measures that were adopted “in direct response to Insull’s real or alleged doings”² This legislation, a substantial part of the New Deal regulatory agenda, includes the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Federal Power Act of 1935, and the legislation creating the Tennessee Valley Authority and the Rural Electrification Administration.³ As noted by one Insull historian, “It is no exaggeration to see in the legislative innovations of the New Deal a phoenix arising from the ashes of the Insull empire.”⁴

At least superficially, the Insull failure and the Enron collapse seventy years later appear to have followed virtually identical scenarios.⁵ For example, both companies rose to dizzying levels of economic power and political and public adulation. Virtually overnight, both icons plummeted ignominiously into bankruptcy, giving rise to frantic hand wringing and finger pointing by politicians and

1. See JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE* 22 (Houghton Mifflin Co. 1982) [hereinafter SELIGMAN].

2. FORREST McDONALD, *INSULL* 335 (Univ. Chi. Press 1962) [hereinafter McDONALD].

3. *Id.*

4. ROBERT GRANT & JOSEPH KATZ, *THE GREAT TRIALS OF THE TWENTIES: THE WATERSHED DECADE IN AMERICA’S COURTROOMS* 245 (Sarpedon 1998) [hereinafter GRANT & KATZ].

5. See, e.g., John Micklethwait & Adrian Wooldridge, *A Corporate Crisis? No, Just Business As Usual*, WASH. POST, June 23, 2002, at B1 (discussing corporate crises in the aftermath of the Insull and Enron debacles and noting that “the echoes of the current crisis are uncanny”); Peter G. Gosselin, *Enron a Rerun of History*, L.A. TIMES, Feb. 22, 2002, at A1 (opining that “Lay, Skilling and Enron could rightfully claim to be Insull’s historical heirs”); Rebecca Smith, *Enron’s Rise and Fall Gives Some Scholars a Sense of Deja Vu*, WALL ST. J., Feb. 4, 2002, at A1 (discussing the Insull debacle and noting that “many students of corporate history get a sense of *deja vu* as they watch the Enron saga unfold.”).

the press. Apparently, everyone had been duped.

Yet, a careful examination of the rise and fall of Samuel Insull reveals many interesting (and sometimes ironic) differences from the Enron debacle. Perhaps most striking is the fact that all of the Insull criminal and civil proceedings, which dragged on until Insull's death in 1938, ended in acquittals for Samuel Insull and his large coterie of executives.⁶ In contrast, the federal laws that were passed in the aftermath of Insull have been successfully deployed to obtain several criminal convictions of Enron figures (with possibly more to come)⁷ and numerous civil settlements.⁸ Another fortunate and arguably related distinction between the Insull and the Enron eras is that, notwithstanding similar stock market collapses in 1929 and 2000, the country has thus far averted a severe economic depression in the wake of Enron. Thus, Insull's most consoling legacy may be that the full force of history has *not* repeated itself in full.

There is nothing like a narrow escape from ruin to produce sober, level-headed reflection on matters of public policy. This Article suggests that our ruminations on government regulation are more likely to draw the right conclusions if we understand the historical continuum that connects Insull with Enron. The setting for our analysis is the growth and maturation of the electric power industry over a span of 120 years. At two junctures – separated by a nearly seventy-year interval – the collapse of two energy titans, Insull and Enron, helped to galvanize major changes in the regulation of financial markets. Since the Enron experience is current and ongoing, as well as the subject of numerous discussions and analyses in a continuing torrent of books and articles,⁹ its specific facts will be dealt with in a summary fashion. The Insull story, by contrast, is not well known to the modern reader, and will be described in some detail.

The central lesson that emerges from a comparison of the Insull and Enron eras is not so much that we need to strengthen laws on corporate wrongdoing—it is in recognizing that during a financial bubble driven by rapid changes in network industries (e.g., electricity and the Internet) regulatory officials will inevitably buckle under political pressure and (a) fail to issue new rules that might in-

6. GRANT & KATZ, *supra* note 4, at 242–44 (discussing criminal proceedings); MCDONALD, *supra* note 2, at 338 (noting that after the criminal trials, Insull executives continued winning the “barrage of civil suits,” though Insull himself did not participate because “his personal estate and debts were [turned over to] trustees for his creditors”).

7. See, e.g., Greg Farrell, *White-Collar Cases Become N.Y. Specialty*, USA TODAY, Sept. 20, 2004, at B4 (reporting that through September 2004 the Enron Task Force had charged 32 defendants in connection with accounting fraud at Enron and that “[s]o far, 15 defendants have been convicted or have pleaded guilty”).

8. See, e.g., Kurt Eichenwald, *Ex-Directors of Enron To Chip In On Settlement*, N.Y. TIMES, Jan. 8, 2005, at C1 (reporting that Enron shareholders reached a \$169 million settlement with ex-Enron directors and noting earlier settlements against other defendants, including Lehman Brothers, Bank of America, and the umbrella organization representing the Arthur Andersen accounting firm).

9. See, e.g., ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS (Nancy B. Rapoport & Bala G. Dharan, eds. Fountain Press 2004) [hereinafter CORPORATE FIASCOS] (anthology of commentaries by legal academics, lawyers, and consultants); ROBERT BRYCE, PIPE DREAMS: GREED, EGO, AND THE DEATH OF ENRON (PublicAffairs 2002); BETHANY MCLEAN & PETER ELKIND, THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (Portfolio 2003); PETER C. FUSARO & ROSS M. MILLER, WHAT WENT WRONG AT ENRON (John Wiley & Sons, Inc. 2002); LOREN FOX, ENRON: THE RISE AND FALL (John Wiley & Sons, Inc. 2003).

terfere with the financial “hijinks” and (b) fail to vigorously enforce laws already on the books. This Article suggests that the laws adopted in response to Enron are destined to be watered down and ignored during the next boom, just as New Deal laws, passed in response to the Insull era, were watered down and ignored during the 1990s. This seems to be a reality of the economic cycle during its most accelerated phases. For, when prosperity seems to be waxing and wealth is building at an amazing rate, no one wants to be perceived as an agent of restraint, trying to brake the boom. This is the reason regulation is shunned when it is most needed and pursued only long after the horse has left the barn.

This Article is divided into three parts. Part II tells the largely forgotten story of Insull, which begins with his early apprenticeship with Thomas Edison in the 1880s, chronicles the construction of an extensive and efficient electric utility system by Insull and his rivals that serviced seventy percent of the nation’s households, and ends with the shocking collapse of Insull’s seemingly invulnerable (but dangerously over-leveraged) empire.

Part III reviews the maturation of the electric industry including the apparent exhaustion of economies of scale, the rise of the environmental movement, and how the Public Utility Regulatory Policy Act of 1978 (PURPA) and the Energy Policy Act of 1992 altered the state-regulated monopoly franchise model that emerged in the aftermath of Insull, and ultimately laid the groundwork for market-based approaches championed by Enron.

Finally, with the benefit of this relatively long historical view of the electric industry, Part IV suggests that Insull and Enron are emblematic of relatively rare moments in history when the birth of a new infrastructure industry creates an enormous surge in economic activity that captures the imagination of the investing public and weakens the willingness of the political class to serve as vigilant, disinterested regulators. This final part makes three observations. First, it argues that the opaque capital structures of both Insull and Enron companies should have put a (hypothetical) rational investor on notice that both Insull and Enron were loaded with risk; but, with a dearth of rational investors, a situation which accurately described conditions during these two eras, additional disclosure would not necessarily have helped.¹⁰ Second, it suggests that in both the securities and energy industries, the prevailing laissez-faire, free-market ethos of the 1920s and 1990s produced an ideologically charged environment in which officials refused to enact or to enforce unpopular (but, as it turned out, necessary) laws and regulations. Finally, it ends with some concluding remarks on how the Insull and Enron debacles affect the longstanding debate on how to regulate elec-

10. As discussed in the body of the Article, the capital structures of the Insull empire and Enron were hopelessly opaque, and the managements of both companies refused to undertake any substantial efforts to simplify them. Thus, dispassionate investors should have discounted the value of Insull and Enron stock. Instead, Insull and Enron became quintessential “faith” stocks in which their high stock prices were supported by their iconic status rather than by a careful inspection of their disclosures. See generally Part III.A, *infra*; see also Jon Birger, *No Looking Back for Him; A Chat with a Fund Manager Who Lost Some \$ 600 Million on His Enron Stake*, in 31 MONEY MAGAZINE, Feb. 1, 2002, at 95 (discussing opaqueness of Enron’s financials, and quoting one institutional investor that “[o]ther than a very few short-sellers, nobody really dug into the footnotes” of Enron’s financial statements, which purportedly discussed the partnerships and off-balance sheet debt that ultimately lead to the company’s collapse).

tricity.

II. INSULL AND ELECTRICITY

The story of Samuel Insull is the story of the origins and growth of the electric utility business itself. Subpart A summarizes Insull's early career, including, almost providentially, his employment as a very young man as Thomas Edison's personal secretary and "Man Friday." Subpart B discusses Insull's technological and business innovations and spectacular accomplishments as a utility operator in Chicago. Subpart C examines how Insull and other utility operators turned to the device of the holding company to build, continuously improve, and expand the nation's power systems. Subpart D chronicles Insull's heady days as an industry titan and his ultimate fate as a scapegoat for the evils of capitalism. Finally, subpart E reviews the Insull criminal trials, which ultimately ended in acquittals—delivering a verdict much different than that rendered by the political process.

A. Insull's Origins and Early Career, 1859–1892

Insull was born in England in 1859 to a middle-class family of dissenting Protestants. His father was a down-at-the-heels temperance crusader, and the doors of the university were, of course, closed to the young, bright, and immensely energetic Sam. Determined to escape his unpromising and humdrum circumstances, Sam went to work at age fourteen. At night, he schooled himself in shorthand, bookkeeping, and the classics. In 1879, he responded to an advertisement for a secretary placed by a banker who turned out to be the European representative of the renowned scientist and inventor, Thomas Edison, whom Insull saw as only a step short of a deity. After landing the job, Insull burrowed into the office files and impressed Edison's chief engineer, who was visiting London, with his detailed knowledge of Edison's European affairs. This led eventually to the answer to Insull's dream—a cabled summons from that same engineer to come to the United States to become Edison's private secretary.¹¹

Insull took on every conceivable duty from Edison, ranging from securing financing for Edison's projects to buying the great man's clothes. Edison was impressed with his young assistant's dedication, energy, and ingenuity. The first big project to absorb Insull's attention was financing for the Edison Electric Illuminating Company of New York, which was to build the Pearl Street station, the first central electric generating station in the United States.¹² This installation was completed in September 1882. One of its first fruits was the illumination

11. There are several sources, including Insull's personal memoirs that provide excellent accounts of Insull's early life. See SAMUEL INSULL, *THE MEMOIRS OF SAMUEL INSULL: AN AUTOBIOGRAPHY* 1–32 (Larry Plachno, ed., Transp. Trails 1992) [hereinafter INSULL]; HAROLD L. PLATT, *THE ELECTRIC CITY: ENERGY AND THE GROWTH OF THE CHICAGO AREA, 1880–1930* 66–68 (Univ. Chi. Press 1991) [hereinafter PLATT]; THOMAS P. HUGHES, *AMERICAN GENESIS: A CENTURY OF INVENTION AND TECHNOLOGICAL ENTHUSIASM, 1870–1970* 227–28 (Viking 1989); McDONALD, *supra* note 2; John T. Flynn, *Up and Down with Sam Insull*, *COLLIER'S*, Dec. 3, 1932, at 10 [hereinafter Flynn] (first article in a four-part weekly series on Insull).

12. See JAMES TOBIN, *GREAT PROJECTS: THE EPIC STORY OF THE BUILDING OF AMERICA* 106–07 (Free Press 2001) [hereinafter TOBIN].

from 106 Edison-developed incandescent lamps in the offices of Drexel Morgan—the firm of J.P. Morgan, who was the financial power behind Thomas Edison.¹³ The Pearl Street station set the pattern for electric utility development for the next eighty years.

During the 1880s, the alternative to central stations was “isolated” or “self-contained” plants, which were installations designed for lighting a single, large building from a “powerhouse” that was typically located in the basement. Edison was convinced that the larger generating capacity of central stations, which could supply power to a number of “loads” (users of electric power) within the reach of the plant, offered impressive reliability and efficiency advantages that would only increase over time as plant capacities grew. The simple, yet elegant, principle that underlay this preference was the concept of economies of scale. In the case of electricity, this meant that the continuous decline in cost per kilowatt-hour associated with the increasing size of the generating plant would make feasible a flood of new industrial and consumer applications. In turn, these proliferating applications – the incandescent lamp, the clothes iron, the electric stove, the refrigerator, the dishwasher, air conditioning, electric heating, etc. – meant constantly growing demand requiring, in turn, ever larger generating plants. This was the happy cycle of development into which Insull was to lead the electric utility industry.

In 1886, Edison responded to growing demand for equipment and appliances by building a large manufacturing facility in Schenectady, New York (a project built under the supervision of Samuel Insull). After Insull had successfully overseen the new plant construction, Edison put him in charge of its manufacturing and sales divisions—an impressive responsibility for a man still in his twenties.¹⁴ Due in part to the success of Edison’s incandescent light bulb, and in part to Insull’s relentless organizational skills, employment at the Schenectady plant of Edison General Electric swelled from 200 to 6000 during its first six years of operations.¹⁵

In 1891, under the aegis of J.P. Morgan and Henry Villard (an entrepreneurial German), the Edison interests merged with its major competitor, the Thomson-Houston Electric Company of Lynn, Massachusetts.¹⁶ The Schenectady operations then became the focus of activity of the newly formed General Electric Company.¹⁷ Although Insull was elevated to the number three spot in the corporate hierarchy, the top jobs went to people from Thomson-Houston. Not surprisingly, Insull viewed his new promotion as a step down.¹⁸ However, Insull also

13. *Id.* (noting also that when Edison threw the switch to complete the circuit, “[f]ifty-two more lamps came on in the offices of the *New York Times*, and more still in the stores along Fulton and Nassau Streets”).

14. INSULL, *supra* note 11, at 46–49, 54.

15. PLATT, *supra* note 11, at 67.

16. *Id.*

17. At the behest of Thomas Edison, who profited from the consolidation but no longer retained control, the Edison name was dropped from Edison General Electric shortly after the merger. See INSULL, *supra* note 11, at 55–56 (discussing Edison’s attitude toward the merger).

18. PLATT, *supra* note 11, at 67; Flynn, *supra* note 11, at 33 (quoting Insull, “I was demoted from the top to the bottom”). In his memoirs, Insull attributed his dissatisfaction to the fact that the new top executives “did

had come to believe that the greatest opportunities in the new electrical field were in the generation and distribution of electricity rather than in the manufacture of electric wares.¹⁹

In the spring of 1892, Insull shocked his colleagues by announcing that he was leaving General Electric to become the new president of the Chicago Edison Company (Chicago Edison). At the time, the prospects of this fledgling electricity supplier were not obvious. Chicago Edison was only one of thirty central station companies in a place that New Yorkers regarded as a “cow town.”²⁰ Yet, Insull was a font of knowledge and experience that set him far ahead of his rivals. As historian Harold Platt has observed, “In little over a decade [Insull] had learned every aspect of the business firsthand, from the art of invention, the science of engineering, and the techniques of manufacturing to the finances of Wall Street and the economics of utility operators.”²¹ Prior to accepting his new position, Insull cannily negotiated key provisions in his contract, ensuring that the board of directors would effectively support his ambitious plans for expansion with a willingness to supply additional capital, which Insull foresaw as a continuing and intense need.²² Moreover, to guarantee that the reins of company control would remain securely in his hands, Insull purchased a large block of Chicago Edison stock, which he financed through a \$250,000 loan from one of his backers, Chicago retail magnate, Marshall Field.²³

Prior to his departure for his new post, fifty electricity executives and notables gathered at Delmonica’s, an exclusive New York restaurant, for a farewell dinner in Insull’s honor. The occasion provided a telling glimpse of the colorful personalities that were jockeying for power in a rapidly growing industry that was destined for a key role in the American economy. Insull would later recall a sardonic remark made by one of his hosts, that the guest list included “most of [Insull’s] intimate friends and intimate enemies.”²⁴ After numerous speeches of lavish praise, Insull rose and graciously thanked his colleagues. Then, much to the amusement of his audience, he informed his colleagues that one day Chicago Edison would be the equal in invested capital, or would even exceed, the General Electric Company.²⁵

B. Insull’s Early Years as a Utility Operator, 1892–1912

1. Chicago Edison

not really understand the central station business . . .” INSULL, *supra* note 11, at 58.

19. See INSULL, *supra* note 11, at 60–61 (stating that after the merger that created General Electric, “I made up my mind that I would leave the electric manufacturing side of the business” and “engage myself in the operation of a central station company . . .”); MCDONALD, *supra* note 2, at 52 (noting that after the merger, “[Insull] had grown increasingly convinced that the central station industry, not manufacturing, was the electric business with a future.”).

20. TOBIN, *supra* note 12, at 112.

21. PLATT, *supra* note 11, at 68.

22. MCDONALD, *supra* note 2, at 53–54.

23. *Id.*; see also INSULL, *supra* note 11, at 65 (discussing the loan from Marshall Field).

24. INSULL, *supra* note 11, at 62.

25. *Id.*

Upon his arrival in Chicago, Insull had two integrally related goals. The first was the elimination, mostly by absorption, of the numerous competitive electric companies operating in Chicago. The second was the further development of central station power.²⁶ The challenges that confronted him were daunting and involved both the financial and the technological. Insull might have been able to best his competitors with reliable power at a cheaper price, but there was little evidence he could turn a consistent profit without relying on the cycle of promotional prices, expanding volume, greater capacity, and lower unit costs leading in turn to ever-cheaper prices. He had to confront the problem that central station power was extremely capital-intensive, and financial leaders were not yet fully persuaded that it was here to stay or that it could be counted on to produce a reliable return on investment.²⁷

From Insull's perspective, one of the major problems that plagued the industry was competition. Duplication of expensive distribution, transmission, and generating facilities meant that investors in less efficient companies were destined to lose virtually all of their investments. Further, the financial uncertainty engendered by competition made it more difficult (and expensive) to finance large capital projects that could substantially reduce the per-unit cost of electricity.

Shortly after his arrival, Insull persuaded the directors of Chicago Edison to purchase their second largest competitor.²⁸ Three months later, with consolidation in the air, the president of the Chicago Arc and Power Company (Chicago Arc and Power), the city's largest operator, approached Insull about joining a syndicate to underwrite a large issue of Chicago Arc and Power stock. Insull brusquely rejected the opportunity, informing the executive that Chicago Arc and Power was not built upon sound economic and engineering principles and that, regardless, Insull intended eventually to acquire the company by purchase or consolidation with Chicago Edison.²⁹ The executive laughed at Insull, pointing out that his company was much the larger of the two and that the exact opposite to Insull's forecast would likely come to pass.³⁰

Yet, Insull clearly had a plan. Chicago Arc and Power's major investor, B.E. Sunny, wanted to sell out and move on to more lucrative ventures.³¹ Fur-

26. INSULL, *supra* note 11, at 75-78.

27. Insull's memoirs aptly describe the situation:

It should be remembered that at this time [circa 1893] the manufacturing side of the electrical business was apparently the more profitable side. The central station side of the business, whilst showing a return on its investment, was of necessity very much slower in its development because of the large capital required for it as compared with the manufacturing business. The difficulties of raising capital were great, because financiers had yet to acquire the necessary confidence in the permanency and remunerative character of the electric lighting central station business.

Id. at 61.

28. MCDONALD, *supra* note 2, at 59 (discussing Chicago Edison's purchase of Fort Wayne Electric Company).

29. INSULL, *supra* note 11, at 75-76 (recalling a conversation with Norman Fay, president of Chicago Arc and Power).

30. *Id.* at 75-76; MCDONALD, *supra* note 2, at 59.

31. One of these opportunities was in the nascent telephone industry. See Flynn, *supra* note 11, at 19

ther, the company president was more interested in stock promotion than in mastering the technical details of the electricity business.³² Thus, in early 1893, Chicago Edison absorbed its largest competitor. Further, Insull devised financial terms that were especially advantageous to Chicago Edison, using debentures that had a lower effective yield than the eight percent dividends that Chicago Edison was paying on its own common stock.³³ As noted by a journalist of the time, “La Salle Street was astonished by this. It had predicted Insull’s absorption, but the sparrow had eaten the cat.”³⁴

On a technological level, Insull’s plans were no less audacious. Shortly after his arrival at Chicago Edison, Insull hired “Frederick Sargent, a brilliant engineer” with whom he had worked at Edison General Electric, to design a new generating facility.³⁵ This plant, which became known as the Harrison Street Station, was ideally located on the Chicago River near the southern fringe of the central business district (the Loop). Although the station’s initial generating capacity was enormous by the standards of the day, Insull purposefully instructed Sargent to design the plant so that it could be expanded to several times its initial capacity. In 1893, as the economy sank into a deep recession, Insull negotiated the purchase of the largest and most efficient electric generator in the world, which General Electric had demonstrated at the Columbian Exposition in Chicago during that same year. When the Harrison Street Station went on line in the summer of 1894, it was by far the largest electric power station in the world, with a total capacity of 16,400 kilowatts.³⁶

During the next several years, Insull pursued a two-pronged growth strategy—expanding generating capacity (to lower per-unit cost) and cutting rates (to spur demand). Although by far the greater part of Chicago Edison’s electric output was initially used for lighting, Insull aggressively promoted electricity as a means of powering appliances and small industrial equipment.³⁷ Not only were power sales a source of additional volume, but, in general, the machine load drew on generators at different times of the day than the lighting load (a quality known as “diversity”). Hence, this new load could use the same generating capacity as the lights – but at different times of day – thus producing substantial additional revenues with only a modest increase in cost. As Insull had discovered, the costs incurred in the generation of electricity can be classified in two categories: fixed costs and operating costs.³⁸ By a wide margin, the largest cate-

(discussing the merger between Chicago Edison and Chicago Arc and Power and noting that Sunny later became “[the] telephone king of Chicago”).

32. MCDONALD, *supra* note 2, at 59.

33. *Id.*

34. Flynn, *supra* note 11, at 19 (noting that “[f]or the first time bankers and financiers in the big city began to ask about this man Insull”).

35. MCDONALD, *supra* note 2, at 58 (discussing hiring of Frederick Sargent).

36. *Id.* at 60–61 (discussing the acquisition of generators from General Electric); INSULL, *supra* note 11, at 76–77 (discussing Harrison Street Station).

37. Compared to the gas lamp, the incandescent light bulb was a superior form of lighting. However, the high cost of electricity made it a luxury good that was beyond the reach of the vast majority of consumers.

38. MCDONALD, *supra* note 2, at 67. McDonald traces Insull’s understanding of fixed versus operating costs to an 1894 trip to Brighton, England, where Insull learned about the use of demand meter from Arthur

gory was fixed costs, which were the costs of providing capacity to meet *peak* demand, however short in duration that peak might be. In contrast, operating costs were the costs directly related to providing energy (such as the costs of fuel), and which varied directly with the amount of energy produced (usage). Revenues generally were the sum of demand charges related to kilowatts of demand and energy charges related to usage. Usually, the most advantageous loads from a revenue standpoint were those having the highest load factor—that is, those which had the most uniform demands and which registered their maximum demand most continuously.³⁹ In considering the combination of loads, the more “diverse” the loads (that is, the less simultaneous their demands), the lower the cost of providing a given amount of energy. The process of acquiring loads diverse from others enabled Insull to cut rates in light of higher sales without a higher demand.

From Insull’s perspective, this process of continuously building load (though attempting to smooth demand) required constant additional capital. Although Insull had joined Chicago Edison with the expectation that company directors would raise ample capital for expansion, Insull and the board were soon at loggerheads over the amount of additional debt that the company should take on.⁴⁰ Much to Insull’s disgust, the board preferred a more conservative course than he recommended. This situation became critical when bank loans became unattainable in 1896 as a result of William Jennings Bryan’s receiving the Democratic nomination for president on a populist platform aimed at reducing the debt burden of farmers by providing for the free coinage of silver at a ratio to gold of sixteen to one. During his years with Edison, Insull had come to loath the burdens of financing a promising yet perpetually cash-strapped business.⁴¹ And, as the American money markets dried up pending the outcome of the national election, Chicago Edison’s need for operating capital became ever more acute. Forced once again to rely upon his own resourcefulness, Insull departed for London. Within two weeks of his arrival, Insull concluded a substantial bond placement with a London syndicate. Upon hearing the news via telegram, the Chicago business community looked on with astonishment.⁴² As one journalist later observed, “When [Insull] came back it was as the undisputed master. After that the directors were merely ornaments.”⁴³

Wright, manager of a municipally owned electric utility company. The demand meter enabled an operator to calculate not only a customer’s total usage but also the magnitude and duration of its peak demand. Thus, as Wright pointed out, customers with sporadic, uneven demand drove up an operator’s fixed costs without contributing correspondingly to total revenues. After adopting the demand meter at Chicago Edison, and introducing the two-part rate, Insull set the pattern for rate-making throughout the world. *Id.* at 67–68.

39. See MCDONALD, *supra* note 2, at 68.

40. See INSULL, *supra* note 11, at 85; MCDONALD, *supra* note 2, at 71.

41. See MCDONALD, *supra* note 2, at 53 (noting that Insull’s “harrowing decade of financing Edison’s enterprises on a helter-skelter, hand-to-mouth basis had been enough to last him a lifetime.”).

42. *Id.* at 73, n.29 (quoting Chicago’s leading financial editor, “Such a sale had been thought an impossibility” and citing several sources, including the *Chicago Economist*, the *Chicago Tribute*, and the *Chicago Record*).

43. Flynn, *supra* note 11, at 19.

2. Insull Creates and Perfects a New Industry: Electric Utilities

As noted, during the early years of the electric power industry the self-contained and isolated power plant was the primary mode of generation. Although electricity energizing the incandescent lamp offered a process superior to gas, the high cost of self-contained generators suggested that electricity was destined to be a luxury good, only available to the rich. Insull, however, shared Thomas Edison's deep faith in the potential of central station service. After mastering the economics of load diversity and demand charges, Chicago Edison was quickly winning over large commercial customers in the Chicago Loop with long-term contracts that offered "ridiculously low" prices for electricity.⁴⁴

Despite Chicago Edison's outstanding success, the growth potential of central station service was severely limited by a major technical flaw. The Edison technology used by Insull was primarily designed to power Edison-built lamps, which used direct current (DC) and operated at 100 volts. However, at such a low voltage, the system experienced intolerable line losses in transmission. Therefore, to minimize line losses, service was typically limited to a one-mile radius from a generating station.⁴⁵ But a rival system had been devised by George Westinghouse, which utilized alternating current (AC). AC could be transmitted at high voltages over relatively long distances with considerably lower loss of energy. During the decade of the 1880s, Edison, who had become financially and psychologically wedded to his own DC system, resisted attempts to experiment with AC technology, claiming (probably correctly) that the high voltage made it unsafe for most consumer applications. Yet, Westinghouse was in the process of developing transformer technology that could step down the high voltage appropriate for large capacity transmission lines to provide power for local distribution at lower voltages, such as 100 volts. Perceiving the competitive threat of the Westinghouse system, Insull urged Edison to begin experimenting with AC apparatus. Although Edison grudgingly accepted Insull's advice, the Edison laboratories failed to produce any commercially viable AC equipment.⁴⁶

In 1893, the Columbian Exposition and its White City (a brilliant lighting display) provided important clues about how the AC and DC systems could be effectively linked. Using AC electricity generated on-site by massive General Electric steam engines (that Insull would later purchase for the Harrison Street Station), the Exposition utilized a rotary convertor (a motor-generator set), a recent Westinghouse invention, to convert the AC to DC and thus power a wide range of appliances. Prior to the introduction of this technology, engineers had worked in vain to design AC light bulbs and electric motors that functioned as

44. INSULL, *supra* note 11, at 74-75 (describing the Great Northern Hotel as "the first step in the direction of low prices for large users of energy . . ." and noting that other central station operators "were unwilling to take risks in trying to develop a real knowledge of the economic conditions governing the business.").

45. See LEONARD S. HYMAN, *AMERICA'S ELECTRIC UTILITIES: PAST, PRESENT AND FUTURE* 82-83 (5th ed., Pub. Utils. Reports, Inc. 1994) [hereinafter HYMAN] (discussing technical differences between AC and DC systems along with Edison's persistent efforts to discredit AC power as unsafe).

46. McDONALD, *supra* note 2, at 44 (discussing "battle of the currents" and Edison's opposition to AC power).

well as their DC counterparts. On Insull's initiative, Chicago Edison became the first or second operator to put the rotary convertor to commercial use, transmitting 2300 volts of AC power from the Harrison Street Station to another power plant on the Near South Side, where the power was first stepped down in voltage and then converted to DC and distributed to local homes and businesses.⁴⁷ The experiment proved so successful that Insull soon began building local freestanding substations that merely stepped down the voltage and converted the power flowing from large power plants.⁴⁸

On a technical level, Insull had laid the groundwork for efficient electric service on a metropolitan-wide basis. Further, the prodigious success of Chicago Edison also earned Insull the respect of his peers. In 1897, Insull was elected president of the National Electric Light Association (NELA).⁴⁹ In his inaugural at the 1898 NELA convention, in a speech which would later be viewed as a seminal event in the development of the industry,⁵⁰ Insull articulated a vision of the future that few of his colleagues were ready to accept.

Insull argued that the entire industry had been held back by wasteful competition that "frightens the investor, and compels corporations to pay a very high price for capital."⁵¹ According to Insull, the best service at the lowest possible cost could only be obtained through a monopoly provider that had an exclusive geographic franchise. Although Insull was understood by some as making concessions to advocates of municipal ownership (a movement which had not yet gained much momentum), he, in fact, expressed doubt whether elected officials, confronted by the opportunity, could resist the temptation to use their rate-setting authority to augment the public treasury, thus defeating the goal of pricing electricity at the cost of production.⁵² In lieu of public ownership, Insull proposed a bargain designed to serve the interests of consumers, taxpayers, and investors: (1) a single operator should be given an exclusive franchise to provide electricity on the basis of cost plus a reasonable profit, and pricing on this basis would be enforced by state regulation; (2) to deter monopoly abuse, the public would retain the right to purchase the electric plant; (3) to protect investors (and thus lower the cost of financing), the public's right to purchase must be exercised only at fair value.⁵³

3. Insull and the Movement for State Regulation of Electricity

Insull's startling proposal – public control over private monopolies – initially found few supporters at the NELA convention. However, a small coterie of sympathetic executives were appointed to the NELA's Committee on Legisla-

47. PLATT, *supra* note 11, at 80–81.

48. *Id.*

49. See Samuel Insull, Speech at the 1898 National Electric Light Association Convention 34 n.1 (June 7, 1898) [hereinafter 1898 NELA Speech].

50. PLATT, *supra* note 11, at 86 (observing that 1898 NELA convention "marked a major crossroads in the energy revolution").

51. 1898 NELA Speech, *supra* note 49, at 44.

52. *Id.* at 45–46.

53. 1898 NELA Speech, *supra* note 49, at 45–47.

tive Policy, which Insull created by executive order. Yet, for the next several years, the committee failed to make much progress toward Insull's goals. While Insull's call for regulation may have initially been dismissed by his colleagues as naive or worse, his thinking was basically pragmatic and far-sighted. During the 1890s, Insull looked on as the Chicago streetcar magnate, Charles Yerkes, squandered the good will of the public and became the perpetual target of extortion by the City's corrupt politicians.⁵⁴ Yerkes had cobbled together a group of small traction (streetcar) companies into the most extensive and efficient transit system in the country. However, each of the acquired companies operated under an exclusive franchise agreement granted by the city of Chicago. Under Illinois law, the maximum duration of such an agreement was twenty years. Thus, every few years, the viability of Yerkes's system would be cast into doubt by franchise expirations. Not only did this arrangement make Yerkes exceptionally vulnerable to political extortion, it also destroyed his ability to sell long-term bonds and to expand and modernize his system.⁵⁵

By 1897, Yerkes had become desperate. With all of his most important franchises set to expire within a few years, he appealed to the state legislature to extend for fifty years all existing streetcar and elevated railway franchises. Although the proposed law included a mechanism for sharing revenues with municipalities, it also would have placed control of local transportation companies "in the hands of a state regulatory commission that would, at least by design, be tough, expert, and nonpartisan."⁵⁶ In order to secure the freedom to develop his business free of the shackles of local politics, Yerkes was willing to pay the substantial price of inviting state regulation. However, Yerkes' dismissive attitude toward his customers had already stirred up growing support for municipal ownership of the transit system. When a Chicago journalist speculated in print that Yerkes had established a half-million dollar escrow account to bribe state officials, Yerkes quickly became an easy target for all the Chicago politicians who would be cut out of the system of spoils by Yerkes' legislative proposal. In "one of the most ironic fits of righteous indignation on record," the reform bill backed by Yerkes was scuttled.⁵⁷ In its place, the Illinois legislature passed the Allen Law, which authorized city councils to grant utility franchises for up to fifty years.⁵⁸

Yerkes, however, had become too unpopular to benefit from the new regime. Various Chicago politicians therefore approached Insull to see how much he was willing to pay to prevent the enfranchisement of a competitor. Much to

54. See MCDONALD, *supra* note 2, at 84-85, n.15 (noting that "Yerkes' unqualified and indiscriminating contempt for politicians, customers, and stockholders spoke so loudly that his superior abilities and solid achievements as an entrepreneur were scarcely remarked on" and observing that Yerkes' had become the "principal victim" of the city's corrupt politics).

55. *Id.* at 85-86.

56. MCDONALD, *supra* note 2, at 87. As McDonald notes, the proposed reforms were remarkably similar to Wisconsin's renowned legislation, which created the first public utility commission in 1907 and thereby lent momentum to the Progressive movement. *Id.*

57. MCDONALD, *supra* note 2, at 88.

58. *Id.*

their surprise, Insull rebuffed their demands. Shortly thereafter, the Chicago city council authorized a fifty-year franchise for a shell corporation to be named Commonwealth Electric. When Insull once again refused to budge, steps were taken to actually capitalize Commonwealth Electric. Only then did the Chicago politicians learn that Insull had quietly acquired the exclusive rights to buy from every American manufacturer of electrical equipment.⁵⁹ No new electric company could acquire equipment without Insull's consent. As noted by Forrest McDonald, "Commonwealth could hold its franchise for eternity but could never light a single bulb."⁶⁰ Within four months, Insull obtained Commonwealth Electric for a mere \$50,000. "When the Allen Law was repealed in 1898—and for decades thereafter—Insull was the only electric utility operator in the state with a franchise for more than twenty years, and his franchise would not expire until 1947."⁶¹

As Yerkes liquidated his streetcar holdings in the early 1900s, the remaining traction companies struggled to remain solvent. One of the principal burdens weighing on the industry was the high cost of generating its own electric power. Although Chicago Edison was growing at a phenomenal rate, Chicago's patchwork of street and elevated railways still consumed three times the energy of Edison's combined light and power customers.⁶² In 1902, with the Fisk Street Station, the world's largest and most efficient generating facility, nearing completion, Insull struck a deal with the Lake Street Elevated Company to supply all the electric power needed for a commuter rail system that ran between downtown Chicago and suburban Oak Park.⁶³ Although Lake Street obtained ridiculously low rates for electric power, Insull achieved something even more valuable: a large daytime load that utilized capacity that would otherwise be idle until the early evening, when the demand for commercial and residential lighting would build.⁶⁴ During the next five years, Insull secured contracts to supply nearly thirty percent of all power utilized by the Chicago transit companies. In turn, with these agreements in hand, Insull had little trouble lining up new investors for his utility's ambitious expansion program.⁶⁵

As the growing transit system gradually spilled over the city limits, Insull began to adopt a more regional perspective. The remarkable efficiencies of the Fisk Street Station convinced Insull "that his formula of transit contracts, large generators, low rates, and load management could be applied profitably to the

59. PLATT, *supra* note 11, at 82; MCDONALD, *supra* note 2, at 89.

60. MCDONALD, *supra* note 2, at 89.

61. *Id.* For a similar account of Yerkes' misfortunes and the political wrangling that led to Insull's acquisition of Commonwealth Electric, see Forrest McDonald, *Samuel Insull and the Movement for State Utility Regulatory Commissions*, 32 BUS. HIST. REV. 241, 245-56 (1958).

62. PLATT, *supra* note 11, at 119.

63. *Id.* at 120.

64. See DAVID E. NYE, *ELECTRIFYING AMERICA: SOCIAL MEANINGS OF A NEW TECHNOLOGY, 1880-1940* 92-93 (MIT Press 1990) [hereinafter NYE] ("Insull conducted studies and discovered that because traction loads peaked at different times from the rest of his business, he could supply traction companies with electricity more cheaply than they could produce it for themselves. By 1908, two-thirds of his total load was based on Chicago's streetcars and elevated roads.").

65. PLATT, *supra* note 11, at 120-22.

outlying districts of the city.”⁶⁶ Insull bought several electric utility companies in communities like Evanston and Highland Park that would later become important Chicago suburbs. He also formed the North Shore Electric Company (NSEC), which began experimenting with electrification in low-density residential communities.⁶⁷ In 1907, the NSEC and Chicago Edison were interconnected by high voltage lines, thus marking the beginning of an integrated metropolitan power network.⁶⁸ During the same time period, Insull merged Chicago Edison into Commonwealth Electric Company (thus taking advantage of the fifty-year franchise) to form Commonwealth Edison.⁶⁹ The new company was sixty times larger than Chicago Edison at Insull’s arrival and controlled virtually the entire Chicago service area.⁷⁰ As noted by Richard Munson, “sales [of Commonwealth Edison] surpassed the combined outputs of New York Edison, Brooklyn Edison and Boston Edison.”⁷¹ Moreover, the unit price of Insull’s output had plummeted from twenty cents per kilowatt hour in 1892 to 2.5 cents by 1909.⁷²

Yet, the extension of power throughout an entire metropolitan region posed a new set of problems. Although Insull had successfully negotiated the treacherous waters of Chicago politics (due in no small measure to frequent and unsolicited rate cuts that often preempted his critics), expansion beyond the city limits meant that Insull had to bargain with literally hundreds of small municipalities.⁷³ Moreover, small and medium-sized cities, impatient for reliable and efficient service, were increasingly voting for municipal power plants. Taking advantage of the low interest rates offered by tax-exempt bonds, municipal power companies grew twice as fast as private electric firms, “expanding from 400 in 1896 to more than 1,250 a decade later.”⁷⁴

With the looming threat of municipal expropriation, the executives of the electric power industry increasingly viewed Insull’s pro-regulation stance as a safe-harbor.⁷⁵ Moreover, with a softening of the market for municipal bonds, which dramatically raised the cost of public ownership, reform-minded politicians increasingly acceded to the idea of state regulation.⁷⁶ In 1907, the NELA

66. *Id.* at 164.

67. PLATT, *supra* note 11, at 164.

68. *Id.*

69. PLATT, *supra* note 11, at 132–35; RICHARD MUNSON, *THE POWER MAKERS: THE INSIDE STORY OF AMERICA’S BIGGEST BUSINESS . . . AND ITS STRUGGLE TO CONTROL TOMORROW’S ELECTRICITY* 60–61 (Roddale Press 1985) [hereinafter MUNSON].

70. MUNSON, *supra* note 69, at 60–61.

71. *Id.*

72. Peter Fuhrman, *Do It Big, Sammy*, FORBES, July 13, 1987, at 278 [hereinafter Fuhrman] (discussing Insull’s technical feats).

73. MUNSON, *supra* note 69, at 60–61.

74. *Id.*; see also HYMAN, *supra* note 45, at 127 (noting that “[b]etween 1896 and 1906, the number of municipal systems more than tripled”); MCDONALD, *supra* note 2, at 118 (noting that the rapid growth of municipal power was aided by “the low cost of money and the favorable market for municipal bonds”).

75. See Richard F. Hirsch, *Consensus, Confrontation and Control in the American Electric Utility*, in *THE VIRTUAL UTILITY* 23 (Shimon Awerbuch, ed. 1997) [hereinafter Hirsch] (“[B]y 1907, the bulk of utility managers viewed regulation by expertly-trained men as a means by which the companies could achieve legal monopoly status and avoid the threat of municipal expropriation.”).

76. See MCDONALD, *supra* note 2, at 119; see also NYE, *supra* note 64 (discussing collapse of the mu-

formally adopted a report prepared by its Public Policy Committee, which included Insull and several executives who were sympathetic to Insull's views.⁷⁷ The report bluntly asserted that "the public will is that [utility] companies shall exist, not primarily to make dividends upon certain investments of capital, but as the most efficient means of supplying the public needs."⁷⁸ Thus, in order to avoid public ownership, the report included three central recommendations:

- (1) that the industry, through the N.E.L.A., 'should favor properly constituted general supervision and regulation of the electric light industry'; (2) that regulation should be vested in state commissions, whose members should be appointed in a manner 'that will give them the greatest freedom from local and political influences'; and (3) that commissions should have [the] power to control franchises, protect users against unreasonable or discriminatory rates, enforce a uniform system of accounting, and make public all pertinent information about the affairs of the regulated companies.⁷⁹

During the same period, Insull served on the executive committee of the National Civic Federation, which was highly influential in bringing about progressive labor and business reforms.⁸⁰ In 1907, the federation published a three-volume study of public utilities and municipal ownership, which listed as its first recommendation a principle that Insull had forcefully espoused for more than a decade: that "[p]ublic utilities, whether in public or in private hands, are best conducted under a system of legalized and regulated monopoly."⁸¹ John R. Commons, the distinguished labor historian and economist at the University of Wisconsin, served as one of the full-time investigators for the study and ultimately drew upon his experience to draft the legislation that created the Wisconsin Railroad Commission,⁸² the first agency in the nation to regulate commerce at the state level. By July 1907, the Wisconsin legislature extended this regulatory regime to cover electric utility companies.⁸³ Using the Federation's report and the Wisconsin law as models, within a few years more than thirty states passed laws for the regulation of public utilities, including electric companies.⁸⁴ As noted by technology historian Richard Hirsch, "The regulatory model appeared to have won the day."⁸⁵ Of course, as these private monopolies consolidated and expanded far beyond state boundaries, this issue was destined to be re-

municipal bond market).

77. *Id.* at 114, 117 (discussing how members of the Legislative Policy Committee, which Insull had created by executive order in 1898, were subsequently included on the Public Policy Committee).

78. MCDONALD, *supra* note 2, at 117-18 (quoting N.E.L.A. *Proceedings*, 1907).

79. *Id.* at 118 (quoting N.E.L.A. *Proceedings*, 1904).

80. MCDONALD, *supra* note 2, at 120 (also noting that Louis Brandeis, future Supreme Court Justice, and John Mitchell, head of the United Mine Workers, served on the committee).

81. *Id.* at 120 (quoting NAT'L CIVIC FED'N, 1 MUNICIPAL AND PRIVATE OPERATION OF PUBLIC UTILITIES (1907)).

82. MCDONALD, *supra* note 2, at 121.

83. Hirsch, *supra* note 75, at 24.

84. MCDONALD, *supra* note 2, at 121; *see also* Hirsch, *supra* note 75, at 24 ("By 1914, 45 states had established some form of apparatus for regulation [of] utility companies though not always regulating electric power companies.").

85. Hirsch, *supra* note 75, at 24.

visited at the federal level.

C. *Middle West Utilities and the Coming of the Holding Company Era, 1912–1926*

In 1911, Insull created the world's largest power station by placing ten twelve-megawatt turbines in the Fisk Street Station along the Chicago River. As Insull's engineers continued to exploit the seemingly inexhaustible economies of scale in the industry, Insull's lawyers and accountants established a holding company, Middle West Utilities (Middle West), as the primary vehicle for financing the acquisition of power companies outside the Chicago metropolitan area.⁸⁶ Similar holding companies were being formed on the East Coast by Sidney Mitchell (Electric Bond and Share) and H.M. Byllesby (Standard Gas and Electric), both of whom Insull had worked with during his tenure with Edison.⁸⁷ Although the consolidation within the industry was undeniably being driven by the efficiencies of superior management and better (but costly) technology,⁸⁸ the giant egos of these industry moguls no doubt played a part in stimulating the sprawling growth of utility holding companies that defied all economic logic.⁸⁹

The capital structure of Middle West, which initially sold \$4.5 million of preferred and common stock to the public, was deliberately designed to give Insull absolute control over a geographically diverse array of operating companies with a disproportionately small initial investment.⁹⁰ With Insull's unparalleled record of growth and profitability as an operator, these terms nonetheless proved attractive to investors. In 1912, operating companies controlled by Middle West owned a mere 600 miles of power lines serving 140 small towns in southern Indiana.⁹¹ Over the next five years, Middle West pursued a plan of steady and deliberate growth that encompassed 400 communities in thirteen states.⁹² Yet, the financial payoff to Insull or his investors was by no means obvious. As ob-

86. MUNSON, *supra* note 69, at 62; Flynn, *supra* note 11, at 20 (discussing how the successful turnaround of several Indiana utilities prompted Insull to create Middle West Utilities and apply this formula at other locations).

87. Flynn, *supra* note 11, at 21.

88. See THOMAS P. HUGHES, NETWORKS OF POWER: ELECTRIFICATION IN WESTERN SOCIETY, 1880–1930 403 (John Hopkins Univ. Press 1983) (“Expansion [of the electric utility holding companies] was not simply an aggressive drive for undifferentiated size. It was a purposeful move to lower the cost of energy.”).

89. Walter M.W. Splawn, who served as special counsel to the FTC's massive investigation of utility holding companies stated, “there grew up the practice of pyramiding one company on top of another in order to enable promoters to acquire control of vast properties with a minimum of investment and risk of capital. . . . The waste from the abuses of this mushroomed and illogical growth has cost the American people billions of dollars.” *Relation of Holding Companies to Operating Companies in Power and Gas Affecting Control*, H. REP. NO. 827, Part 2, at vi (1934); see also JAMES C. BONBRIGHT, PUBLIC UTILITIES AND THE NATIONAL POWER POLICIES 24–25 (Columbia Univ. Press 1972) (1940) (commenting that the sprawling growth of the electric utility holding companies “def[ie]d] the principles of regional planning and of engineering integration” and that “in their rivalry with each other to buy up properties they paid exorbitant prices in cash or in securities—prices on which there was no hope of earning an adequate return, except, perhaps, through a levy of extortionate rates upon their customers.”).

90. Flynn, *supra* note 11, at 21 (discussing the mechanics of the holding company and the sale by Middle West Utilities Company of preferred stock with no voting power).

91. *Id.* at 20–21.

92. MCDONALD, *supra* note 2, at 155–56, n.30.

served by Insull's biographer, Forrest McDonald:

As a business, Middle West was expanding and keeping afloat, meeting its interest payments, amortizing the discounts on its stocks, making the payments on its preferred stock, and occasionally paying modest dividends on its common stock. But though hopes for its financial future might be bright, it would have been clear to anyone less optimistic than Samuel Insull that Middle West would never be as strong as its subsidiaries and would always be better at building utilities than at making money.⁹³

Surprisingly, the entrance of the United States into World War I in 1917 proved to be a pivotal moment in the growth of Insull's holding company empire. As one of the state's leading businessmen, Insull was asked to serve as head of the State Council of Defense. This agency was designed to work with the newly created Council of National Defense, which President Wilson had established only a few months earlier. Working with a former newspaperman and brilliant publicist, Bernard J. Mullaney, Insull created a remarkably potent public relations machine that enlisted the state's editors as active propagandists and "enrolled a small army of ministers, fraternal orders, labor organizations, nationalistic societies, mayors, and civic and commercial groups to stage" events and provide public speakers.⁹⁴ Starting with a modest \$50,000 budget, the Council raised an impressive \$24 million for war relief, actually returning a profit of more than \$450,000 to the state and federal treasuries.⁹⁵ In addition, the Council assumed the unofficial task of selling Liberty Bonds in Illinois. "Using high-pressure, razzle-dazzle salesmanship the council induced patriotic citizens to spend more than \$1,300,000,000 for Liberty Bonds in a period of eighteen months."⁹⁶ Awed by Insull's well-publicized success as a fund-raiser, citizens often opined that if Insull "had been running the war, he would have run it at a profit."⁹⁷

Yet, through his experience as head of the State Council of Defense, Insull gained new insights into the creation of a favorable public attitude toward electric utilities and into financing the expansion of his holding company empire. In one of Insull's first moves after the war, the propaganda machinery of the State Council of Defense, which operated as the Committee on Public Information, was transformed "man for man, from Bernard J. Mullaney on down," into the Committee on Public *Utility* Information.⁹⁸ Drawing on his experience of using high-pressure sales tactics to sell Liberty Bonds to the public, Insull also commenced an immensely successful program of "customer ownership," which

93. *Id.* at 156.

94. MCDONALD, *supra* note 2, at 170.

95. *Id.* at 172; *see also* SAMUEL INSULL, PUBLIC UTILITIES IN MODERN LIFE 173 (William Eugene Keily, ed. private printing 1924) (discussing the finances of the State Council of Defense).

96. MCDONALD, *supra* note 2, at 172.

97. *Id.*

98. *Id.* at 182; *see also* MUNSON, *supra* note 69, at 66 ("Intoxicated by his PR machine's ability to raise money and influence public opinion, Insull simply changed the war council's name in March 1919 to the Committee on Public Utility Education and sought to equate patriotism with a favorable attitude toward utilities.").

sought to defuse political attacks on public utilities by turning potentially angry voters into Insull stakeholders.⁹⁹ At the same time, Insull and the investment banking firm of Halsey, Stuart and Company pioneered exploitation of the retail market for corporate bonds. Although selling thousands of bonds having a face value of \$1000 was an unwieldy operation, the number of willing investors was potentially inexhaustible. Utility holding companies such as Middle West had an irresistible pitch: “if the light shines, you know your money is safe.”¹⁰⁰ Further, with widely dispersed bondholders and shareholders, Insull was no longer at the mercy of a handful of well-heeled corporate financiers and thus could do as he pleased.¹⁰¹

Insull’s campaign of promotion of populist capitalism proved to be an enormous success. In a 1921 speech, Insull’s public relations wizard, Bernard Mullaney, reported:

Many hold that Illinois is now the best-educated State in the Union on the utility industry. Surely the process of educating it has been of some help to the customer ownership campaigns by means of which the number of utility security holders in the State has been increased from 50,000 in 1919 to nearly 500,000 now—an impressive figure, the significance of which is being conveyed to the utility-baiting politician.¹⁰²

By the mid-1920s, customers signed up for residential service at a record pace and bought an ever widening array of electric appliances (e.g., irons, vacuum cleaners, toasters, coffee percolators, and washing machines) relentlessly promoted by Insull’s army of marketers. Between 1915 and 1925, Commonwealth Edison customers more than doubled their per capita use of electricity, making Chicago “the most energy-intensive city in the world.”¹⁰³ To Insull investors, most of whom resided in Illinois, the maturation of the Chicago market afforded a dizzying glimpse of the financial prospects of Insull’s holding companies, such as Middle West Utilities, which now provided service in thirty-two states, accounting for one-eighth of the nation’s total output of electricity and

99. MCDONALD, *supra* note 2, at 203 (noting that most of the stock sold to the public was non-voting preferred stock).

100. MUNSON, *supra* note 69, at 67–68.

101. MCDONALD, *supra* note 2, at 204–5 (noting that “with four investors [Insull] was at the mercy of four men, while with a thousand [investors Insull] was at the mercy of no man.”). In 1932, when Adolf Berle and Gardiner Means’ published their classic book on the rise of the modern corporation, their analysis certainly applied to the Insull empire:

The [emerging] corporate system appears . . . [when] a large measure of separation of ownership and control has taken place through the multiplication of owners. . . . Under such conditions control may be held by the directors or titular managers who can employ the proxy machinery to become a self-perpetuating body, even though as a group they own but a small fraction of the stock outstanding.

ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 4–5 (Macmillan Co. 1933). Shortly after its publication, *The Modern Corporation* became suddenly and mysteriously unavailable in Chicago. Berle, who was at that moment working as a speech writer in Franklin D. Roosevelt’s presidential campaign, attributed the disappearance to the Committee on Public Utility Information. See MCDONALD, *supra* note 2, at 310 n.8.

102. M.L. RAMSEY, *PYRAMIDS OF POWER: THE STORY OF ROOSEVELT, INSULL AND THE UTILITY WARS* 136 (1st ed. Bobbs-Merrill Co. 1937) [hereinafter RAMSEY] (quoting Mullaney speech).

103. PLATT, *supra* note 11, at 235.

gas.¹⁰⁴

In many respects, Middle West and other large holding companies were uniquely well-positioned to take on the highly technical challenge of providing reliable and economical electric power to the nation's vast rural and low population-density regions.¹⁰⁵ As noted by historian Thomas Hughes, "[e]ngineers and technically trained managers [such as Insull, Sidney Mitchell, and H.M. Byllesby] dominated the early history of major holding companies."¹⁰⁶ As these operators bought out financially strapped local operations, the holding company apparatus leveraged its expertise in engineering and management services.¹⁰⁷ Further, holding companies had established reputations in the capital markets, which significantly reduced the staggering costs of expanding and modernizing the nation's electric infrastructure.¹⁰⁸ Yet, because the process of electrification was in the hands of large, unregulated interstate holding companies intent on turning a profit,¹⁰⁹ there were large disparities in the levels of service available in

104. See TOBIN, *supra* note 12, at 128.

105. Following the public backlash against electric utility holding companies, including the passage of the Public Utility Holding Company Act of 1935, several commentators acknowledged that the holding company device had initially served an important function in the development of cheap, universal power. See, e.g., Norman S. Buchanan, *The Public Utility Holding Company Problem*, 25 CAL. L. REV. 517, 517 (1937) ("During the early days of the electric power and light industry the problems of how to procure sufficient capital and efficient management were vitally important; the holding company device seemed to provide a working solution to both difficulties."); Comment, *Federal Regulation of Holding Companies: The Public Utility Act of 1935*, 45 YALE L.J. 468, 473 (1936) ("It is generally conceded . . . that an integrated holding company system could furnish to the public better and cheaper service than small, independent companies. The fact, however, is that the holding companies have . . . neglected to employ their advantages in the public interest."); JAMES C. BONBRIGHT & GARDINER C. MEANS, *THE HOLDING COMPANY: ITS PUBLIC SIGNIFICANCE AND ITS REGULATION* 7 (McGraw-Hill Book Co. 1932) [hereinafter BONBRIGHT & MEANS] ("The conclusion to which we are led, as a result of the study outlined in [this book on holding companies], is, first, that the public utility holding company has been a great factor in the development of efficient electrical systems throughout the country, and, second, that its almost complete freedom from regulation has become a major public menace.").

106. HUGHES, *supra* note 88, at 393.

107. *Id.* at 393-94 (noting that holding companies "provided the small operating company with the experts' solutions to the problems of generation, transmission, distribution, and utilization of electricity"); see also Samuel Insull, *How Has it Been Done?* in *UTILITY CORPORATIONS*, 70th Cong., 1st sess. Senate. Doc. 92, Exhibits vol. I; 321, 324-25 (1935) (excerpt from 1925 speech, in which Insull commented that the holding company "is more properly an investment company; even more accurately perhaps, a development company. Its primary purpose is to expand and energize the facilities and resources and activities of the local or subsidiary companies that are under its wing, and to broaden opportunities for safe investment.").

108. See Insull, *supra* note 107, at 325 (explaining that holding companies, "having established a high credit rating, sees that the capital is provided, and provided at lower interest rates than the local company could get for itself").

109. Although the holding companies owned literally hundreds of regulated public utilities, they were not themselves subject to any regulation. See BONBRIGHT & MEANS, *supra* note 105, at 7 (1932), stating:

"[T]he holding company has become the greatest of the modern devices by which business enterprises may escape the various forms of social control In the furtherance of this object, the holding company has been blessed with the traditional legal doctrine that a company which owns the controlling stock interest in a railway or utility company is not itself a common carrier or a public utility, and that it is therefore not 'affected with a public interest.'"

Id.

The Supreme Court's ruling in *Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927), which precluded states from regulating any wholesale interstate transactions by utility companies, provided further protection to holding companies. See, e.g., *Duke Power Co. v. FERC*, 401 F.2d

different parts of the country.¹¹⁰ Although the holding companies, through the well-organized public relations and lobbying efforts of the NELA, had amassed enormous economic and political power, many underdeveloped portions of the country were becoming increasingly impatient for the advantages of cheap and plentiful electric power.¹¹¹ Moreover, even in regions with excellent service, there were legitimate questions whether excessive fees charged to operating utilities by service companies owned by holding-company parents were artificially inflating costs to consumers. By the mid-1920s, populist critics of holding companies began to rail against the “power trust” and to champion the idea of public ownership. In the coming years, Samuel Insull and Franklin D. Roosevelt would occupy the highly visible poles of this debate.¹¹²

D. *The Rise and Fall of Insull as an Icon, 1926–1932*

During the decade of the 1920s, the American public was increasingly won over by the social and economic potential of electric power. As the per unit cost of electricity continued to drop, electric service rapidly became an amenity available to most American households. Between 1922 and 1930, the generating capacity of the nation’s electric operators almost doubled, rising from 22 million kilowatts to 43 million.¹¹³ To facilitate such prodigious growth, the electric utility industry experienced two dominant tendencies. First, the industry was rapidly consolidating, with the number of operating companies dropping from 6355 in 1922 to 4409 five years later.¹¹⁴ Second, successful utility operators such as Insull were increasingly resorting to the holding company device to raise sufficient capital to modernize and expand the existing electric infrastructure. Thus, while operating companies were becoming larger but less numerous, the number of electric utility holding companies was growing at a relatively rapid pace.¹¹⁵

930, 934 (D.C. Cir. 1968) (noting that “[i]n the laissez-faire milieu thus created [by *Attleboro*,] utility holding companies flourished, and behind the Attleboro shield abuses became flagrant.” (footnotes omitted)). Congress filled the “Attleboro gap” a few years later by passing the Federal Power Act and the Public Utility Holding Company Act of 1935. *Id.*

110. As noted by one commentator of the holding company era:

The density of the number of isolated establishments—municipal or private—in any given area, has been a factor [in the development of interconnected power networks]. In states with a high density of small isolated municipals, Georgia, Illinois, Michigan, Ohio, Oklahoma and Minnesota, among others, it required fewer miles of transmission line on the average to connect the various distributing systems with central generating plants that it does to connect the widely scattered municipals in California, Colorado, Utah, Washington, or Wyoming. Hence, it was more profitable for the private companies to purchase municipal establishments in the former than in the latter groups.

Ralph L. Dewey, *The Municipal Plant: Is it Coming or Is it Going?*, PUB. UTIL. FORT., June 12, 1930, at 720–21.

111. PLATT, *supra* note 11, at 266.

112. GRANT & KATZ, *supra* note 4, at 222–23 (discussing rapid growth of electrical service during the 1920s and placing Insull within that context).

113. GRANT & KATZ, *supra* note 4, at 222–23 (discussing rapid growth of electrical service during the 1920s and placing Insull within that context).

114. HYMAN, *supra* note 45, at 102–03 (discussing growth of electrical industry and lucrative nature of holding company financing and noting that “[b]etween 1922 and 1927, the number of holding companies rose from 102 to 180, while the number of operating companies [due to consolidation] fell from 6,355 to 4,409”).

115. *Id.* (reporting that the number of electric utility holding companies went from 102 in 1922 to 180 in

A handful of holding companies, however, were beginning to dominate the field. Samuel Insull, who was credited with expanding access to cheap, reliable power while simultaneously enriching his numerous middle-class investors, was indisputably the most celebrated and well-known figure within the industry. As Insull's biographer, Forrest McDonald, observed:

In the hero-worshipping postwar decade, Insull became the Babe Ruth, the Jack Dempsey, the Red Grange of the business world. The people—butchers, bakers, candlestick-makers who invested their all in his stocks—fairly idolized him, and even titans viewed him with awe. He measured up to America's image of itself: a rich, powerful, self-made giant, ruthless in smashing enemies, generous and soft-hearted in dealing with the weak. His doings, small and large, became a great spectator sport, and they were reported and followed accordingly.¹¹⁶

Insull had dominated every arena he entered. In 1912, a visiting writer opined that the city of Chicago could more accurately be dubbed "Insullopolis."¹¹⁷ A few years later, as Middle West continued to prosper, Insull came to be known as "the uncrowned king of Illinois."¹¹⁸ Not surprisingly, during the 1920s, when his holding company empire acquired operating companies in over thirty states, Insull became "a welcome and frequent guest at the White House."¹¹⁹

1. The Public Utility Holding Company

Insull's rise and fall coincides exactly with the ups and downs of the electric utility holding company. The abusive practices of the Insull holding companies, bound up with their eventual collapse, are often cited as the driving force behind several pieces of New Deal legislation,¹²⁰ including the Public Utility Holding Company Act of 1935 (PUHCA).¹²¹ The PUHCA essentially eliminated sprawling, interstate holding companies of Insull dimensions in the gas and electric industries.¹²² Further, the accounting and disclosure requirements of the New Deal

1927).

116. MCDONALD, *supra* note 2, at 237.

117. RAMSEY, *supra* note 102, at 56.

118. *Id.*

119. RAMSEY, *supra* note 102, at 56.

120. See note, *supra*, and accompanying text; see also GRANT & KATZ, *supra* note 4, at 224–45 (recounting the aftermath of Insull's collapse). "It is not an exaggeration to see in the legislative innovations of the New Deal a phoenix arising from the ashes of the Insull empire." *Id.* at 245.

121. See, e.g., Peter Behr, *In Enron's Fall, an Echo of the 1930s*, WASH. POST, July 13, 2003, at E2 (observing that the PUHCA was "passed in 1935 to effectively outlaw the kinds of corporate empires Insull and his peers created in the [electrical] industry's formative years"); SELIGMAN, *supra* note 1, at 122 (noting that in Section 11 of the PUHCA, "the controversial 'death sentence' provision of the act" was designed "[t]o deal with the sprawl and inefficiency of public utility empires, such as that of Samuel Insull"); Jim McTague, "Big John," *Though in a Minor Role These Days, Stands as a Big Roadblock to Utility Deregulation*, BARRON'S, Feb. 3, 1997, at 29 (noting that "Congress enacted [the PUHCA] mainly in reaction to one man, Samuel Insull," and recounting the details of Insull's spectacular fall); ROBERT F. RITCHIE, INTEGRATION OF PUBLIC UTILITY HOLDING COMPANIES 2 (1954) ("The Insull debacle impressed upon the public the need for some sort of regulation to prevent the recurrence of such financial slaughter and was thus the prime causative factor in the enactment of the Public Utility Holding Company Act of 1935.").

122. See SELIGMAN, *supra* note 1, at 259 (noting that "[t]he cumulative effect of the SEC's 11(b) proceedings against Electric Bond and Share, the United Corporation, and the Insull interests was to transform

federal securities laws now ensure that investors can more easily ascertain the amount of debt in proportion to equity carried by a holding company. (Indeed, as discussed in Part IV.A, the availability of this information is a distinction between Insull and Enron before their respective debacles.) As a result, the fact that a holding company is constituted only of regulated electric utilities (each with an allowed rate of return) may be viewed alongside the salient facts of the holding company's degree of leverage, which can dramatically magnify both risk and return.

That said, during the pre-New Deal era, the holding company device played a crucial role in the enormously demanding and expensive task of building an efficient and reliable electric infrastructure.¹²³ By placing huge amounts of capital at the disposal of a few highly skilled, technologically sophisticated entrepreneurs, the holding company device seemed to have the potential for drawing upon the benefits of central planning while stepping around the pitfalls of bureaucratic inefficiency and sloth.

In 1940, Professor Bonbright observed three principal advantages of the holding company framework. First, large holding companies can "secure capital on more favorable terms" than a small, municipal plant.¹²⁴ Second, holding companies can coordinate investment decisions for an entire regional network based on engineering factors rather than political boundaries. Third, a large holding company system can attract and cultivate a larger pool of engineering talent, which, in turn, can be deployed on an ad hoc basis to a wide array of companies and locations within the system. However, Professor Bonbright points out that, "during the stock-market boom of the 1920's the utility holding company became an instrument of high finance that . . . has no parallel in the entire history of American business—not even in the earlier history of the railroads."¹²⁵ Bonbright concluded that "the holding companies, by their unsound financial practices, just about neutralized the advantages which they possessed over small, isolated operating companies."¹²⁶

The "unsound financial practices" to which Bonbright referred involved the technique of pyramiding an array of holding companies, typically with a capital structure heavily biased toward bonds and toward preferred stock with a guaranteed dividend, to secure the ownership of a large stable of diverse electric operating companies. With the growth of electric service throughout the country, the revolutionary potential of electricity had captured the public imagination. Moreover, the bonds and preferred stock of successful operators, such as Insull, seemed like a perfectly safe investment. Yet, the insatiable public demand for holding company securities meant that skilled electric operators now had two ways to make money: (1) by selling electric power to consumers, and (2) by

three super-holding companies that directly or indirectly had controlled about half of the nation's electrical generation into approximately forty-five regional, state, or local utility companies.").

123. See *supra* note 105.

124. BONBRIGHT, *supra* note 89, at 23.

125. *Id.* at 24.

126. BONBRIGHT, *supra* note 89, at 26.

promoting stocks and bonds to the investing public.¹²⁷ And, because electricity, largely through the efforts of Insull,¹²⁸ had become a state-regulated industry with a fixed rate of return, the rapid growth of electric power demand made the business of stock promotion far more lucrative.¹²⁹

In theory, a highly leveraged holding company pyramid with a major constituent of fixed-return securities can service its obligations to bond and preferred stock holders and still return a comfortable profit to common stock holders. This occurs if the return on the fixed assets adequately exceeds the requirement for interest and dividend payments *and operating revenues continue to grow*. However, debt and equity investors near the top of the pyramid and far removed from the operating assets bear the bulk of the risk that is typically associated with leverage—in good times, rapidly burgeoning profits; in bad times, the danger of losses.¹³⁰ In his public speeches, Insull cast investments in his holding companies in a soft and mellow light. In April 1925, Insull expressed the opinion that the “so-called ‘holding company’ in the electric light and power business” is actually an “investment company” that could “expand and energize the facilities and resources and activities of the local or subsidiary companies that are under its wing, and [could] broaden opportunities for safe investment.”¹³¹ Insull then stated:

This type of investment company, as adapted to the public utility industry here, serves the investor as the foreign “investment” trust does. Its securities enable him “to put his eggs in more than one basket even though he has only one egg.” It does this by applying the insurance principle; by spreading the risk and so minimizing it; for, back of the investment or “holding” company’s securities, lies the earning power of several companies doing a highly diversified business in diversified com-

127. For example, in 1923, Insull commented, “‘They used to say . . . that if we issued a piece of brown paper with a signature on it we could raise all the money we wanted to.’” RAMSEY, *supra* note 100, at 254 (alteration in original) (quoting Insull from the *Chicago Tribune*, Nov. 4, 1923).

128. See *supra* notes 76–85 and accompanying text.

129. See HYMAN, *supra* note 45, at 102–03 (noting that during the 1920s, “promoters saw the huge profits to be gained from [the] holding company business, [and] they began to bid against each other to buy operating properties to put into the holding companies . . .”); cf. CARL D. THOMPSON, CONFESSIONS OF THE POWER TRUST 96–97 (1932) quoting Samuel Ferguson, President of Hartford Electric Company, *Electric World*, Mar. 20, 1926:

The outstanding danger of the holding company situation centers around the investor rather than the consumer. . . . I know of no more reprehensible abuse than for speculators to buy up companies for high prices, put them in a holding company, and then, by trading upon the credulity of the investing public relative to claimed increases in economy to unload the holding company’s securities at advanced prices and thus get completely out from under before the bubble is punctured leaving the unfortunate final investor to face an angry consumer.

130. See, e.g., BONBRIGHT & MEANS, *supra* note 105, at 46–47, stating:

While a top-heavy superstructure of this nature may please a management that is interested in maintaining control by the ownership of the thinnest possible equity, it must displease any management that is interested in the financial integrity of the system rather than in the opportunity of stock-jobbing profits. Indeed, even the most speculative management must be aware of the dangers lurking in a top-heavy financial structure which may collapse at any time, and which may place the control of the [operating] properties in the hands of the senior security holders.

Id.

131. See Insull, *supra* note 107, at 324 (speech before the NELA).

munities.¹³²

Notwithstanding any benefits of diversified holdings, the financial health of Insull's highly leveraged empire was obviously highly dependent on the continued growth of the electric industry. Perhaps, from Insull's vantage point, the sky was the limit. In 1927, a financial reporter for *Forbes* magazine queried Insull on the potential dangers of leveraged holding companies if revenues in the industry began to drop. Insull replied, "A slump or calamity that would be disastrous [for electric utilities] is practically inconceivable."¹³³

2. The Frank Smith Episode and the FTC Investigation

By the mid-1920s, Samuel Insull was the nation's most famous utility operator. Insull companies produced highly reliable, affordable electric power for a broad range of U.S. consumers in urban, suburban, and rural locales. Further, for over a decade, the companies organized under the ever-widening Insull holding company umbrella had consistently made interest and guaranteed dividend payments to a broad array of middle-class investors. Because of the heavily leveraged nature of his pyramidal capital structure, Insull directly controlled over half a billion dollars worth of capital investment with an equity stake of less than \$30 million.¹³⁴ With an unparalleled record of success, and with the adulation of consumers, investors, and politicians, Insull had little reason to doubt his own judgment.

Yet, during the 1926 United States Senate race in Illinois, Insull may have finally overplayed his hand. In a bitterly fought Republican primary, Insull contributed nearly \$160,000 to the campaign of Frank L. Smith, chairman of the Illinois Commerce Commission.¹³⁵ Although Insull's biographer, Forrest McDonald, charitably attributed this generosity to Insull's deep-seated enmity toward

132. *Id.* at 324–25.

133. James W. Michaels, *History Lesson*, *FORBES*, Dec. 24, 1990, at 38, 39 (alternation in original) (quoting Insull from a 1929 *Forbes* interview).

134. Among the numerous sources consulted for this Article, there are broad discrepancies in both the value of public investment in Insull companies and Insull's own equity stake. Compare HYMAN, *supra* note 45, at 138 ("With a capital investment of about \$27 million, Insull controlled at least half a billion dollars of assets in 1930."), with Fuhrman, *supra* note 72, at 278 ("Insull, with only \$ 150 million in personal wealth at his peak, controlled \$3 billion in assets."), and Seligman, *supra* note 1, at 22 (noting that when "the heavily indebted Insull system" collapsed in September 1931, "[n]ewspapers claimed that the fall of the \$3 billion empire was 'the biggest business failure in the history of the world.' Insull's personal fortune of over \$150 million also vanished."). These discrepancies are probably due to the dramatic rise in market price of Insull securities during the stock market bubble of the 1920s and the various divergent methods for valuing these securities. For a meticulous breakdown of the losses from Insull securities suffered by the investing public, including an explanation of the valuation problems involved, see Arthur R. Taylor, *Losses to the Public in the Insull Collapse, 1932–1946*, 36 *BUS. HISTORY REV.* 188, 188 (Summer 1962) (calculating that as of 1932, the public owned "a total of \$2,647,000,000 of [Insull] securities" and that the total loss to investors, as of 1946, "when all reorganizations in the system had been completed and claims of security holders had been adjusted . . . [was] \$638,000,000, or a percentage loss of 24.1 per cent."). As Professor Taylor notes, "Insull investors suffered losses almost exclusively in the collapse of the great investment trusts and holding companies [as opposed to Insull operating companies]." *Id.* at 194.

135. McDONALD, *supra* note 2, at 262 (noting that Insull gave \$125,000 directly and another \$33,735 to propaganda efforts against the World Court, "that being Smith's principal issue").

the incumbent, Senator William McKinley, a traction magnate from southern Illinois,¹³⁶ Insull was certainly aware of the political fallout that might follow if the public learned that the state's largest utility operator had financed the campaign of the state's top utility regulator. Between December of 1925 and the April 1926 primary, Insull made three *cash* payments to Smith's campaign manager totaling \$125,000.¹³⁷

During the spring of 1926, the U.S. Senate created a Special Committee to investigate corrupt campaign practices in senatorial elections.¹³⁸ The infusion of cash into Frank Smith's campaign caused McKinley to escalate his own spending during the 1926 primary elections, involving the contribution of a substantial share of his own fortune. After hearing an account of the Illinois situation from a member of McKinley's staff, the Special Committee quickly turned its attention to the recent Illinois primary elections.¹³⁹ During the subsequent investigation, the Special Committee discovered that Insull's direct and indirect contributions to candidates in the senatorial primary election in Illinois totaled more than \$238,000.¹⁴⁰ Further, this amount included \$15,000 to the leading Democratic candidate, George Brennan, which constituted eighty percent of Brennan's total campaign contributions,¹⁴¹ and \$10,000 to a Republican group that supported McKinley (though Insull denied that he knew this at the time).¹⁴² As one news story noted, Insull had managed to be "[h]elp[ful] on all sides."¹⁴³ However, there was an enormous political backlash against the largesse bestowed upon Smith.¹⁴⁴ When Smith eventually prevailed in the general election, the U.S. Sen-

136. *Id.* at 262 (noting that "Smith's record as a regulator of Insull utilities had been such as to lend credence to Insull's later protestation that he was motivated only by his longstanding personal enmity toward McKinley. . .").

137. CARROLL H. WOODY, *THE CASE OF FRANK L. SMITH* 52-53 (Univ. of Chicago Press 1931).

138. *Id.* at 23 (quoting Senate resolution that created a special committee "to investigate what moneys, emoluments, rewards, or things of value, including agreements or understanding of support for appointment or election to office have been promised, contributed, made or expended . . . by any person, firm, corporation, or committee, organization or association to influence the nomination of any person as a candidate of any political party or organization for membership in the United States Senate").

139. WOODY, *supra* note 137, at 24-25 (discussing how the Special Committee turned its attention to Illinois at the behest of Senator Caraway of Arkansas, who was a close friend of McKinley).

140. *Id.* at 56.

141. *Frank Smith Spent \$253,547 in Illinois; M'Kinley \$260,000*, N.Y. TIMES, July 27, 1926 at 1 (reporting Brennan's testimony that his campaign contributions during the primary consisted of \$15,000 from Insull and plus an additional \$3,000 from two friends).

142. *Insull in Defiance Refuses Gift Data*, N.Y. TIMES, Aug. 5, 1926, at 1 (reporting on Insull's admission that he inadvertently gave money to the McKinley campaign and Insull's subsequent refusal to answer Senator Reed's follow-up questions, informing Sen. Reed, "I'm not used to being cross-examined. You're too smart for me.").

143. *Insull Fund Rises to \$ 971,603 Total*, N.Y. TIMES, July 29, 1926, at 1 (summarizing Insull contributions to candidates and groups involved in the 1926 Illinois primary for the U.S. Senate).

144. See, e.g., MCDONALD, *supra* note 2, at 267 (reporting that Insull "was not at all squeamish about admitting large contributions to Smith's campaign" and that "newspapers across the country clucked editorially that he was 'brazen,' 'insolent,' and 'arrogant'"); *Rich Men and Corrupt Politics*, N.Y. TIMES, Mar. 6, 1927, at E10 ("What aroused the public conscience in the [Insull] matter was the fear that we were in for a return of the old days when it was not considered wrong, or at least not unnatural, for a railroad to buy up a Legislature . . ."); *Denounces Illinois Funds*, N.Y. TIMES, Sept. 22, 1926, at 26 (President of Indiana Telephone Association condemning Insull's campaign contributions to candidate who had rate-making authority over him and stating

ate refused to let him take his seat.¹⁴⁵

During the winter of 1927, several senators who were sympathetic to the development of electric power by the Federal government, particularly at Muscle Shoals (a World War I project) and in the Boulder Canyon, used the negative publicity generated by the Smith affair to advance their argument that a vast “power trust” was exerting a dangerous influence over the nation’s electoral politics.¹⁴⁶ In particular, George Norris, the progressive Republican Senator from Nebraska, railed against Insull, arguing that the issue of seating Smith “is not a question of Illinois being deprived of her two votes in the Senate”; rather, “it is a question of Mr. Insull being deprived of his votes in the Senate.”¹⁴⁷ Norris also cited Insull’s political activities in Maine as further evidence that Insull was circumventing honest elections and helping to destroy a “fundamental cornerstone of this democracy.”¹⁴⁸ Further, during approximately the same period, Norris launched into a tirade about the “exorbitant” price of electricity, noting that electric rates of some U.S. citizens were up to fifteen times higher than their Canadian counterparts.¹⁴⁹

With the public embarrassment that surrounded the Frank Smith episode, Insull endured his first significant setback in the arena of public opinion. The political assault directed at Insull and other members of the alleged power trust eventually culminated in the Senate’s passage in 1928 of a resolution directing the Federal Trade Commission (FTC) to undertake an extensive investigation of the nation’s gas and electric utility companies.¹⁵⁰ This undertaking took seven years to complete and ultimately produced findings and exhibits that spanned eighty-four book-length volumes. Although the investigation plodded along for several years without much impact or compelling public testimony, the newspapers of the late 1920s and early ‘30s often provided sensational coverage.¹⁵¹ In turn, this created an opportunity for progressive politicians to engage in full-throated attacks on Insull and other electric utility magnates.¹⁵² The FTC’s conclusions are memorialized in section 1 of the PUHCA and there served as the factual basis for dismantling the giant holding companies. Yet, irrespective of any claims that *consumers* had been ill-served by the pyramidal structure of elec-

that “our business cannot afford to tolerate that sort of thing in the ranks of fellow public utilities without frank repudiation.”).

145. MCDONALD, *supra* note 2, at 267; *Senate, 48 to 33, Refuses to Seat Smith: Demands Prompt Committee Inquiry; Democrats May Control Next Session*, N.Y. TIMES, Jan. 21, 1927, at 1 (noting that outcome of vote was widely anticipated, even by Smith).

146. MCDONALD, *supra* note 2, at 266–67 (noting efforts of Senators Norris of Nebraska and Walsh of Montana).

147. ROCHARD LOWITT, GEORGE W. NORRIS: THE PERSISTENCE OF A PROGRESSIVE 1913–1933 393–94 (1971) (commenting that Norris exploited Smith’s connection to Insull “to the utmost”)

148. *Id.*

149. MUNSON, *supra* note 69, at 76 (reporting on Norris reaction after reviewing the electric bill of a Canadian citizen).

150. See S. Res. 83, 70th Cong., 1st Sess., Rept. No. 225 (Feb. 13, 1928).

151. See MCDONALD, *supra* note 2, at 268 (noting that the FTC’s rather prosaic early findings were seized upon by “newspapers seeking circulation” and that “[a]lmost daily from 1928 to 1935, increasing numbers of newspapers . . . blasted the utilities or Insull or other giants of the industry”).

152. *Id.*

tric utility holding companies, reform of the industry was a forgone conclusion by 1932, when holding company *investors* suffered massive and unexpected financial losses. Thus, virtually overnight, Insull was deprived of his most vocal and devoted constituency. During the 1932 presidential campaign and thereafter, Insull became a veritable poster boy for all the evils of the capitalist system.

3. Cyrus Eaton, the Great Crash, and Control of the Insull Empire

Notwithstanding the caricatures of the 1930s, which portrayed Samuel Insull as a man motivated by greed, the collapse of his holding company empire had little to do with avarice and everything to do with Insull's unrelenting drive to maintain control of his sprawling operations at all costs. The seeds of Insull's destruction were sown in late 1927 and early 1928, when a Cleveland financier named Cyrus Eaton began using surrogates to quietly amass large blocs of stock in Insull companies.¹⁵³ Prior to this time, Insull's control of his operations was secured primarily by the dispersion of ownership among large numbers of small stockholders, many of whom lived in Chicago or worked for Insull companies. By mid-1928, however, Insull had learned that Eaton's holdings were several times larger than his own.¹⁵⁴ Further, other groups were making large purchases of stock in Insull companies, and Insull had no way of determining whether these parties were secretly aligned with Eaton.

In the summer of 1928, Insull was returning from Europe on an ocean liner on which (coincidentally) another passenger happened to be Cyrus Eaton. Although these two powerful industrialists often chatted during the voyage, Eaton never discussed his recent substantial purchases of Insull stock, and Insull never disclosed that he was aware of Eaton's use of surrogates to make the purchases. Eaton's facade of casual unconcern ultimately convinced Insull that Eaton was poised to mount a corporate raid.¹⁵⁵

Insull responded to the Eaton threat by erecting a new layer of holding companies atop his existing corporate pyramid. Specifically, Insull instructed his family and close business associates to tender their shares of company stock to a newly created company, Insull Utility Investments (IUI). In turn, IUI sold large quantities of bonds and non-voting preferred stock to the public to obtain working control of the Insull companies. In a remarkable display of candor, the press release announcing the creation of IUI stated that the purpose of the new company was "to perpetuate . . . the existing management of the Insull group of public utilities."¹⁵⁶

Insofar as IUI sold common stock to the general public, it was Insull's belief that a widely dispersed (and historically content) public ownership posed little threat to his control. Unfortunately for Insull, one of the technical features of IUI common stock was that existing shareholders had a pre-emptive right to buy

153. McDONALD, *supra* note 2, at 279; INSULL, *supra* note 11, at 188-91.

154. McDONALD, *supra* note 2, at 279-80.

155. *Id.* at 280; INSULL, *supra* note 11, at 192 (concluding after the ocean voyage that "[Eaton] must be purchasing the securities not merely as an investor but for some ulterior purpose").

156. McDONALD, *supra* note 2, at 281.

additional IUI common stock before those shares could be offered to the public. Thus, in theory, an outsider stockholder with sufficient financial resources could aggregate a large block of IUI stock, exercise the preemptive rights, and ultimately challenge Insull for control of the company.¹⁵⁷ Further, with the stock market mania that enveloped the country in the summer of 1929, it quickly became prohibitively expensive to guarantee control of the sprawling Insull empire through market purchases of IUI stock.

In September 1929, Insull attempted to solidify his control by forming another holding company, Corporation Securities of Chicago (commonly known as Corp). The capital structure of Corp was similar to that of IUI, but the proceeds from the bond and preferred stock offerings were used to secure control of IUI. Ultimately, Corp and IUI held substantial minority blocs of each others' stock. Further, through interlocking directorates between Corp and IUI, together with a voting trust agreement among Insull and a small group of insiders, Insull managed to substantially reduce (but not eliminate) any outside threat to his continued control.¹⁵⁸ Despite the increased leverage of the IUI-Corp structure, Insull effectively used the stock market mania to refinance a substantial part of this structure on more favorable terms.¹⁵⁹ Insull also began paying dividends in shares of company stock rather than cash in order to retain sufficient funds to finance continued expansion.¹⁶⁰

When the Great Crash occurred in October 1929, Samuel Insull gave his stock and bond investors several reasons to believe that they had made a sturdy and secure investment. The first example of this reassurance came only one day after Black Tuesday (October 29, 1929), when Insull stepped into the breach and personally offered a guaranty against margin calls for every employee in his organization.¹⁶¹ Although Insull was arguably acting out of self-interested motives rather than magnanimity (after all, most of his employees would have satisfied their brokerage-house creditors by allowing the Insull stock to be sold, thereby causing the stock price to plummet), to the world he conveyed the appearance of calm steadiness in the crisis. At a convention of company executives on November 9, 1929, Insull (in a procedure suggestive of CEO Ken Lay's infamous online forum with Enron employees¹⁶²) assured his managers that the company was well positioned for the long haul:

We are just now experiencing some of the difficulties of customer and employee ownership, owing to the operations of the stock market. None of us feels as rich as

157. INSULL, *supra* note 11, at 191 (Insull noting that the existence of the pre-emptive rights threatened "the object for which [IUI] . . . had been formed . . . namely, that the control of it by associates and myself would be lost.").

158. MCDONALD, *supra* note 2, at 282-83.

159. *Id.* at 283.

160. MCDONALD, *supra* note 2, at 283.

161. Rosenwald, *Insull Aid Workers in Crash*, N.Y. TIMES, Oct. 31, 1929, at 2 (reporting that "Samuel Insull, public utilities magnate, has placed his vast fortune behind those among his thousands of employees [sic] who have dabbled in stocks and who face financial ruin.").

162. See Julie Mason, *Former Enron Workers Air Complaints on CNN*, HOUS. CHRON., Jan. 21, 2002, at A10 (quoting Ken Lay in Sept. 26, 2001 internal online forum, "The company is fundamentally sound. The balance sheet is strong. Our financial liquidity has never been stronger.").

he did a few weeks ago. . . . The stock market may have affected the volume of our personal wealth for the moment, but it has not affected the volume of our business. If the volume of business keeps up, conservative values of securities must come back. They always have in the past.¹⁶³

A week later, Insull informed the press, "The stock market hasn't made the slightest difference in our policies. We are spending hundreds of millions of dollars next year, as in every year, for new construction."¹⁶⁴ Remarkably, as Wall Street struggled to recover the nearly twenty-five percent loss in stock values, Insull's refinancing of \$147 million worth of Middle West securities was fully subscribed by investors.¹⁶⁵

Distressed by the dramatic downturn in the stock market, President Hoover convened a meeting of industry leaders at the White House in late November 1929. As Insull would later recall in his memoirs, the purpose of the conference was to "urg[e] all the industries of the country to carry on as if nothing of a serious nature had happened. The idea being that if we would go ahead and 'attend to our knitting' and not curtail our operations, the panic and depression would not really happen."¹⁶⁶ Although Insull later claimed to have serious doubts about the propriety of aggressive expansion, Hoover's plea made an impression.¹⁶⁷ Shortly after the conference, Insull committed his companies to an additional \$200 million in capital improvements.¹⁶⁸ Investors were temporarily buoyed by Insull's display of optimism, as utility stocks were among the first to show signs of recovery.¹⁶⁹ Yet, by early 1930, the stock market malaise had broadened to the utility sector, including the various Insull companies. Thus, in order to finance his \$200 million capital expansion pledge to President Hoover, Insull was forced to turn to the bond market and to take on substantial amounts of debt.

Although this highly leveraged expansion, by itself, involved significant risk,¹⁷⁰ the financial health of the Insull empire was further imperiled by Insull's continued preoccupation with Cyrus Eaton's large holdings of Insull stock. Thus, in early 1930, when Cyrus Eaton contacted Insull and offered to consoli-

163. *Insull Strikes Cheerful Note*, L.A. TIMES, Nov. 10, 1929, at A9.

164. *Cheerful in Chicago*, N.Y. TIMES, Nov. 18, 1929, at 2.

165. *Insull Reports Success*, N.Y. TIMES, Nov. 17, 1929, at N9 ("In the face of the stock markets' collapse that for a time swept its stock below the offering price, the Middle West Utilities Company announced today the successful flotation of its refinancing scheme under the rights which expired yesterday.")

166. INSULL, *supra* note 11, at 129.

167. *Id.* (discussing "very great misgivings" about heeding Hoover's pleas but concluding that "I thought it [was] my duty to put the President's policy into effect.")

168. See MCDONALD, *supra* note 2, at 285.

169. See, e.g., *Upswing Continues on Curb Exchange*, N.Y. TIMES, Nov. 22, 1929, at 46 (listing Insull Utilities as one of the companies leading gains on the stock market); *Stock Market Upturn Slows*, L.A. TIMES, Dec. 5, 1929, at 15 (noting that the "utilities shares again led the advance, stimulated [by various factors, including] . . . optimistic statements by Samuel Insull"); *Bullish Activities Send Stocks Rising*, WASH. POST, Dec. 5, 1929, at 13 (noting utility-led advances in market and noting that "Insull's report helps"); *Insull Reports Investment Gains*, N.Y. TIMES, Feb. 18, 1930, at 35 (discussing presentation by Insull at annual shareholders meeting that Insull Utility Investments, which sat atop his corporate pyramid, "came through [1929] with an appreciation in the market value of its investments in spite of the November stock market collapse").

170. See MCDONALD, *supra* note 2, at 286 (noting that Insull's "1930 financing set Chicago observers gaping").

date his holdings with those of Insull, under Insull's exclusive management, Insull brushed aside the contradictory advice of his most trusted associates and agreed to pay Eaton \$56 million for this entire stake. Unfortunately for Insull, the manner of financing the purchase (and its potential risks) was not fully known at the time. By the mid-1930s, however, the slide in the capital markets made it impracticable to raise substantial funds through either debt or equity offerings. Although Insull had received assurances that the Continental Bank of Chicago (Continental) could finance the purchase through a loan secured by stock in the IUI and Corp portfolios, it turned out that Continental, even in combination with other Chicago banks, could not finance the entire purchase price.¹⁷¹ Insull had to turn to New York for \$20,000,000.

Until this point in his career, Insull assiduously avoided any dealings with the New York bankers, owing in no small measure to the sharp practices he encountered during his days with Edison.¹⁷² Of course, the New York banking community was equally aware that they had received zero underwriting fees from the financing of Insull's sprawling utility empire.¹⁷³ In comparison to his total capital (representing about twelve percent of the nation's electric generating capacity), Insull's requirements for immediate cash were minuscule. Yet, the only suitable collateral that he could offer was the IUI and Corp common stock on which he relied for control of his operations. As a result, if the value of these stocks declined below a certain level, and Insull could not hypothecate additional stock to satisfy his creditors, he could be ousted from control and ultimately rendered virtually penniless. It was a high-stakes game that the New York bankers were happy to play.

4. The Collapse of the Insull Empire

During the early 1930s, as the country descended into the grip of the Great Depression with financial panic and mass unemployment, there was virtually no outward sign that Samuel Insull's holding company empire was headed for trouble. However, the financial viability of IUI and Corp – the two Insull holding companies that sat atop six layers of other holding and operating companies – depended upon a relatively simple but arguably unrealistic economic assumption: the demand for electric power would continue to grow unabated, even if the United States economy foundered. And, as noted, Insull believed that a significant slump in electrical demand was “practically inconceivable.”¹⁷⁴

171. *Id.* at 289.

172. MCDONALD, *supra* note 2, at 39 (noting that the financing difficulties he faced as an Edison employee caused Insull to develop “a deep-seated antipathy for banks and bankers, especially those in New York”); *id.* at 286, n.23 (noting Insull's “incendiary blast” against the “concentration of financial power in New York” at the annual dinner of the Chicago Stock exchange in 1930). *See also* INSULL, *supra* note 9, at 85 (Insull observing that “if . . . I had paid more attention to dealing with New York bankers, and less with London bankers, when the troubles came in 1932, I would probably have found the New York bankers more receptive of my requests for help.”).

173. Between 1923 and 1933, Insull's investment bank, Halsey, Stuart & Co. of Chicago, purportedly underwrote over \$ 1.4 billion worth of Insull securities. *See* INSULL, *supra* note 11, at 161.

174. *See* Michaels, *supra* note 141, at 39 (quoting Insull in an interview for *Forbes* magazine).

As the Great Depression deepened, the revenues of the nation's manufacturing companies would ultimately decline by sixty-three percent. In contrast, total revenues for the electric utility industry fell by only six percent.¹⁷⁵ Remarkably, by mid-1931, this relatively modest drop in revenue had become an economic vise, squeezing the highly leveraged Insull empire. Although Insull's operating companies were regulated to earn a fixed rate of return on their capital, any increase in their earnings was, at this juncture, entirely consumed by interest payments to bondholders and guaranteed dividends to preferred stockholders.¹⁷⁶ Insull had temporarily financed the purchase of Eaton's stock by intra-system loans to IUI and Corp. Since companies making up the pyramid required repayment of these loans in order to finance the expansion promised to President Hoover, Insull scrambled for the (relatively small) amount of cash needed to satisfy his New York creditors.

By the end of 1931, Insull was out of options. Following England's announcement in September that it was leaving the gold standard, the U.S. stock markets reacted violently, touching off a period of sharp decline.¹⁷⁷ In an effort to stave off disaster, the entire stock portfolios of IUI and Corp had been pledged as collateral.¹⁷⁸ With the New York bankers now in control, they set about the task of casting Insull as a villain in order to permanently remove him as head of the empire he created.¹⁷⁹ Their first maneuver was to appoint a new auditor, Arthur Andersen & Co., to oversee the operations of the two holding companies at the top of the pyramid.¹⁸⁰ Because Andersen built its reputation in part on the basis of its handling of the high-profile Insull debacle,¹⁸¹ it is stunningly ironic that the collapse of latter-day energy icon, Enron Corporation, would ultimately

175. MUNSON, *supra* note 69, at 71.

176. Remarkably, right up until the collapse of his holding company empire in late 1931, Insull never missed a single interest or dividend payment. See MCDONALD, *supra* note 2, at 301. Undoubtedly, this track record contributed to the public illusion that Insull was invincible; and just like Enron, it deepened the sense of public shock when the truth was finally revealed.

177. See *Chronological Record of the Outstanding Financial Events During the Past Year*, N.Y. TIMES, Dec. 31, 1931, at 25 (noting that the financial history of 1931 is "in some respects the most remarkable in our lifetime" and providing a chronology of events).

178. MCDONALD, *supra* note 2, at 294.

179. As noted by Insull's biographer, Forrest McDonald,

[T]he bankers could have taken over by voting power. But they had no desire to be cast in the role of the cruel creditor—or outright pirate—that such action would have involved. This was 1932, and corporate rape had ceased to be fashionable. Millions of unemployed Americans were seething with an as-yet-unfocused anger What the bankers had to do was reverse the facts and cast themselves in the role of man on the white horse, rescuing the widows and orphans from the clutches of a scoundrel.

Id. at 296.

180. INSULL, *supra* note 11, at 210–11 (discussing appointment of Arthur Andersen to represent interests of New York bankers).

181. See John C. Spsychalski, *Andersen's Rise in the 1930s Collapse*, WALL ST. J., Feb. 11, 2002, at 24 (letter to the editor) (noting that Andersen, "then a modest-sized Chicago-based firm, [became] a key player in the huge game of untangling the Insull empire's opaque financial maze" and that "[t]he expertise and patina of rectitude that Andersen gained from this experience brought it a plethora of new clients."). Andersen subsequently became a leading public accountant in the public utility industry.

lead to Andersen's extinction seventy years later.¹⁸²

With respect to accountants, Insull (similarly to Enron) was used to getting his way. In 1929, an independent auditor concluded that the Insull companies' distribution of profits was inflated because in-kind stock dividends were routinely distributed to shareholders at their market value. When Insull got wind that the practice had been rejected by the auditors, he wrote to them:

I have your letter of the 2nd, addressed to Mr. P.J. McEnroe, president Insull Utility Investments, Inc. This letter treats of so serious a subject that I do not think your firm should have made a ruling in this matter without first discussing the matter with me, more especially as I do not agree at all with the decision taken in your letter.¹⁸³

After a discussion between Insull and his auditors, Insull's view prevailed.¹⁸⁴

In the case of Andersen, however, Insull had no leverage. Based on a detailed examination of company operations and their financial health, Andersen concluded that Insull's system of capital depreciation was too generous. After substituting a straight-line depreciation method, which was common in industrial accounting, for Insull's retirement reserve system, Insull's purported golden touch was reduced to a complete illusion. As Forrest McDonald observed:

By the stroke of the pen Middle West became insolvent; and when the system was extended backward, Middle West became retroactively insolvent, never having earned any money and thus nothing but a worthless pile of paper that had been kept alive only by continuous impairment of capital, disguised by improper bookkeeping. This provided the New York bankers with an excuse for anything they chose to do.¹⁸⁵

As news of the poor health of the Insull companies became public, so did stories of allegedly abusive intercorporate transactions.¹⁸⁶ Certainly, the relevant question, a precursor of the Enron collapse seventy years later, was how a corporate enterprise of such formidable size and power could crumble for lack of adequate cash? And, at first glance, illegal or even criminal behavior seemed a plausible (if not probable) explanation.¹⁸⁷

182. See Jonathan D. Glater, *Last Task at Andersen: Turning Out the Lights*, N.Y. TIMES, Aug. 30, 2002, at C3 (stating that after 89 years in existence, "[t]he remaining tasks of the once-proud firm—which was convicted in June of obstructing the government's investigation into the collapse of Enron, an Andersen client—are to deal with obligations and shut itself down.").

183. RAMSEY, *supra* note 102, at 102.

184. Compare *id.* (quoting Insull's testimony at a latter mail-fraud trial, where he was acquitted, "I wanted to do it that way, and I had a long discussion with [the auditors] and some of my accounting associates, and it was the consensus of opinion that I was right on the matter"), with GARY JOHN PREVITS & BARBARA DUBIS MERINO, *A HISTORY OF ACCOUNTANCY IN THE UNITED STATES: THE CULTURAL SIGNIFICANCE OF ACCOUNTING* 267 (Ohio State Univ. Press 1998) ("Samuel Insull (the utility wizard), and other promoters had no fear that independent auditors would be called in. The reaction of the stock exchange was disinterest when the [Association of Independent Accountants] attempted to devise a plan for audits of all corporations; no one wanted to tamper with the 'prosperity of the times.'").

185. MCDONALD, *supra* note 2, at 297.

186. *Id.* at 298.

187. For example, the federal judge presiding over the Insull collapse informed the bankruptcy trustees, "I want you to understand that the court will not tolerate receivers who do not do their duty. . . . If there is any personal liability on the part of the officers or directors of [Middle West], the receivers will take steps to insti-

With the credibility of his management now in tatters, Insull knew that he had little choice but to step down from numerous companies he had formerly created and controlled. In June 1932, Insull submitted resignations from all the official titles he had held within this empire. This process, which included eighty-five directorships and eleven presidential posts, reportedly took over *three hours* to complete.¹⁸⁸ Exhausted by his unsuccessful battle with the New York bankers, Insull boarded an ocean liner and headed for Europe. Yet, as Insull investors began to understand the depth of their prospective losses, Insull's serene retirement voyage was increasingly viewed by the media as the flight of a fugitive criminal.

Public suspicion against Insull was also fueled in no small measure by Governor Franklin D. Roosevelt of New York, who was at the time campaigning for the U.S. presidency. Roosevelt had long been an advocate of public power; and Insull, as the principal architect of the NELA's propaganda machine against state and municipal ownership,¹⁸⁹ was at the epicenter of the "power trust" that allegedly controlled America. Although Roosevelt had long maintained that the consolidation of electric generating capacity in the hands of a few private companies created a monster that harmed consumers and threatened democracy,¹⁹⁰ the collapse of the Insull empire enabled Roosevelt to argue that Insull had defrauded *investors* as well. When his stump speeches turned to the topic of securities law reform, Roosevelt would heap scorn on "the reckless promoter, the Ishmael or Insull whose hand is against every man's."¹⁹¹

Roosevelt's populist rhetoric gained increased traction because Insull had deliberately built his empire with the funds of relatively small investors (including employees and customers) who were more likely to hold onto their stock and

tute the proper suits." *Court Orders Audit of an Insull Trust*, N.Y. TIMES, June 8, 1932, at 29 (quoting judge). The story went on to note allegations that "[c]ertain securities had been sold to members of the Insull family below the market" that they should aggressively pursue. *Id.*

188. See Marquis W. Child, *Samuel Insull, III: The Collapse*, NEW REPUBLIC, Oct. 5, 1932, at 203; JOHN DOS PASSOS, *THE BIG MONEY* 609 (Butler & Tanner, Ltd. 1936).

189. See GRANT & KATZ, *supra* note 4, at 228-29 ("Insull was responsible for shaping the National Electric Light Association—the public relations, or propaganda, agency of the industry. . . . It lobbied unceasingly. . . . The propaganda campaign was intense and it was powerful.").

190. See, e.g., Richard V. Gulahan, *Muscle Shoals: Symbol of the Nation's Power Issue*, N.Y. TIMES, Dec. 7, 1930, at 145 ("[Governor Roosevelt and other progressive politicians] contend that the 'power trust' is a menace to the whole country. The public utility interests, they charge, have a common understanding which has resulted in a consolidated force of tremendous influence, capable of and now actually engaged in attempting to control political parties or political groups for their own benefit."); RAMSEY, *supra* note 102, at 75 (quoting Roosevelt's June 1932 remarks that the financing methods used to create the "Insull monstrosity" were "wholly contrary to every sound public policy").

191. SELIGMAN, *supra* note 1, at 19-20 (quoting Roosevelt). Roosevelt's Portland speech was arguably his most pointed and well-publicized attack on Insull. Roosevelt exhorted his audience:

[The] crash of the Insull empire has given excellent print to the truth of what I have been arguing for a long time. The great Insull monstrosity . . . had distributed securities among hundreds of thousands of investors and had taken their money to an amount running to over one and a half billion dollars. . . . It shows us that the development of these financial monstrosities was such as to compel ultimate ruin As always, the public paid and paid dearly.

James A. Hagerty, *Portland Cheers Speech: The Governor Cites 'Insull Monstrosity' as He Hits 'Interests'*, N.Y. TIMES, Sept. 22, 1932, at 1.

less likely to question his management.¹⁹² One day, a lawyer for the still ongoing FTC investigation of the utility industry stood and watched the Insull investors file their claims at the receiver's office: "They were just the average run of people—clerks and school teachers there in Chicago, small shopkeepers in Illinois, farmers from Wisconsin—and what they brought in, of course, was worth nothing. They had lost every penny."¹⁹³ The perceived injustice of the Insull debacle was further compounded by the fact that Insull was living in Europe, outside the subpoena power of state and federal investigators.¹⁹⁴

E. *Insull's Criminal Trials*

Amid the hue and cry that followed the collapse of the Insull holding companies, state and federal officials adopted the most politically expedient strategy available: they moved rapidly to issue criminal indictments against Insull (now in absentia) and his associates. In October 1932, a Cook County grand jury issued charges of embezzlement and larceny; in February 1933, a federal indictment alleged use of the mails to defraud investors; and in June 1933, Insull and his brother and son were charged with criminally fraudulent conveyances to defeat claims under the National Bankruptcy Act.¹⁹⁵ Of course, prosecution for his alleged crimes was thwarted by the fact that Insull, following the advice of Chicago attorneys, established a domicile in Greece, which at the time had no extradition treaty with the United States.¹⁹⁶ Insull maintained his innocence, and he was convinced the criminal charges were inspired by the highly politicized atmosphere surrounding the collapse of his holding companies. Thus, he believed a fair trial would be virtually impossible. Moreover, in Greece, the criminal justice system seemed to support him. In December 1932, an Athens court considered the merits of the state embezzlement and larceny charges and concluded that, "Insull had no fraudulent intention, that he committed no offense, and that,

192. As noted by Fredrick Allen:

Long after the panic [of 1929], the salesmen of Insull securities were still selling stocks to little investors who were considered more likely to hold them than the big investors. Wrote Frank R. Evers, secretary of the unit which distributed shares, "The success of our business has lain in our getting the small fellow to buy." And again, . . . "my experience with those big buyers has been that they sell out on the least turn of the market."

FREDERICK LEWIS ALLEN, *THE LORDS OF CREATION* 285 (Harper & Bros. Publishers 1935) (alteration in original); see also MCDONALD, *supra* note 2, at 204–5 (discussing Insull's belief that widely dispersed ownership made him beholden to no one).

193. RAMSEY, *supra* note 102, at 224–225 (quoting Walter Splawn, general counsel for the House Interstate and Foreign Commerce Commissions, which authorized the FTC investigation). See also MUNSON, *supra* note 69, at 71 (characterizing the Insull collapse as "the tragedy of the century").

194. See, e.g., *The Crime Hunt in Insull's Shattered Empire*, LITERARY DIG., Oct. 15, 1932, at 12 (noting that Insull is living "in voluntary exile, while investigators study the extradition laws and hunt for evidences of criminality in his transactions."); see also *The Insull Disclosures*, WORLD TOMORROW, Oct. 12, 1932, at 343 (discussing departure from the United States of Insull and his brother Martin, massive losses to investors, and expanding investigations and commenting, "[i]t would seem indeed as though men jealous for their honor would seize the opportunity to return and try to vindicate themselves.").

195. FRANCIS X. BUSCH, *NOTABLE AMERICAN TRIALS: GUILTY OR NOT GUILTY?* 132–33 (Bobbs-Merrill Co. 1952).

196. *Id.* at 133.

therefore, the petition for extradition should be rejected, and the arrest warrant annulled."¹⁹⁷ At least in Greece, Insull was a free man—and an honest one, too.

Throughout 1933, the U.S. State Department pressured the Greek government to hand over Insull, with the accompanying proceedings raising novel issues of extradition law.¹⁹⁸ In December 1933, the Greek Premier ruled that Insull's residency permit would not be renewed and that Insull had to leave the country, though Insull would be free to travel to any country that would take him.¹⁹⁹ However, after successfully gaining modification of this order to accommodate his allegedly poor health, Insull surprised everyone by secretly boarding a small Greek steamship and departing the country.²⁰⁰ As Insull cruised the Mediterranean for the next two weeks, Congress quickly passed a bill authorizing the removal of U.S. citizens from any country where the United States exercised extraterritorial rights.²⁰¹ On March 29, 1934, Insull's steamship arrived in Istanbul, Turkey.²⁰² Although the Turkey government had not yet ratified its extradition treaty with the United States, Turkish officials ultimately proved to be much more cooperative than their Greek counterparts. After an extradition hearing lasting less than twenty minutes, the Turkish court ordered Insull's extradition. Under heavy guard, Insull was subsequently transported by ocean liner back to the United States and delivered back to Chicago via train.²⁰³

After a three day stay in the Cook County jail, Insull posted bond for state and federal charges and made the following statement to the press:

I have erred but my greatest error was in underestimating the effects of the financial panic on American securities and particularly on the companies I was trying to build. I worked with all of my energy to save those companies. I made mistakes, but they were honest mistakes. They were errors in judgment and not dishonest manipulations.²⁰⁴

Insull's statement summarized the entire theory of this defense. The first criminal trial, which dealt with the federal mail fraud charges against Insull and sixteen co-defendants, commenced on October 2, 1934. Although the U.S. At-

197. See *Insull Escapes Chicago's Clutch*, LITERARY DIG., Jan. 7, 1933, at 8 (quoting an Athens correspondent for the Associated Press); See also Charles Cheney Hyde, *The Extradition Case of Samuel Insull, Sr., in Relation to Greece*, 28 AM. J. INT'L L. 307, 308 n.4 (1934) (providing similar quotation from the Council of Judges of the Court of Appeals of Athens).

198. See, e.g., Ellery C. Stowell, *The Obligation of Extradition in the Insull Case*, 27 AM. J. INT'L L. 129, 129-30 (1933) (contending as erroneous Insull's argument that the recently enacted American-Greek extradition treaty could not be applied retroactively to him); Hyde, *supra* note 197, at 309-11 (discussing legal positions on the Insull matter taken by Greek courts and the unsuccessful efforts by State Department officials to appeal or reopen the case); *Extradition: The Insull Case*, 14 BRIT. Y.B. INT'L L. 150, 150-51 (1933) (summarizing legal issues and proceedings surrounding Insull extradition case).

199. *Insull Must Quit Greece by Jan. 1*, N.Y. TIMES, Dec. 13, 1933, at 11.

200. BUSCH, *supra* note 195, at 134; see also *Samuel Insull Vanishes; Greeks Start Wide Hunt; Cabinet Crisis Expected*, N.Y. TIMES, Mar. 16, 1934, at 1.

201. *New Insull Curb Passed by Senate*, N.Y. TIMES, Mar. 22, 1934, at L12 (discussing uncertain destination of Greek freighter carrying Insull and that purpose of the new law was to "tighten the grip of this government on the fugitive").

202. BUSCH, *supra* note 195, at 134.

203. *Id.*

204. BUSCH, *supra* note 195, at 135 (quoting Insull).

torney characterized the trial as a “simple conspiracy to swindle, cheat, and defraud the public,” the unwieldy array of evidence told a different story: the government presented a list of 200 prosecution witnesses and commissioned the building of specially designed courtroom bookcases to store over 2500 documentary exhibits.²⁰⁵ After four weeks of testimony, the prosecution rested, and the defense called its first witness—Samuel Insull. Under direct examination, Insull looked directly into the jury box and told his life story, from his days as an Edison office boy, to the construction of efficient electric grids, to the unfortunate and untimely events that led to the unraveling of his companies (We can only hope for similar courtroom drama in the criminal trials of Kenneth Lay and Jeffrey Skilling!).

By all accounts, Insull had delivered a masterful and convincing explanation of his innocent role in the tragic events.²⁰⁶ John Healy, a prominent lawyer and former state’s attorney who represented one of the co-defendants, summarized his impression in his subsequent argument to the jury:

I have sat in the prosecutor’s chair, and I have sat on the defendant’s side of the table, and in my almost fifty years of experience I have never seen a more remarkable exhibition on the witness stand than you gentlemen witnessed when Samuel Insull was upon that stand. This old man, now on the rim of the dying day, with the courage of a lion, fought for the only thing he has left – his honor and his good name. And I say to you . . . that he could not have given that exhibition if there had not been in his heart a consciousness of innocence. No crook, no scoundrel could have withstood the withering cross-examination of my friend Salter if there had been any falsehood in his make-up.²⁰⁷

After two weeks of character witnesses for the remaining sixteen defendants (Insull refused to put on any character witnesses for himself) and testimony from expert accountants who endorsed the accuracy and soundness of Insull’s book-keeping, the jury deliberated for a grand total of two hours and acquitted all defendants on all charges.²⁰⁸ One of the jurors, who had formerly served as a sheriff, opined to his fellow jurors that in all his years of law enforcement, he had “never heard of a band of crooks who thought up a scheme, wrote it all down, and kept an honest and careful record of everything they did.”²⁰⁹

The prosecution fared no better in subsequent state and federal trials. In

205. *Samuel Insull Faces Bar of Justice*, LITERARY DIG., Oct. 13, 1934, at 4; see also GRANT & KATZ, *supra* note 4, at 239 (commenting that “the government provided a painstaking, step-by-step analysis of the company’s records, using the testimony of former employees, independent accountants, government agents, experts, and college professors—all to show how Insull’s companies ‘cooked’ their books”).

206. See, e.g., BUSCH, *supra* note 195, at 166 (commenting that Insull’s story was “one of the most remarkable ever heard in an American courtroom”); McDONALD, *supra* note 2, at 330 (observing that Insull “did more than tell his story—he wove a spell. Before he was through, everyone in the courtroom was entranced.”); *Insull Wins Acquittal*, LITERARY DIG., Dec. 1, 1934, at 8 (noting that “[t]he jurors . . . were won over to Insull by his dramatic story of his rise from an office-boy’s job in London at five shillings per week to ruler of a utility empire which covered twenty-three States”).

207. BUSCH, *supra* note 195, at 181.

208. GRANT & KATZ, *supra* note 4, at 243 (noting that the actual deliberations took only five minutes but, in light of the high profile nature of the trial, the jurors made small talk for two hours to defuse any suggestions of bribery).

209. *Id.* at 239–240.

March 1935, Insull and his brother Martin were tried and acquitted in Illinois state court of allegedly embezzling \$66,000 from Middle West. Three months later, a different set of U.S. prosecutors attempted to convict the Insulls and their investment banker, Harold Stuart, of making illegal asset transfers in contemplation of bankruptcy. Yet, as the Insulls pointed out, the bankruptcy had been entirely involuntary and had been forced upon them by events beyond their control.²¹⁰ At the close of the government's case, the judge granted a directed verdict in favor of the defense.²¹¹

III. POST-INSULL UTILITY REGULATION: THE RISE AND FALL OF NEW DEAL REFORMS

By June of 1935, the criminal justice system had vindicated Insull and his associates of any criminal wrongdoing. Yet, amidst the financial chaos (and attendant unemployment) that burdened the country, the political process moved much faster and delivered a dramatically different verdict. The New Deal legislation that passed on the heels of the Insull debacle proceeded on the assumption that Insull and other high-profile promoters and utility magnates had swindled the American people.²¹² President Roosevelt's program, which included the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, and the Federal Power Act of 1935, was predicated on the assumption that big business could not be effectively regulated by the states. In the arena of political discourse, the Insull collapse (and images of an elderly Insull living comfortably as a fugitive in Europe) epitomized the corruption of the old order. Seventy years later, the collapse of the Enron Corporation was employed in a similar way to push through "the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt."²¹³ And as with the Insull debacle, Congress was not about to wait for a courtroom verdict to respond.

Part III of this Article presents a brief chronology of events that are essential to an understanding of the similarities and differences between the Insull and Enron eras. The central argument is that the New Deal regulatory framework designed to tame Insull and the "power trust" gradually gave way over a period of decades to a deregulatory ethos that was tailored-made for Enron. Part III is organized as follows: Section A outlines the basic regulatory assumptions of the New Deal legislation passed in the wake of the Insull collapse. Section B dis-

210. BUSCH, *supra* note 195, at 193.

211. *Id.* at 194 (quoting Judge Knox that "the proof offered by the Government is not of a quality . . . to find the defendants guilty beyond a reasonable doubt").

212. The eminent labor economist and historian John Commons opined that the politicians of the early 1930s used Insull as a "scapegoat for the sins of capitalism." MUNSON, *supra* note 69, at 83 (quoting Commons).

213. Michael A. Perino, *Enron's Legislative Aftermath: Some Reflections on the Deterrence Aspects of the Sarbanes-Oxley Act of 2002*, 76 ST. JOHN'S L. REV. 671, 671 (2002) (quoting Elisabeth Bumiller, *Bush Signs Bill Aimed at Fraud in Corporations*, N.Y. TIMES, July 31, 2002, at A1). See also ROBERT W. HAMILTON & JONATHAN R. MACEY, *CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES* 716 (Thomson West 8th ed. 2003) (stating that Sarbanes-Oxley represents "the most sweeping revision of the securities laws since the New Deal").

cusses the golden age of electric utilities that culminated in the exhaustion of economies of scale and the new concerns of the environmental movement. Section C reviews the circumstances surrounding the passage of the PURPA and the Energy Policy Act of 1992. These two pieces of legislation liberalized the post-Insull regulatory framework and paved the way for deregulation of the industry and Enron's foray into the energy trading business. Finally, Section D chronicles Enron's relatively brief time in the political and economic limelight that ended in its sudden and ignominious collapse.

A. The New Deal Reforms and the Regime of State Regulated Utilities

The collapse of the Insull holding company empire had a significant effect on two areas of New Deal legislation: (1) the federal securities laws, including the Securities Act of 1933 (1933 Act) and the Securities and Exchange Act of 1934, and (2) the federal regulation of the utility industry, including the Federal Power Act, the PUHCA, and various acts dealing with the financing and administration of several new federal public power projects. In contrast to Insull's diffuse impact on New Deal securities laws, which is largely attributable to the sheer size of his failure and, perhaps more importantly, its proximity to the famed "first hundred days" of the Roosevelt administration, Insull and his ilk were the pinpoint target of the new federal utilities laws. In particular, the section 11 "death sentence" provision of the PUHCA was intended to permanently dismantle the power trust by causing the fragmentation of the large power utility companies into hundreds of local and regional power companies that could be effectively regulated at the state level. Although the drafters of the PUHCA firmly believed that there were no economies of scale that justified large interstate utility companies, the more fundamental purpose behind the Act was, in the words of Roosevelt, to destroy the "private socialism of concentrated private power."²¹⁴

This post-Insull regulatory framework remained largely intact (and indeed was broadened) before the early 1990s, when academics and policy makers embraced market-based reforms as alternatives to the seemingly expensive and allegedly unwieldy New Deal regime. Of course, with the passage of more than half a century, few people either remember or appreciate the magnitude of problems that the federal government was forced to confront. Thus, a brief review is in order.

After the collapse of the stock market in the fall of 1929, the nation gradually slid into a broad economic malaise. During the next three years, the value of all stock traded on the New York Stock Exchange declined from \$90 billion to \$16 billion, while the value of bonds dropped from \$49 billion to \$31 billion.²¹⁵ At various points, many of the nation's leading "blue chip" stocks lost over

214. MICHAEL E. PARRISH, *ANXIOUS DECADES: AMERICA IN PROSPERITY AND DEPRESSION: 1920-1940* 343 (W.W. Norton & Co. 1992) (discussing Roosevelt's desire, in enacting the PUHCA, "to demolish concentrations of private power in the hands of behemoth public utility holding companies").

215. SELIGMAN, *supra* note 1, at 1.

ninety percent of their value.²¹⁶ Further, about one half of the \$50 billion worth of stock issued between the end of World War I and the 1929 crash eventually proved to have little or no value.²¹⁷ Owing in part to Insull's emphasis on customer and employee ownership, these losses affected 600,000 Insull stockholders and 500,000 bondholders.²¹⁸ In September 1932, newspapers heralded the Insull holding company collapse as "the biggest business failure in the history of the world."²¹⁹

By the fall of 1932, it was obvious that the old economic order was no longer viable.²²⁰ Amid a devastated stock market, severe deflation, and swelling unemployment, Franklin D. Roosevelt was elected President of the United States of America in a landslide.²²¹ Shortly after the election, the U.S. Senate announced plans to reconvene an investigation on stock exchange practices that would later become known as the Pecora hearings.²²² These hearings were named after the Senate committee's able chief counsel, Ferdinand Pecora, and exposed a seemingly endless stream of corruption and self-dealing among the nation's business elite. As Joel Seligman observed, "In retrospect, it is plain that the combination of the stock market crash and the Pecora hearings' revelations were instrumental in transforming national political sentiment from a laissez-faire ideology symbolized by the views of President Coolidge to a regulatory-reform ideology associated with Roosevelt's New Deal."²²³ In this respect, it is telling that the first three days of testimony at the Pecora hearings were devoted exclusively to the collapse of the Insull empire.²²⁴

Not surprisingly, in the legislative debates that preceded the passage of the 1933 Act, the Insull debacle was frequently offered up as a vivid justification for the new law. For example, in the House of Representatives, Representative Chapman of Kentucky exhorted his colleagues,

What a blessing such a law as this would have been during the past decade. We believe it would have saved tens of thousands of people from the losses incident to a wild orgy of speculation. Such a remedial measure would have saved \$25,000,000,000 to the American people during that period. If it had been upon the

216. *Id.* at 2 (citing as examples General Electric, U.S. Steel, Sears, and Roebuck).

217. SELIGMAN, *supra* note 1, at 1-2.

218. *Id.* at 22.

219. SELIGMAN, *supra* note 1, at 22.

220. See generally WILLIAM E. LEUCHTENBURG, *FRANKLIN D. ROOSEVELT AND THE NEW DEAL* 18-40 (Harper & Row 1963).

221. *Id.* at 17 (reporting at 472-59 victory in the Electoral College).

222. SELIGMAN, *supra* note 1, at 20.

223. *Id.* at 2.

224. SELIGMAN, *supra* note 1, at 21-22; see also FERDINAND PECORA, *WALL STREET UNDER OATH: THE STORY OF OUR MODERN MONEY CHANGERS* 224-33 (Simon & Schuster 1939) (discussing testimony on the Insull debacle); *Insull Stock Deal Netted \$ 25,000,000*, N.Y. TIMES, Feb. 16, 1933, at L8 (discussing Samuel Insull, Jr.'s testimony as the first witness in the Insull inquiry, including an alleged \$ 25,000,000 "paper profit" on a inter-affiliate stock transaction); *Dawes Concedes Bank Abused Law in Insull Loans*, N.Y. TIMES, Feb. 17, 1933, at 1 (Chicago bank official conceding that he loaned various Insull companies in excess of fifteen percent of his bank's capital in violation of state law); *Traces Millions in Paper Profits to Insull Bankers*, N.Y. TIMES, Feb. 18, 1933, at A1 (reporting on \$ 36,000,000 in "paper profits" made by Insull's investing banking firm, Halsey, Stuart & Co.).

statute books, it would have been the salvation of thousands of people who today shudder at the mention of Insull's name If there had been such a law, thousands of widows and orphans would not today be saddened and crushed as the result of having invested their money in worthless securities²²⁵

Remarkably, after a mere five hours of debate in the House, the 1933 Act passed by a *unanimous* vote.²²⁶ A few days later, it cleared the Senate with comparable support.²²⁷

The operative assumption underlying the 1933 Act was that the public could protect itself against unduly speculative securities if issuers, under threat of federal civil and criminal sanctions, were required to make in their promotional materials complete and accurate disclosure of all material risks in the proposed investment.²²⁸ Shortly after the Act became law, a Washington Post editorial commented, "If the Roosevelt securities bill were law years ago, it would have blighted that ancient Athenian, Samuel Insull, before he had inveigled investors into a loss running into \$700,000,000."²²⁹ As if to foreshadow the Enron era, the editorial went on to observe, "The 'if' appended to the foregoing clauses is a very big one, indeed. It runs something like this; If the law were enforced properly. Proper enforcement of the law is not America's strong suit, and the enforcement of law against wealthy malefactors is a distressingly rare phenomenon."²³⁰ The following year, Congress adopted the Securities Exchange Act of 1934 (1934 Act), which established the Securities and Exchange Commission (SEC) and extended the reach of federal securities laws to secondary transactions on stock exchanges. Once again, the echoes of the Insull debacle resounded in the halls of Congress.²³¹

In contrast to the relative calm that surrounded the passage of the 1933 Act

225. 77 CONG. REC. H2935 (daily ed. May 5, 1933) (statement of Rep. Chapman). See also 77 CONG. REC. H2943 (daily ed. May 5, 1933) (statement of Rep. Keller) ("Who is there among us able to say that we shall not tomorrow be faced with another . . . Insull?"); 77 CONG. REC. S3223 (daily ed. May 11, 1933) (statement of Sen. Norbeck) (discussing Insull's flight to Greece and his attempts to evade extradition and Insull's corrupting influence on state and federal politics); 77 CONG. REC. S3231 (daily ed. May 11, 1933) (statement of Sen. Norbeck) (noting that the Insull collapse "was one of the worst, if not the most colossal, failures on record in this country"). At the time, Insull was certainly an attractive object for scorn. Only three weeks earlier, the Washington Post editorial page commented that "Sam Insull, late utilities emperor, is reported to be living merely like a king in Athens." Editorial, WASH. POST., Apr. 15, 1933, at 6.

226. *Securities Bill Passed by House; Vote Unanimous*, N.Y. TIMES, May 6, 1933, at A1.

227. As noted by Joel Seligman, "the First Hundred Days of the Roosevelt administration was that rare time when money talked and nobody listened." SELIGMAN, *supra* note 1, at 66.

228. *Id.* at 39.

229. "If" *It Becomes a Law*, WASH. POST, June 1, 1933, at 6.

230. *Id.* Remarkably, as this Article is being prepared for publication, the Secretary of Treasury, to the delight of the nation's business leaders, has publicly urged the SEC to be "balanced" in its enforcement of the Sarbanes-Oxley Act. See Jackie Calmes & Deborah Solomon, *Snow Says 'Balance' Is Needed In Enforcing Sarbanes-Oxley Law*, WALL ST. J., Dec. 17, 2004, at A1.

231. See, e.g., *Stock Control Bill Voted by Congress*, N.Y. TIMES, June 2, 1934, at L1 (reporting on passage of the Exchange Act of 1934 and fact that final conference bill excluded an exemption for employer stock plans because, according to Senator Couzens, "the record shows that literally millions of shares of Insull corporations' stock were sold to their employes [sic] merely upon representations of the corporation itself."); *Exchange Act Passes; Final Debate Quiet*, WASH. POST, June 2, 1934, at 1 (discussing effect of "Insull transactions" on final bill).

and the 1934 Act, the legislative debates and lobbying turmoil accompanying the PUCHA made that legislation the most bitterly contested of the New Deal.²³² As historian Michael Parrish observed:

Utility executives . . . regarded the Wheeler-Rayburn bill as a declaration of war more threatening than TVA, which they were also fighting on several fronts. Armed with a war chest of millions of dollars, their public relations firms bombarded Congress and the public with pamphlets, letters, and advertisements designed to discredit the legislation and the president [sic], who was alleged to support the bill because he suffered from a mental breakdown. . . . Their lobbyists swarmed over Capitol Hill, buying votes and threatening legislators with the economic collapse of their regions in the event the [death sentence] measure became law.²³³

During the summer of 1935, the PUHCA seemed on the brink of defeat. However, in a remarkable turn of events, Senator Black of Alabama compelled numerous utility executives to appear before a special committee on lobbying and subpoenaed all of their correspondence for the relevant time period.²³⁴ Much to the public's horror, the committee discovered that one utility executive had hired Western Union to transmit a thousand phony telegrams from residents of a small town in Pennsylvania to their local congressman.²³⁵ This episode seemed to confirm Roosevelt's position that the utility industry in its current form had become a threat to democracy itself.²³⁶ Shortly thereafter, Roosevelt had the necessary votes to push the PUHCA through Congress. Nevertheless, the PUHCA's "death sentence" provision was so controversial that the first SEC chairman, Joseph Kennedy, submitted a proposed draft of his resignation on almost the same day that Roosevelt signed the bill into law.²³⁷ A few weeks later,

232. BONBRIGHT, *supra* note 89, at 36 (describing circumstances surrounding the passage of PUHCA, including the intense and manipulative efforts of the utility lobby); PARRISH, *supra* note 214, at 345 (noting that PUHCA produced a legislative battle that made the struggle over banking reform seem tame by comparison).

233. PARRISH, *supra* note 214, at 344. For contemporaneous accounts of these contentious debates, see Raymond Clapper, *Between You and Me: Give Congress a Chance! Power Lobby Not Alone in Applying Pressure in Utility Bill Fight*, WASH. POST, July 2, 1935, at 2 (describing the "ruthless intensity" of the legislative battle: "Some members [of the House] had been so harassed that they sat tight in their seats apparently afraid to vote either way. Intemperate speeches on both sides revealed the harassed state of mind of the members. One member shouts, 'to hell with the power trust.'"); AP, *Utility Lobby Tapped Wire, Rankin Says*, Wash Post, July 7, 1935, at 1 (reporting allegations by Rep. Rankin of Mississippi that "[the] utility holding company lobbyists 'tapped telephone wires of members of Congress'").

234. For a detailed discussion of the electric utilities campaign against PUHCA and the investigation by a special Senate committee on lobbying, see RALPH F. DE BEDTS, *THE NEW DEAL'S SEC: THE FORMATIVE YEARS* ch. 5 (1964).

235. PARRISH, *supra* note 214, at 344.

236. See DE BEDTS, *supra* note 234, at 136-37; Turner Catledge, *Lobby Inquiry Gives Aid to the President*, N.Y. TIMES, July 28, 1935, at E12 (discussing how political fallout will benefit President Roosevelt as Congressmen come to grips with the possibility that "some of the most feeling protests of small utility investors were written in the offices of one of the largest holding companies in the business and that signatures to many of them were copied out of telephone directories, off street-car company payroll records or solicited by telegraphic messenger boys.").

237. SELIGMAN, *supra* note 1, at 122-23 (noting that Kennedy "[took] the unusual step of offering his 'personal view'" that the death sentence section was bad policy and discussing sequence of events leading to Kennedy's resignation).

Insull's old lobbying organization, the NELA, which had since been renamed the Edison Electric Institute to disassociate itself from the fallen utility magnate,²³⁸ announced that it had retained two of the nation's most prominent attorneys to challenge the constitutionality of the PUHCA.²³⁹

Undoubtedly, the most significant and controversial provision of the PUHCA was section 11(b)(1), which required the SEC to initiate proceedings to limit each utility holding company "to a single integrated public utility system."²⁴⁰ In addition, section 11(b)(2) mandated the simplification of registered holding companies to include the elimination of pyramidal holding company structures and the disproportionate use of preferred stock to dilute voting rights.²⁴¹ The practical consequence of these two clauses was the mandatory divestment by the holding companies of thousands of gas and electric operating companies.²⁴² This outcome undoubtedly reflected the viewpoint of the National Power Policy Committee (a Roosevelt-appointed advisory group), which urged Congress to pass legislation that would ensure "the elimination of unnecessary corporate complexities and of properties which do not fit into an economically and geographically integrated whole."²⁴³ Moreover, the new law embodied the philosophy of Senator Burton Wheeler of Montana, one of the PUHCA's principal sponsors, who believed that a utility is a "local institution" that ought to be "locally owned and locally controlled."²⁴⁴

After the divestiture process had been completed, the remaining registered holding companies were (and are) subject to special SEC scrutiny in many aspects of their operations, including accounting, issuance of securities, acquisition of utility assets, and intercompany transactions.²⁴⁵ Notwithstanding the fact that the complex provisions of the PUHCA are often decried as antiquated,²⁴⁶ the law did have the effect of strengthening the finances of the nation's utilities. Moreover, as Joel Seligman observed in 1995, one of the most important and unrecognized accomplishments of the New Deal was the dismantling of the so-called power trust: "That today such terms are rarely employed is another measure of

238. MUNSON, *supra* note 69, at 83-84 (discussing renaming of the NELA as Edison Electric Institute and noting that "[o]ne critic complained the industry had changed its clothes but forgot to take a bath"); ERNEST GRUENING, *THE PUBLIC PAYS: A STUDY OF POWER PROPOGANDA* xv (Vanguard Press 1964) (1931) (noting that on the eve of the inauguration of the Roosevelt Administration in 1933, the NELA announced its own dissolution and its eventual reconstitution as the Edison Electric Institute).

239. SELIGMAN, *supra* note 1, at 131.

240. Public Utility Holding Company Act, § 11(b)(1), 15 U.S.C. 79k(b)(1) (2000).

241. *Id.*; see also THOMAS LEE HAZEN, *LAW OF SECURITIES REGULATION* § 18.4 (4th ed. 2002) (discussing PUHCA's simplification provisions).

242. See generally RITCHIE, *supra* note 121.

243. SELIGMAN, *supra* note 1, at 129.

244. PARRISH, *supra* note 214, at 157 (quoting Wheeler).

245. HAZEN, *supra* note 241, at § 18.5 (discussing various PUHCA strictures that apply to registered holding companies).

246. See, e.g., Barry P. Barbash, *Whither PUHCA?*, Speech Given Before the Tenth Annual Utility M&A Symposium (Feb. 4, 1997) [hereinafter Barbash] (noting that "the tension of applying an antiquated statute to a modern industry becomes ever more intense"), available at <http://www.sec.gov/news/speech/speecharchive/1997/spch147.txt>.

the SEC's achievement under Section 11."²⁴⁷ The other side of the coin is that nuclear development in the United States might have been more successful if carried out under the aegis of larger corporate organizations than by fragmented utilities.

B. Exhaustion of Economies of Scale and the Environmental Movement

The New Deal regulatory framework was confronted with an electric utility industry that was bifurcated into two spheres: investor-owned utilities, which were regulated by the states, and public power, which was reinvigorated by the creation of the Tennessee Valley Authority and the Rural Electrification Administration. With government involvement in virtually every facet of the industry, the post-Insull reforms delivered over three decades of reliable power with a continuously declining cost and rate structure.²⁴⁸

This outcome was driven by the constant exploitation of economies of scale, which were seemingly inexhaustible. Until about 1970, the story of the industry was an almost continuous increase in the size of generating units, accompanied by a correspondingly continuous decline in the costs of generation.²⁴⁹ Of course, the increases in size were matched with higher pressures and temperatures, strength of materials, and other technological improvements. Economies of scale were also exploited through promotional pricing—underpricing of the electrical product to stimulate consumption and to promote new uses for electricity in, for example, refrigeration, air-conditioning, and electric heating. Yet, in accord with the Insull tenets, the production of electricity was thought to be a “natural monopoly,” in which the costs of the original producer continued to decline as output rose over the full range of its potential.²⁵⁰

These traditional (or Insullian) principles of economic power generation are well known. For electric power, the initial investment is very high in relation to total costs. This cost characteristic has a great deal to do with the natural monopoly character of the activity since capital costs, which so predominate, are spread over constantly growing output (meaning ever-diminishing unit costs as output rises), and it is more efficient to increase output than to allow additional plants to compete.²⁵¹ Of course, generating systems are designed and operated so that high capital cost units operate around the clock while high fuel cost generators only meet peak demands. Since electricity cannot be stored, there must be plant capacity available to meet the highest demand for power that will be placed on the system at any one time—in present-day urban systems, usually the hottest day in summer when the air-conditioning load is highest. Meeting that load means bringing low capital cost “peakers” (and old, heavily depreciated

247. SELIGMAN, *supra* note 1, at 259.

248. For an overview of industry development see CHARLES F. PHILLIPS, *THE REGULATION OF PUBLIC UTILITIES: THEORY AND PRACTICE* 624–44 (3d ed. 1993).

249. See ALFRED E. KAHN, I *THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS* 124–30 (MIT Press 1988).

250. See ALFRED E. KAHN, II *THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS* 116–20 (MIT Press 1988).

251. *Id.*

units) on line with their high fuel costs.²⁵²

The last major technological improvement in generation in the economies of scale era involved the transition from fossil fuels as a source of thermal energy to uranium in a nuclear reactor. This transition began in the 1960s. The disappointing performance – and particularly the large cost overruns – associated with many nuclear plants raised real questions about the potential for extracting more economies of scale in generation. Nuclear plants were certainly a step upward in scale, but they did not seem to provide a corresponding reduction in cost. Excessive cost was also linked with safety concerns. These developments opened the door to a belief that economies of scale had been exhausted in electric generation and that it was no longer a natural monopoly.

In contrast to the problems and limitations that were being encountered in electric generation, improvements in power transmission continued under established principles. Use of ever-higher voltages and the consequent capacity to transmit ever-growing quantities of power while minimizing line losses, continued as it had traditionally. As noted by several commentators of the time,²⁵³ it was becoming increasingly evident that the alleged natural monopoly of the electric utility industry existed, if at all, only in transmission but not in generation.

C. *The PURPA, the Energy Policy Act, and the Deregulatory Ethos*

Beginning in the 1970s, circumstances conspired to change the industry's course radically from the one pioneered by Samuel Insull. Pressure to change was coming from two principal sources: (1) the burgeoning environmental movement, which was rapidly developing political muscle, and (2) higher costs of electric power, breaking a trend of continuously declining production costs that had been in force since the days of Edison and Insull.²⁵⁴ With respect to the environment, proposals for ever-larger power plants to service rapidly growing loads stirred a realization that electrical generation was a major source of air and water pollution.²⁵⁵ This understanding frowned on building loads and instead exalted conservation, and the environmental impulse received more sweeping expression in such works as *Small Is Beautiful*²⁵⁶ and *Soft Energy Paths*²⁵⁷ (which was specifically directed to questions of electrical generation). Parallel-

252. See generally FRED BOSELMAN ET AL., *ENERGY, ECONOMICS AND THE ENVIRONMENT: CASES AND MATERIALS* 649–54 (Foundation Press 2000).

253. A number of analysts were questioning the sustainability of “natural monopolies” across industries in the late 1970s and early 1980s. See, e.g., WILLIAM G. SHEPHERD, *THE TREATMENT OF MARKET POWER* ch.9 (Columbia Univ. Press 1975); RICHARD SCHMALENSEE, *THE CONTROL OF NATURAL MONOPOLIES* 35 (Lexington Books 1979); Gerald R. Faulhaber, *Cross-Subsidization: Pricing in Public Enterprises*, 65 AM. ECON. REV. 966–77 (1975); John C. Panzar & Robert D. Willig, *Free Entry and the Sustainability of Natural Monopoly*, 8 BELL J. ECON. 1–22 (1977); William J. Baumol et al., *Weak Invisible Hand Theorems on the Sustainability of Multiproduct Natural Monopoly*, 67 AM. ECON. REV. 350–65 (1977); WILLIAM W. SHARKEY, *THE THEORY OF NATURAL MONOPOLY* ch.5 (Cambridge Univ. Press 1982).

254. The macro-level shifts in the industry are summarized in PHILLIPS, *supra* note 248, at 661–62.

255. See BOSELMAN ET AL., *supra* note 252, at 674–78.

256. E.F. SCHUMACHER, *SMALL IS BEAUTIFUL: ECONOMICS AS IF PEOPLE MATTERED* (Harper & Row Publishers, Inc. 1989) (1973).

257. AMORY B. LOVINS, *SOFT ENERGY PATHS: TOWARD A DURABLE PEACE* (Ballinger Publ'g Co. 1977).

ing these relatively new environmental concerns, unpredictable nuclear plant costs, skyrocketing fuel costs (stimulated by OPEC and the Arab Oil Embargo), and other factors drove electric rates off their long-established declining trend and sent them through the roof.

The supplanting of the utility franchise model in favor of deregulation and competition was hastened by several key developments and shifts in thinking. For example, in 1973, the U.S. Supreme Court in *Otter Tail Power Co. v. United States*²⁵⁸ approved as an antitrust remedy, the requirement that an investor-owned electric utility provide transmission service for its former municipal customer, to permit the municipality to buy cheaper electric power from a (government-owned) competitor of the investor-owned utility. Another pressure point for change was the circumstance that increases in the price of power varied by region, and, in fact, were evident in adjacent service areas.²⁵⁹ These differential increases in the cost of electric power got customers – particularly large industrial users – to thinking about the possibility of buying power from a cheaper source outside the service area of the local utility and wheeling it to their facility for use.²⁶⁰

The two threads of environmental concern and competition came together in the PURPA.²⁶¹ To further the policy goal of clean energy, section 210 of the PURPA provided for a new category of electric generators called “qualifying facilities” (QFs), whose output electric utilities were required to buy at stipulated prices. QFs were defined by statute to be of a specified smaller size and to be powered by renewable sources of energy, such as wind and geothermal resources, or to employ co-generation.²⁶² These provisions, although perhaps principally intended to stimulate renewable sources of energy, permitted electric generators that were not utilities, to be placed on the grid, to contribute to the electric supply, and to be guaranteed a market for their power. As part of the same measure, the Federal Energy Regulatory Commission (FERC) was given power to require utilities owning transmission to grant access, after a showing of compliance with certain conditions, to other electric generators.²⁶³ This grant of power to a federal agency to treat the transmission system as a common carrier,

258. *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973).

259. See, e.g., Charles Studness, *Regulators and Utility Deregulation: The Seeds of Failure*, 131 PUB. UTIL. FORT., Jan. 15, 1993, at 41 (noting that “sharp cost of production differences prevalent among neighboring utilities suggest that the potential benefits of competition are huge” and that “in 1991 there were 15 instances of utilities that either were contiguous or within 150 miles of each other having electric rates that differed by from 30 percent to 80 percent”).

260. For example, industrial plants in Northern Illinois, served by expensive nuclear plants, might save money by importing power from Wisconsin, where the only nuclear power was furnished by “turnkey” plants, acquired at low cost. The prevailing modes of regional coordination in the industry are discussed in PHILLIPS, *supra* note 248, at 637–44.

261. Public Utility Regulatory Policy Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 (1978).

262. Co-generation is the system of using steam from electric generators for other processes, like steam heating.

263. Public Utility Regulatory Policy Act of 1978 § 210. Although this provision implemented a policy that favored greater competition for sources of electric power, it was never successfully used to obtain access to transmission—apparently because the prerequisite showing, required by the statute, was too obscure to be understood and too difficult to comply with even if it were understood.

with open access for non-owner entities engaged in generation, had been sought for many years primarily by public power entities seeking access to transmission owned by the investor-owned utilities.²⁶⁴ Thus, the 1978 provision along these lines was, at the time, viewed in the public-private context, and advocated or opposed on that basis. Yet, a provision with the same purpose could, in a broader context, be an instrument of competition.

In some respects, the PURPA was evidence of a political mood that favored liberalization or dismantling of regulation in infrastructure industries.²⁶⁵ For example, during the late 1970s, the Carter administration initiated the complete deregulation of the airlines, and a similar momentum was building for deregulation in the telecommunications industry. Further, the Natural Gas Policy Act,²⁶⁶ which was jointly enacted with the PURPA in 1978, took the FERC out of the business of wellhead price fixing and pointed the way toward eventual deregulation of the commodity function.²⁶⁷ In the 1980s, the FERC, with respect to natural gas, effectively ceased to control commodity pricing and established the pipelines as transporters rather than as merchants of gas. This process was called “unbundling” of the functions of sale and transportation. FERC Orders 436, 500, and 636 contemplated that wholesale gas customers would negotiate and enter into gas sales contracts with natural gas producers and that the pipelines would be compensated only for bringing the gas from the field to the city gate. The only serious obstacle to this arrangement was the overhanging liability of “take or pay” contracts between the pipelines and the producers; this problem was eventually solved, with only one bankruptcy of a major pipeline disturbing the relatively smooth transition.²⁶⁸ (It is worth noting, of course, that one of the companies to master the economics of the deregulated natural gas industry was Houston Natural Gas (HNG), which renamed itself the Enron Corporation shortly after an economist named Kenneth Lay became the company’s CEO.)

By the end of the 1980s, there was a growing consensus that the new arrangements in the natural gas industry had proven to be quite workable. This relative success prompted a belief by the FERC and among numerous commentators that the principles of these innovations could be applied almost intact to the electric power industry. Specifically, all generators would have access to the transmission system so that power could be moved from distant points to wholesale users as determined by market forces. Basically, unlike the natural gas in-

264. It is noteworthy that a provision to treat the transmission system as a common carrier was contained in the original version of the legislation that became the Federal Power Act of 1935; however, it was removed before enactment. See *Otter Tail Power Co. v. United States*, 410 U.S. 366, 375 (1973) (“So far as wheeling is concerned, there is no authority granted the Commission under Part II of the Federal Power Act to order it, for the bills originally introduced contained common carrier provisions which were deleted.”) (citing S. REP. NO. 621 (1935); H.R. REP. NO. 1318 (1935)). See also Richard D. Cudahy, *Retail Wheeling: Is This Revolution Necessary?*, 25 ENERGY L.J. 161 (2004).

265. See Richard D. Cudahy, *PURPA: The Intersection of Competition and Regulatory Policy*, 16 ENERGY L.J. 419, 421, 425 (1995).

266. Natural Gas Policy Act of 1978, Pub. L. 95-621, 92 Stat. 3350 (1978) (codified as amended in scattered sections of 15 U.S.C.).

267. See PHILLIPS, *supra* note 248, at 656–67.

268. For a discussion of the “take or pay” obstacle, see *id.* at 710–11, 714.

dustry, jurisdiction over electric power was divided between the federal government and the states, with the FERC governing wholesale transactions and the states controlling retail. Thinking at the federal level about deregulation was, therefore, focused on the wholesale market.

The next major statutory move toward deregulation and competition in electric power came in the Energy Policy Act of 1992 (EPAAct), which was a comprehensive statute covering many and diverse aspects of energy production and use and the environmental and other impacts of these activities.²⁶⁹ This legislation contained a key provision whereby transmission owners could be required by the FERC, upon a proper showing, to "wheel" or provide transmission service to generators that requested it.²⁷⁰ Of course, the transmission owners could charge a fee for providing the service, and the showing required to obtain a wheeling order was, unlike the 1978 provisions,²⁷¹ within the understanding and capability of electric generators. There were not, therefore, any obvious barriers to seeking and obtaining transmission service when required to do so. The same legislation contained a provision which forbade the ordering of transmission service to furnish power to an ultimate user (retail wheeling). The scope of the EPAAct, therefore, included only wholesale wheeling (which was within federal jurisdiction).

The need for wholesale wheeling was enhanced by another very important provision of EPAAct, which authorized a new category of independent generator – the exempt wholesale generator, or EWG. These new plants were not subject to the sort of restrictions of size and fuel that applied to QFs under the PURPA. EWGs were exempted from the provisions of the PUHCA, which would otherwise have made their operation, particularly under utility ownership, very difficult, if not impossible.²⁷² EWGs were not guaranteed a market, as were QFs. However, EWGs had the advantage of recent natural gas technology, which made possible the construction of relatively small and simple turbines (with concomitantly low capital requirements) that were cleaner and more efficient than the power plants constructed in earlier decades.

In 1996, the FERC, through its famous Order 888,²⁷³ took the next major

269. See PHILLIPS, *supra* note 248, at 657–58.

270. Energy Policy Act of 1992 § 721 (amending § 211 of the Federal Power Act) provides: Any electric utility, Federal power marketing agency, or any other person generating electric energy for sale for resale, may apply to the Commission for an order . . . requiring a transmitting utility to provide transmission service (including any enlargement of transmission capacity necessary to provide such services) to the applicant.

271. Public Utility Regulatory Policy Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 (1978) (codified as amended in scattered sections of 15, 16, 43 U.S.C.).

272. See PHILLIPS, *supra* note 248, at 658. See also U.S. GEN. ACCOUNTING OFFICE, GAO/RCED-92-98, ELECTRICITY SUPPLY: REGULATING UTILITY HOLDING COMPANIES IN A CHANGING ELECTRIC INDUSTRY (1992); KENNETH W. COSTELLO ET AL., IMPLICATIONS OF A NEW PUHCA FOR THE ELECTRIC INDUSTRY AND REGULATORS (1992).

273. Order 888, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, [Regs. Preambles 1991–1996] F.E.R.C. STATS. & REGS. ¶ 31,036 (1996), 61 Fed. Reg. 21,540 (1996) (to be codified at 18 C.F.R. pts. 35, 385) [hereinafter Order 888].

step in promoting competition among electric generators. Order 888 furthered this objective in at least two basic provisions. First, Order 888 effectively required all owners of transmission to grant access, for a non-discriminatory price, to generators seeking to transmit power. The Commission did not rely on the new authority provided by the EPAct but, instead, based its proposal on the long-standing prohibition in the Federal Power Act against discrimination.²⁷⁴ The Commission's procedure was to require owners of transmission to provide the same transmission service for the same price to their competitors (and others) as to themselves. Second, Order 888 prescribed the unbundling of certain functions normally performed by a single electric utility. Thus, generation had to be insulated from other utility functions, particularly transmission, so that it would compete on an equal basis with other generators. The requirement for unbundling, in turn, ultimately caused many utilities to divest ownership of substantial parts of their generating facilities and to sell them to generating companies. These changes established the framework of wholesale deregulation of electric power.

D. Enron Moves into the Limelight

The arrival of competition to the electric power industry gave rise to the entry into the power business of a whole congeries of new companies. There were, first of all, the generating companies, whose business was to own EWGs and to supply electric power independently to the grid. Beyond these, there was a wide variety of companies engaged in marketing and trading in electricity products in megawatt-hours, firm and non-firm, on-peak and off-peak, and electricity derivatives, making markets that grew up with deregulation. Enron, which was anxious to shed its stodgy image of being a gas transmission company, moved into the vanguard of this movement. Enron was in some ways, but certainly not in all ways, the turn-of-the-century counterpart of the Insull empire. It streaked across the last decade of the twentieth century like a newly discovered comet, burning bright as it flew, only to flame out suddenly with a blinding flash. Enron represented a spectacular investment in innovation, riding very high with that quality, which was treasured above all else at the time.²⁷⁵ But Enron's ultimate collapse was, in many ways, a case of innovation of the wrong sort gone awry.

Enron Corporation was the brainchild of Kenneth Lay (Lay), a Phi Beta

274. Specifically, Order 888 provides that "[i]n this Rule, the Commission seeks to remedy both existing and future undue discrimination in the industry and realize the significant customer benefits that will come with open access. Indeed, it is our statutory obligation under sections 205 and 206 of the Federal Power Act (FPA) to remedy undue [past] discrimination." *Id.* at 21,541.

275. See, e.g., Nicholas Stein, *The World's Most Admired Companies*, FORTUNE, Oct. 2, 2000, at 182. The article, which was subtitled *How do you make the Most Admired List? Innovate, innovate, innovate*, opined, "No company illustrates the transformative power of innovation more dramatically than Enron. Over the past decade Enron's commitment to the invention—and later domination—of new business categories has taken it from a \$200 million old-economy pipeline operator to a \$40 billion new-economy trading powerhouse." *Id.* at 184. See also Agis Salpukas, *Firing Up an Idea Machine; Enron is Encouraging the Entrepreneurs Within*, N.Y. TIMES, June 27, 1999, at § 3, 1 ("In less than a decade, . . . Enron has emerged from its unlikely perch in the utility industry as a model for the new American workplace — every bit as much as the Silicon Valley start-ups that usually come to mind when the subject is entrepreneurship or innovation.").

Kappa graduate of the University of Missouri, with a doctorate in economics from the University of Houston. After a detour through the Federal Power Commission (FPC), which regulated natural gas and wholesale electricity prior to the FERC,²⁷⁶ he settled down in the natural gas industry, eventually landing at HNG, as chief executive. HNG was primarily an intrastate Texas pipeline. Believing that one had to grow to remain independent, Lay promptly acquired two other pipelines, thereby doubling the size of his own. Negotiations then ensued for a merger with InterNorth, a much larger pipeline enterprise operating in the mid-continent. One of the terms of the merger was that Lay would become CEO of the combined company in two years. In fact, it took Lay less than a year to assume the top office and then move the company headquarters to Houston, where the enterprise acquired the name Enron.²⁷⁷

As owner of the largest interstate gas pipeline network, Enron benefitted from the increased demand for natural gas transmission that resulted from industry deregulation.²⁷⁸ Further, as the volume of gas sales shifted away from long-term contracts in favor of spot market transactions (by 1990, seventy-five percent of all gas sales occurred at spot prices),²⁷⁹ Enron was well-situated to observe the ebb, flow, and idiosyncrasies of this rapidly maturing market. In the late 1980s, a McKinsey consultant named Jeffrey Skilling noted the financial potential of using Enron's institutional and market knowledge to broker a broad array of gas contracts with suppliers and end users. Impressed by Skilling's vision, Lay persuaded Skilling to join Enron. Skilling's first major project was the creation and implementation of a "gas bank," which essentially collected a "pool" of contractual commitments from gas producers that enabled Enron to offer long-term contracts of fifteen years or more to industrial users.²⁸⁰ As Skilling told the press in 1991, "[w]e're conducting an activity like asset-liability management at a bank' . . . 'We have a portfolio of supplies and a portfolio of markets. To the buyer, it's all coming from Enron in the sense that Enron has a corporate guarantee behind the contract.'"²⁸¹

From the outset, Enron's gas bank venture was closely linked to the growth of gas-powered electric plants. In a 1991 forum of gas executives, Skilling commented that the most significant growth in the natural gas markets will occur in the power generation business: "The growth in this segment is driven by an overall increase in the demand for electricity and, more importantly, by the environmental and cost advantages that natural gas has over other fuels competing

276. In 1977, the Federal Power Commission (FPC) was renamed the Federal Energy Regulatory Commission (FERC). See Department of Energy Organization Act, Pub. L. No. 95-91, § 401, 91 Stat. 565, 582 (1977) (codified as amended at 42 U.S.C. § 7171 (2000)).

277. Fusaro & Miller, *supra* note 9, at 4-5.

278. See Krishna G. Palepu & Paul M. Healy, *The Fall of Enron*, 17 J. ECON. PERSP. Spring 2003, 3, 5-6 (noting that Enron's "returns of beginning equity in the years 1987 to 1990, when it was primarily a pipeline business, were 14.2, 13.0, 15.9 and 13.1 percent respectively, compared with an estimated equity cost of capital of around 13 percent").

279. *Id.*

280. See Thomas C. Hayes, *Bottom-Fishing in the Gas Patch*, N.Y. TIMES, May 19, 1991, at § 3, 1.

281. *Id.*

for new generating capacity.”²⁸² Similar to Samuel Insull’s contention that state regulated monopolies benefitted consumers by lowering the financing costs of large capital investments, Enron’s gas bank offered long-term fixed price supply contracts that substantially reduced the risk of financing gas-powered electric plants.²⁸³ To facilitate the growth of the independent power producer (IPP) sector, Enron acted as one of the major lobbyists for the Energy Policy Act of 1992,²⁸⁴ which created a new category of power plants (EWGs) that were exempt from the PUHCA’s corporate ownership and geographic provisions.

In many respects, Enron’s growth in both the gas and power markets was integrally related to the erosion of the greatest legislative legacy of the Insull debacle – the Public Utility Holding Company Act.²⁸⁵ Building upon the perceived success of the PURPA,²⁸⁶ which amended the PUHCA to permit registered holding companies to own up to a fifty percent interest in QFs, EPAct authorized registered holding companies to own a 100 percent stake in EWGs. In short, the nation’s largest utilities, whose growth had been held in check by the PUHCA for over a half century, were invited to become full participants in the deregulation process.²⁸⁷ During the first two years of EPAct, the FERC received more than 170 applications for EWGs and approved most of them.²⁸⁸

At the same time that power companies were investing in EWGs, Enron and other companies applied to the FERC for the right to broker and market power.²⁸⁹ In 1993, Enron Gas Services, which was then the largest buyer and seller of natural gas in North America, formed Enron Power Marketing, Inc.²⁹⁰ Within two years, Enron emerged as the leader in trading electric power, with a 100-employee trading floor in Houston, Texas, “where 100 employees trade in electricity futures around the clock, buying power from generators, taking title to it, finding wholesale markets to supply, and negotiating transmission paths.”²⁹¹

282. #1. *FutureGas Markets*, PUB. UTIL. FORT., Oct. 15, 1991, at 36 (asking several gas executives, including Jeff Skilling, where they envision future growth in the gas industry).

283. See Hayes, *supra* note 280, § 3, 1 (noting that “without ironclad guarantees for 15 years or more of supply, lenders have refused to finance the construction of gas-fired power plants for utilities[]” and that “Enron’s plan for creating a market for long-term gas contracts depends on [the] utilities need to build new gas-fired plants.”).

284. William H. Miller, *Vision Vanquisher*, INDUS. WK., May, 18, 1998, at 37, 39 (reporting that Enron “became a prime lobbyist for [the] 1992 legislation that opened up the nationwide electricity transmission grid to nonutility third parties”; quoting CEO Lay that “electricity was a business in which we wanted to be a major participant.”).

285. See *supra* Part III.A.

286. Studness, *supra* note 259, at 41 (noting that in recent years facilities authorized “under the restrictive auspices of the [PURPA]” accounted for thirty to fifty percent of the industry’s new generating capacity).

287. *Id.* (“In creating EWGs, the [Energy Policy] Act stripped away the legal straight-jacket that kept the industry vertically integrated and fragmented into over 100 local companies for over half a century. The way is now open for competition to restructure the industry.”).

288. See Alex Radin, *Examining the Impacts of the Energy Policy Act of 1992*, 35 MGMT. Q., Sept. 22, 1994, at 15.

289. See W. Lynn Garner & Lori A. Burkhart, *Power Marketers Flex at FERC*, PUB. UTIL. FORT., Feb. 1, 1995, at 35 (reporting “approximately 81 applications [to market power] in 1994, compared to nine in 1993”).

290. See Marie Leone, *Independent Power: State of the Market*, 138 POWER, Feb. 1994, at 45.

291. Herbert A. Cavanaugh, *Round-Table Reveals Executives of One Mind: Competition*, ELEC. WORLD, May 1995, at 27 (caption under photograph of trading floor at Enron Power Marketing, Inc.).

In 1995, a senior executive of CInergy Corporation confided that the company had held a planning retreat in Houston, Texas for “the sole purpose of going over to Enron Corp to look at their [electricity] trading floor.”²⁹²

Enron’s aggressive entry into the power marketing business reflected its belief that the gas and electric industries were converging, primarily because of the cost and environmental advantages of gas-fired electric generation.²⁹³ In 1995, Enron changed its corporate vision statement to encompass its ambition to become “the leading energy company in the world.”²⁹⁴ With \$300 billion per year in annual revenues (more than telephones and airlines combined),²⁹⁵ the electric industry presented Enron with a tremendous opportunity for growth. Shortly after the FERC issued Order 888, which mandated non-discriminatory access to the transmission grid and the unbundling of traditional utility functions, Jeff Skilling commented to the press that “[t]he electricity business, which was a distinct stand-alone business, is now becoming part of the energy industry’ ‘From our humble beginnings, we have a market that’s nine times as big as the original gas market.’”²⁹⁶

With the FERC clearing away all obstacles to interstate competition at the wholesale level, Enron’s financial fortunes were now integrally tied to deregulatory initiatives at the state level. The California Public Utility Commission (CPUC), which grappled with some of the highest power costs in the nation, had been working on a restructuring plan since 1992.²⁹⁷ With the California legislature poised to adopt its famous Assembly Bill 1890 (AB 1890) deregulation plan, which purportedly would serve as the model for the rest of the nation, Enron announced its intention to acquire Portland General Corporation (PGC), a state-regulated regional utility operating in Oregon.²⁹⁸ The acquisition of PGC provided Enron with low-cost generation and transmission facilities in close proximity to the California-Oregon border delivery point for NYMEX electricity future contracts and an excellent platform to market electricity into California.²⁹⁹

292. *Id.* See also A.D. Koen, *U.S. Gas Companies Seek Niches in Decontrolled Power Industry*, OIL & GAS J., Oct. 23, 1995, at 33, 35 (noting that Enron “in [the] first half [of] 1995 sold more than 2.2 billion kw-hr of electrical power, tops in [the] domestic markets among independent U.S. power marketers”); Christopher Palmeri, *Power Broker*, FORBES, Nov. 6, 1995, at 60 (listing Enron as the industry’s largest nonregulated electricity marketer).

293. See, e.g., Miller, *supra* note 284, at 37, 39 (reporting Ken Lay’s conviction, beginning in mid-1980s, that the gas and electric industries were converging, “primarily because natural gas would be the swing fuel in power generation”).

294. *Id.* at 37.

295. James Flanigan, *Deregulating Utilities Can Learn From Enron*, L.A. TIMES, Aug. 18, 1996, at D1.

296. Hillary Durgin, *With Houston Emerging as a Hot Spot for the Sale of Electricity, Companies are Lining Up to Feel the Charge of Intense Demand – and Risk*, HOUS. CHRON., July 7, 1996, at Bus. 1.

297. See Timothy P. Duane, *Regulation’s Rationale: Learning from the California Energy Crisis*, 19 YALE J. ON REG. 471, 496–97 (2002) (discussing how the California deregulation plan evolved from the “Yellow Book” CPUC staff report to the “Blue Book” policy statement to the eventual adoption of AB 1890).

298. Bloomberg Business News, *Enron Buys Oregon Utility*, OMAHA WORLD HERALD, July 23, 1996, at Bus. 16 (reporting Ken Lay’s belief that the acquisition “will prepare his company for deregulated U.S. electricity markets by combining Enron’s marketing and energy supply skills with Portland’s experience running a local utility”).

299. Richard S. Green & J. Michael Parish, *Enron’s End Run: Marriage of Convenience Eyes Retail*

In California, the political mood was certainly welcoming of Enron. After both houses of the California legislature *unanimously* passed AB 1890,³⁰⁰ Governor Pete Wilson signed the bill into law and declared, “[w]e’ve pulled the plug on another outdated monopoly and replaced it with the promise of a new era of competition’”³⁰¹

Reminiscent of Insull’s vast propaganda campaign to highlight the benefits of privately owned utilities and the evils of public power,³⁰² Enron embarked upon a lavish public relations effort designed to educate consumers (and voters) on the virtues of electricity deregulation.³⁰³ In a high-profile experimental pilot program in Peterborough, New Hampshire that permitted the town’s 5300 residents to choose their own electricity provider, Enron opened a local storefront with a thirty-person sales staff.³⁰⁴ After making a \$25,000 donation to a downtown revitalization program, hosting a picnic for local residents, and sponsoring a local high school’s solar-powered car project, Enron received the endorsement of town leaders and signed up the majority of residents in the program.³⁰⁵

Although Enron acknowledged that the Peterborough effort produced a \$100,000 net loss,³⁰⁶ the payoff came on Super Bowl Sunday in January 1997, when Enron debuted a television ad touting its success in New Hampshire. The ad included a newly subscribed Enron customer informing viewers that “Nobody likes a monopoly, particularly in a place where the state motto is ‘Live Free or Die,’” followed by an announcer intoning, “You can choose your neighbors, and soon you may choose your energy company: Enron.”³⁰⁷ The television commercials were followed by print ads with Enron customers from around the globe claiming that Enron had delivered them cleaner, cheaper, and more reliable energy. When readers called the accompanying “800” number, operators provided them with information on how to switch to Enron or how to join the lobbying efforts to bring faster deregulation.³⁰⁸

Market, PUB. UTIL. FORT., Oct. 1, 1996, 24. This article goes on to note that Enron will reincorporate in Oregon in order to qualify as an exempt holding company under section 3(a)(1) of PUHCA. “Because Enron does not have any jurisdictional operations and PGC carries on its electric utility business ‘substantially in a single state,’ the parties believe the section 3(a)(1) exemption should apply to this merger.” *Id.* at 25.

300. See Duane, *supra* note 297, at 497.

301. Dan Morain, *Deregulation Bill Signed by Wilson*, L.A. TIMES, Sept. 24, 1996, at A3 (quoting California Governor Pete Wilson).

302. See Part II.C, *supra*.

303. *Enron Launches Ad Campaign to Become Household Name*, MEGAWATT DAILY, Jan. 15, 1997, at 1 (discussing Enron’s media efforts to become “one of the most recognizable names in the world” and reporting belief among consultants and ad agencies that “the new competitive energy business” will result in “the biggest advertising market since telecommunications”).

304. Agis Salpukas, *Subsidizing Competition in Utilities*, N.Y. TIMES, Feb. 1, 1997, Bus. § 1, at 33 (reporting opening of Enron local office in April 1996).

305. Richard A. Oppel, Jr., *Power Play; New Hampshire Tryout Lets People Shop for Electricity*, DALLAS MORNING NEWS, Apr. 6, 1997, at 1H (quoting manager of Enron’s Peterborough office, “We went back to the basics of selling. . . . We weren’t just another piece of paper on somebody’s desk.”).

306. *Id.*

307. Allen R. Myerson, *The Media Business: Advertising*, N.Y. TIMES, Jan. 14, 1997, at D6 (reporting that the goal of Enron’s ad campaign was “to persuade Americans to demand faster deregulation of the electricity industry, teach them the Enron name and then win them over as customers”).

308. *Id.*

In their public relations and political lobbying campaigns, Enron executives seemed to relish this opportunity to lampoon the inefficiencies and self-interest of old-line utility monopolies. In testimony before the U.S. Senate Committee on Energy and Natural Resources in March 1997, Jeff Skilling stated:

For decades, electric power has been delivered to American households by a patchwork of utility monopolies. No one can seriously defend that system anymore. It is inefficient. It is unnecessarily costly. It stifles innovation. It forces consumers to pay high rates while large industrial customers get special rates. I am absolutely certain, Mr. Chairman, that if you reconvene this panel ten years from now, all of us will wonder aloud why we ever let the monopoly persist for so long.³⁰⁹

Several months later, in a turf battle with Southern Company, the nation's largest power generator, Skilling told a reporter, "If Thomas Alva Edison came back from the dead and called Southern Company to get some electricity, he'd find that nothing has changed. . . . These guys are living in an industry that was created 100 years ago, and they want to keep it that way."³¹⁰

Enron's most impressive push – in fact the high point of its corporate efforts to sell electricity deregulation – came in Pennsylvania. After state regulators tentatively struck a deal with PECO Energy (the local electric utility, formerly Philadelphia Electric) to gradually deregulate the Philadelphia market in exchange for a provision that would compensate PECO for its stranded costs, Enron shocked everyone by submitting a proposal in which Enron would pay off PECO's \$5.46 billion stranded costs *and* guarantee consumers a twenty percent rate reduction – ten percent more than the PECO plan.³¹¹ As a condition of the offer, however, Enron would become the default provider for all customers who had not elected to buy their power elsewhere. In the ensuing public relations free-for-all, Enron chartered a plane to circle PECO headquarters towing a banner proclaiming, "Enron[']s choice plan saves 20%."³¹² The company also blitzed the local media markets with ads and hired Christian Coalition leader Ralph Reed to advise Enron on how to build consumer support within the state.³¹³ In response, PECO hired David Leisure, who gained popularity as the lying car salesman, Joe Isuzu, to portray a slippery energy salesman. Although PECO's ad did not mention Enron by name, the reference was unmistakable. Dressed in full cowboy regalia, the fictional salesman stated that if a customer signed up today, "I'll give all the kids in Pennsylvania a free pony ride and I'll throw in the Brooklyn Bridge as a bonus."³¹⁴ In the end, the Pennsylvania Public Utilities Commission approved a fourteen percent rate cut, a small reduction in

309. See *Competitive Change in the Electric Power Industry: What are the Issues Involved in Competition? Before the Senate Comm. on Energy & Natural Res.*, 105th Cong.(1997) (testimony of Jeffrey K. Skilling, President and Chief Operating Office, Enron Corp.).

310. Matthew C. Quinn, *Power Struggle; Houston-based Enron Vigorously Challenges Southern Co. Across the U.S., Abroad*, ATL. J. CONST., Nov. 23, 1997, at H1.

311. Bruce W. Radford, *Enron Calling*, PUB. UTIL. FORT., Nov. 1, 1997, at 4. Enron purportedly could make this offer because it had the means to finance the stranded costs at a lower rate than PECO. *Id.*

312. Earl Hazen, *Deregulation: The Show Goes On*, TRANSMISSION & DISTRIB. WORLD, Mar. 1, 1998, available at http://tdworld.com/mag/power_deregulation_show_goes/.

313. *Id.*

314. Hazen, *supra* note 312, at 5.

stranded cost recovery and a “shopping” credit for consumers, with PECO as the default provider until the commencement of a competitive bidding in 2001.³¹⁵ Although Enron didn’t get the business, it showed that competition can sometimes work to consumers’ benefit.

Yet, notwithstanding Enron’s herculean efforts, to this day it remains unclear whether electricity deregulation is an issue that resonates with consumers and citizens. For example, in late 1997 and early 1998, Enron launched a \$10 million marketing and advertising campaign in California to entice some of the state’s eight million residential accounts to switch to Enron. In April 1998, Enron abruptly ended its efforts after signing up a mere 30,000 households.³¹⁶ Perhaps even more surprising was Enron’s relative “success”—its 30,000 new customers accounted for seventy-five percent of all residential switches away from California’s three big investor-owned utilities.³¹⁷ This relative consumer apathy is consistent with Representative Peter DeFazio’s observation that:

[The alleged consumer demand for electricity deregulation] was sheer fabrication. In hundreds of town halls, I was never once asked by a constituent to be given the right to shop around for an electricity provider. And why should they? When they flipped the switch, the lights came on. When they received their electricity bill, it was reasonably priced.³¹⁸

Yet, if consumers were relatively content with the status quo, Enron and the major investor-owned utilities were generally allied in their support for additional energy deregulation, including the full repeal of the PUHCA.³¹⁹ Their only major point of disagreement was the extent to which the formerly regulated utilities would receive payment for their stranded costs.³²⁰ Indeed, as the 1990s

315. Michael Davis, *Pa. Utility Makes Deal to Pay Way for Competition*, HOUS. CHRON., May 1, 1998, at B1 (summarizing terms of settlement agreement between state regulators, PECO, Enron, and other private sector power companies); *Market Restructuring; Full Settlement Reached in Pennsylvania*, POWER ECON., June 30, 1998, at 18 (quoting an Enron spokesman, “Without a doubt, this is the best framework for a competitive market to date. It absolutely sets the standard for states across the country.”).

316. Kenneth Howe, *Enron Out of Home Electricity Market*, S.F. CHRON., April 23, 1998, at D1.

317. *Id.* Enron claimed that it was ending its campaign to sign-up residential customers because the structure of the California deregulation made it uneconomical to offer the types of rate discounts necessary to induce substantial customer switching. Howe, *supra* note 316. Yet, the details of the California plan were well-known long before Enron began its customer solicitation campaign. *Id.* (quoting president of the California Public Utilities Commission, “Enron knew the economics before they came to California. I had been led to believe they were in for the long term.”).

318. Rep. Billy Tauzin & Rep. Peter DeFazio, *Should Congress Enact President Bush’s Plan to Restructure Wholesale Electricity Markets?*, ROLL CALL, Oct. 1, 2001, at 3.

319. See, e.g., Nick Anderson, *Electric Power Deregulation Gains Steam*, L.A. TIMES, Sept. 11, 2000, at A3 (“What do all these special interests want? Most players agree that a starting point is repeal of the [PUHCA.]”); Tami Cissna, *White House Deregulation Plan Falls Short*, ELEC. LIGHT & POWER, May 1998, at 1 (reporting favorable response by both Enron and Edison Electric Institute (EEI) to President Clinton’s proposed deregulation plan, which would repeal the PUHCA, though acknowledging EEI’s objections to the administration’s proposed regulations over utility mergers and quoting Enron executive Steven Kean, “You now have a very big consensus for moving forward on competition.”).

320. See, e.g., Dan Morgan, *Rivals Battled Enron in Energy Lobbying*, WASH. POST., Feb. 19, 2002, at A4 (reporting that from 1996 to 2000 the biggest investor-owned utilities in the South and Midwest fought “Enron-backed” legislation that would have opened up retail competition without any provisions for recovering stranded costs); Harvey Wasserman, *The Last Energy War: The Mega-Battle over Utility Deregulation*, THE NATION, Mar. 16, 1998, at 14 (noting Representative Tom Delay’s introduction of “the ‘Enron Bill,’ which

progressed and the political climate favoring deregulation warmed, the electric industry experienced a massive consolidation,³²¹ with merger and acquisition activity increasing from approximately \$2.5 billion in 1993 to \$93.9 billion in 1999.³²² Moreover, between 1992 and 2002, the number of companies operating as registered holding companies under the PUHCA increased from fourteen to sixty-five,³²³ presumably in anticipation of the Act's imminent repeal. If electric deregulation is supposed to deliver the benefits of commodity pricing to the consumer,³²⁴ one might wonder why some major industry players have been in such a hurry to expedite it. If one wants to read the tea leaves for what a fully deregulated electrical industry would look like, perhaps the appropriate model would be the industry *before* federal regulation. And that brings us back to Insull.

Insofar as the free-market attitudes of the 1990s inadvertently gave rise to a modern version of the power trust, Enron was indisputably the standard bearer. Although there were substantial criticisms that Enron and its ilk were corrupting the political process,³²⁵ or in the case of California, fleecing the average consumer,³²⁶ Enron's stature and political influence, like the Insull empire seventy years before, seemed to rise and fall only with its stock price. Further, in terms of the sheer abruptness and magnitude of the Insull and Enron collapses, the parallel between these two energy icons is striking.³²⁷ While the legislative reforms that were passed in the wake of the Enron scandal are designed to protect us against another Enron, the passage of the New Deal securities laws and the

would ban stranded costs from being passed along altogether, a position shared by the right-wing, 'free-market' Heritage Foundation").

321. BARBASH, *supra* note 246, at 8-9 (SEC official commenting in 1997 that "[t]he current merger mania would not likely have pleased the drafters of the '35 Act, whose goal was breakup, rather than combination, of utilities.").

322. Kevin Genieser, *Will M&A Return?*, 4 UTIL. PROJECT at 1, fig.1 (Mar. 11, 2004), at http://www.utilitiesproject.com/documents.asp?d_ID=2392 (figure tracking M&A activity in the utility industry between 1993 and 2003).

323. AM. PUB. POWER ASS'N, THE PUBLIC UTILITY HOLDING COMPANY ACT: ITS PROTECTIONS ARE NEEDED TODAY MORE THAN EVER 6 (2003).

324. As Jeff Skilling commented in 1998, "Electricity will become one of the most brutally competitive markets with all the unfavourable characteristics of commodity chemicals, and none of the positives." William Burke & David Haarmeyer Stone, *Successful Strategies for the New U.S. Electricity Market*, POWER ECON., Sept. 30, 1997, at 29.

325. See, e.g., Bruce Nichols, *Enron Chief Masters Power of Persuasion*, DALLAS MORNING NEWS, July 22, 2001, at H1 (noting that Enron's list of friends in government include "President George W. Bush and Vice President Dick Cheney" and that Lay "was one of the few outsiders to huddle with Mr. Cheney this spring as the vice president prepared the administration's energy policy"); Nick Cohen, *Guess Who's Going to Dubbya's Party*, NEW STATESMAN, Jan. 22, 2001, at 20 ("Governments adore Enron, and the affection is reciprocated. Enron is the global leader in the political 'influence' market.")

326. See, e.g., Jonathan Peterson & Dawn Wotapka, *Lockyer Sues Enron; FERC to Review Tapes*, L.A. TIMES, June 18, 2004, at C1 (discussing audio tapes of Enron energy traders chortling over the company's successful manipulation of the California energy market; reporting that two Enron traders had pleaded guilty to federal charges for market manipulation in California).

327. Compare SELIGMAN, *supra* note 1, at 22 (noting newspaper headlines from 1931 that Insull collapse was "the biggest business failure in the history of the world"), with Connie Armenti, *Spectacular Enron Bankruptcy Biggest in US History*, ENERGY DAY, Dec. 6, 2001, at 11 ("After announcing a [\$638 million] third quarter loss on October 16, the company's fall from grace was swift and heavy, rocking the world's markets and leaving more than 5,500 workers in two continents unemployed.").

PUHCA were supposed to protect us from another Insull. Of course, it is hard to protect ourselves from another Insull debacle when the story of Samuel Insull has faded from our collective memory. Two generations from now, the same might be said about Enron.

In the end, Enron's financial collapse, like Insull's, was caused by a liquidity crisis brought on by excessive debt. Enron's entire business model of making markets in various commodities (electricity and natural gas being the most prominent) required both copious amounts of cash and a sterling credit rating so that the company could grow its trading operations without being required to put up collateral.³²⁸ Although Enron was able to post prodigious earnings by aggressive use of mark-to-market accounting to value a wide range of transactions, often with Enron affiliates, the transactions themselves produced little or no actual cash.³²⁹ Thus, to avoid taking on more debt (which would have affected its credit rating) or issuing additional stock (which would have affected its stock price), Enron ultimately engaged in a series of structured transactions with special purpose entities (SPEs) that were typically managed by company executives and backed by pledges of Enron stock. These transactions permitted Enron to off-load underperforming assets from its balance sheet in exchange for large infusions of cash that were ultimately recorded as operating income. Yet, as the Enron bankruptcy examiner concluded, "Enron retained the risk of ownership of the asset and the recourse obligation to repay the sales 'proceeds.'"³³⁰ In other words, Enron used the now notorious off-balance sheet partnerships to obscure a highly leveraged capital structure.³³¹ Yet, once the investing public began to grasp the true risk that lurked within Enron's obscure financial statements, the Company's stock price plummeted, triggering loan commitments that the company had no reasonable ability to pay.³³² In early December 2001, Enron filed for bankruptcy.

328. See Second Interim Report of Neal Batson, Court-Appointed Examiner, at 18–19, *In re Enron Corp.* (Bankr. S.D.N.Y. Jan. 21, 2003) (No. 01-16034 (AJG)) [hereinafter Second Batson Report] (commenting that Enron's credit rating was crucial to the company's success because the company "needed to trade with other market participants with being required to post collateral").

329. *Id.* at 22–29 (discussing genesis and evolution of Enron's use of mark-to-market (MTM) accounting, which carried assets "at their 'fair value,' based upon publicly quoted prices, or if there are none available, based upon management's estimate using the best information available to determine the fair value of the assets" and noting that overreliance on MTM accounting eventually created a "quality of earnings" problem for Enron).

330. See Third Interim Report of Neal Batson, Court-Appointed Examiner, at 18–19, *In re Enron Corp.* (Bankr. S.D.N.Y. June. 30, 2003) (No. 01-16034 (AJG)) [hereinafter Third Batson Report].

331. See George W. Kunej, *Everything I Needed to Know About Enron I Learned in Kindergarten (and Graduate School)*, in CORPORATE FIASCOS, *supra*, note, at 906-07 (arguing that the basic purpose of Enron's SPEs, "[a]ll the technical accounting and legal explanations aside," was to hide debt and leverage); Harold S. Peckron, *Watchdogs that Failed to Bark: Standards of Tax Review After Enron*, 5 FLA. TAX REV. 853, 903 (2002) (arguing that Enron kept massive debt off its balance sheet and its credit rating high by relying upon "off-the-books partnerships and maddeningly opaque accounting").

332. FUSARO & MILLER, *supra* note 9, at 123 (discussing how the drop in Enron's stock price triggered debt acceleration clauses and calls for additional cash and collateral to protect investors in SPEs created by Enron).

IV. INSULL AND ENRON: REFLECTIONS ON TWO ENERGY ICONS

On the surface, the collapse of Enron and of the Insull empire related to the same phenomenon—the crash of their respective stock prices. In the case of Insull, the bank loans, near the end, to IUI and Corp (the top holding companies) were collateralized by their portfolios of other Insull company securities. The market values of those securities remained buoyant during the first half of 1931, but after that went into a sickening plunge until, by 1932, the collateral value of the IUI and Corp portfolios was exhausted.³³³ This process was replicated by the precipitous decline of Enron stock in 2001, which drove that company to the brink, and over, as it struggled with its crushing debt burden.³³⁴ When, in Insull's case, the New York banks gained a commanding position by reason of the decline in collateral value, the sad ending was assured. Thus, at least superficially, the end of Insull and the demise of Enron shared an aspect repeatedly gracing the annals of capitalism—these collapses resulted from the precipitous decline in the price of stock held on margin.

But, looking below the surface, how much did the crash of Insull and the failure of Enron have in common, and in what respects were they very different phenomena? And, more importantly, what regulatory measures, existing and proposed, can help to avert such disasters in the future? This final Part suggests that Insull and Enron are emblematic of relatively rare moments in history when the birth of a new infrastructure industry creates an enormous surge in economic activity that captures the imagination of the investing public and weakens the commitment of the political class to serve as vigilant, disinterested regulators. Insull owed his rise and fall to the public's powerful faith in an electric industry with a virtually limitless future. Similarly, Enron's proficiency at making markets for energy products converged with the so-called "new economy" to create a sparkling enterprise that "synthesized existing ideas from the Texas oil business, Wall Street and Silicon Valley."³³⁵

In essence, Insull and Enron were unique in their respective generations. Looking at the contemporary scene, there is ample evidence that the remedies adopted to prevent a recurrence of the Insull disaster (in the form of the New Deal regulatory framework) were, to a significant degree throughout the 1990s, viewed by policy makers and academics as anachronistic and irrelevant. Yet, it was this very framework that was dusted off and toughened to respond to the abrupt fall of Enron. Hence, there is a serious risk that policy prescriptions flowing from the Enron debacle will ultimately be thought of as equally obsolete by the time another "Enron" arrives on the scene. History will likely repeat itself, and there is little that can be done beyond general (and vain) admonitions that

333. See *supra* notes 175–179 and accompanying text.

334. See Third Batson Report, *supra* note 330, at 9 (reporting that Enron's total debt on the eve of bankruptcy was \$ 38.1 billion though only \$ 13.0 billion had been reported on the company's most recent Form 10-Q filing with the SEC).

335. Jacqueline Lang Weaver, *Can Energy Markets Be Trusted? The Effect of the Rise and Fall of Enron on Energy Markets*, 4 HOUS. BUS. & TAX L.J. 1, 17 (2004) (quoting Daniel Altman, *Finding Gems of Genius Among Enron's Crumbs*, N.Y. TIMES, Feb. 3, 2002, § 4 at 6).

future generations ought to become more devoted students of history.

Part IV is organized as follows. Section A examines the heavily leveraged nature of both Insull and Enron and how the opaque capital structures of both companies should have put investors on notice that both Insull and Enron were loaded with risk. Section B argues that the ethos of the 1920s and 1990s, characterized by a runaway stock market, resulted in an ideologically charged environment in which officials refused to enact or to enforce unpopular (but, as it turned out, necessary) regulation. Finally, section C ruminates on what the Enron debacle has contributed to the longstanding debate on how to regulate electricity.

A. Leverage, Disclosure, and Risk

The ultimate question about Enron and Insull is why the New Deal regulatory legislation, which was enacted in the wake of the Insull collapse, apparently did little to prevent the Enron catastrophe. This analysis must start with the dangerous condition that characterized both Insull and Enron—excessive leverage.³³⁶ Now, leverage is almost always a factor in a company's spectacular success and even more leverage often plays a part in a subsequent failure. For leverage occupies the same multiplier role in the expanding growth of earnings in a period of corporate success as it may later play on the downside when earnings shrink and ultimately turn into mounting losses.³³⁷ Similarly, when a company raises capital by hypothecating its own stock – a means of financing utilized by both Insull³³⁸ and Enron³³⁹ – a drop (and frequently an accelerating drop) in the stock price can leave debts unsecured and the enterprise bankrupt.

The assumption that drives the New Deal securities laws is that the investing public is adequately protected from unduly speculative securities by requiring issuers to make complete disclosure of all material facts and risks known to management. And significant leverage is obviously a material risk. With respect to disclosing debt to equity ratios, Insull and Enron ostensibly operated under two completely different sets of rules. During the rise of the Insull empire, the strictures of state “blue sky” laws could be easily dodged by using the mails to make a securities offering across state lines.³⁴⁰ In contrast, Enron and its ac-

336. See Kuney, *supra* note 331, at 877 (arguing that Enron's downfall was not attributable to leverage per se, but to the fact that the company used SPEs to conceal its heavy debt load in order to maintain a high stock price and obtain loans on more favorable terms).

337. The amplifying effect of debt on earnings is illustrated by the efforts of some utility regulators in some cases to recast and increase utility debt ratios for ratemaking purposes.

338. See text accompanying footnote 173.

339. As the interim report of the Enron bankruptcy makes clear, Enron's controversial use of special purpose entities (SPEs) essentially amounted to covert loans collateralized by Enron's own stock. See Third Batson Report, *supra* note 330, at 11–12 (discussing Enron's SPE financing, including Enron's Share Trust Transactions, in which (a) proceeds of notes and equity certificates issued by SPEs were used to purchase or finance Enron assets, and (b) the “[r]epayment of the notes and certificates was supported by Enron stock and ultimately by Enron's promise to pay”); see also Steven L. Schwarcz, *Enron and the Use of Abuse of Special Purpose Entities in Corporate Structure*, 70 U. CIN. L. REV. 1309, 1315 (2002) (noting that many of Enron's SPEs, which supplied the company with needed cash, “were capitalized solely with Enron stock”).

340. SELIGMAN, *supra* note 1, at 45 (reporting that as early as 1915, the Investment Bankers Association advised its members to use the mails to avoid state blue sky laws and quoting a 1933 Department of Commerce Study, “[th]e most effective and widely used method of evading the provision of State blue sky laws consists in

countant, Arthur Andersen, worked together to invent complex transactions that could provide a hungry Enron with enough capital while deftly avoiding the disclosure requirements of the federal securities laws.

A stark comparison of Insull and Enron leads to two interrelated conclusions about whether additional disclosures would have been adequate to protect the investing public from loss in either case. First, both Insull's and Enron's operations and capital structures were staggeringly complex, yet the iconic stature of both of these companies, in combination with the speculative milieu of the times, made it unnecessary for either Insull or Enron to simplify their disclosures in order to raise capital on favorable terms. In short, a worshipful public permitted Insull and Enron to play by their own rules.³⁴¹ Second, the effectiveness of a securities regime based on disclosure is premised on the existence of rational, objective investors capable of making rational investment decisions. During the 1920s and 1990s there was enough public information about both Insull and Enron, or, more precisely, an absence of the most crucial information, so that a rational investor would have viewed the securities of Insull or Enron with suspicion rather than enthusiasm.

In the case of Insull, the complexity of his holding companies was almost past comprehension. In his 1939 memoir, *Wall Street Under Oath*, Ferdinand Pecora quipped, "It is said that only twelve men were qualified to understand the Einstein theory of relativity; but the Insull structure was so complex that no one could fully grasp it, not even, probably, Mr. Insull himself."³⁴² To corroborate this observation, Pecora referred to an exchange between himself and the chairman of General Electric, Owen D. Young, during Pecora's famous Senate hearings. During the days before the Insull collapse, Young was asked to broker an agreement between Insull and various New York banks, and he thus became quite familiar with Insull's financial troubles. The Pecora-Young exchange is interesting.

Mr. Pecora: When you refer to the structure of the Insull Companies as being a very complicated one, will you tell the Committee just what you mean by that?

Mr. Young: Well, I confess to a feeling of helplessness as I began to examine in February, 1932, the complicated structure of that organization. . . . Great numbers of operating utilities, with holding companies superimposed on the utilities, and holding companies superimposed on those holding companies, investment companies and affiliates, which made it . . . impossible for any man, however able, really to grasp the real situation.³⁴³

In reply to Pecora's question about whether the Insull companies were overcapitalized, Young offered the following remarkable response:

operating across State lines.").

341. Based on our own extensive readings on Insull and Enron, both of these companies had a track record of real rather than illusory success. Indeed, it was the leveraging of that success that substantially contributed to their demise.

342. PECORA, *supra* note 224, at 224-225.

343. *Id.* at 225. Young goes on to add, "I believe Mr. Samuel Insull was very largely the victim of that complicated structure, which got even beyond his power, competent as he was, to understand it." PECORA, *supra* note 224, at 226.

It would lend itself . . . to overcapitalization, but it is not that aspect . . . which disturbs me. It is this: if I am right in thinking that Mr. Insull himself was not able ultimately to understand that structure, how can the ordinary investor, buying shares or buying obligations, especially of the last companies, on the top, how can they be expected to know, or even to inform themselves, conscientious and able as they might be, really as to the value of those securities?³⁴⁴

What Young seems to be saying is that no human being could have possibly assessed the financial risk that lurked within the Insull empire. Nonetheless, we know that throughout the 1920s, the investing public had an insatiable appetite for Insull securities. As Insull himself noted during his subsequent criminal trial, "They used to say . . . that if we issued a piece of brown paper with a signature on it we could raise all the money we wanted to."³⁴⁵ Perhaps the simplest explanation of this phenomenon is that Insull seemed to have the Midas touch. As a journalist of the time noted, Insull securities offerings were so successful because so many investors bought "wholly on faith."³⁴⁶

Notwithstanding the purported sophistication of modern capital markets, Enron, too, was certainly the beneficiary of copious amounts of investor "faith." As one prominent investment manager, who took a large position in Enron, observed, "'nobody knows how they put everything together.' . . . 'Until they prove you not to be correct' . . . 'you have to trust them. To some degree, [companies like Enron] become faith stocks.'"³⁴⁷ Prior to its collapse, the worst thing that analysts had to say about Enron was that they could not understand the company's business model.³⁴⁸ As early as 1996, some analysts acknowledged that Enron's trading transactions were "so complex that they represent a 'black box,' making it difficult to calculate the company's future profitability."³⁴⁹ Indeed, Enron's energy trading business relied heavily on derivative contracts to hedge its positions. Because of their intricacy and staggering volume, one prominent official of an accounting trade group has referred to the rules governing derivatives as "'a monstrosity of accounting standards that nobody understands,' including accountants and chief financial officers."³⁵⁰

344. *Id.* at 228.

345. RAMSAY, *supra* note 102, at 254 (alteration in original).

346. *Id.* at 137. The journalist, writing in 1937, goes on to make an observation on Insull that, nearly seventy years later, would seem to apply to Enron with equal force:

The faith of the public, as of a superfinancier, is no more conformable to logic than fashions or love. Allowance must be made for the extraordinary tenacity of a powerful going concern, and of a financial scheme which has captured the public's fancy and faith. The human mind is prone to recoil from assailing, or even doubting, a ruling, dominant institution.

RAMSAY, *supra* note 102, at 242.

347. Aravind Adiga et al., *Faith Stocks: Enron's Fall from Grace Poses the Question: Why Believe in Some Companies Over Others?*, MONEY, Mar. 2002, at 23 [hereinafter Adiga] (quoting Alfred Harrison of Alliance Capital); see also Birger, *supra* note 10, at 95 (reporting that Alliance Capital lost \$600 million on its Enron stake).

348. Adiga, *supra* note 347, at 23.

349. Daniel Southerland, *You've Heard of Big Oil. This is the Story of Big Gas*, WASH. POST, Feb. 4, 1996, at H1.

350. Steve Leisman, *Deciphering the Black Box: Many Accounting Practices, Not Just Enron's, Are Hard to Penetrate*, WALL ST. J., Jan. 23, 2002, at C1 (quoting Philip Livingston, President of Financial Executives

Further, Enron's use of SPEs proved baffling to even the most sophisticated observers. As Professor Schwarcz recently observed:

Although securitization and other legitimate structured finance deals can be disclosed with sufficient depth and detail to adequately inform a sophisticated investor in the *SPE's securities*, such disclosure may sometimes go over the head of an ordinary, or even sophisticated, investor in, for example, *equity securities of the company* [e.g., Enron] *originating* the structured finance transaction; whereas a lower level of disclosure is likely to oversimplify the transaction. In these cases, as with Enron, ordinary investors must rely on the business judgment of the company's management in setting up the structured financing transactions for the company's benefit.³⁵¹

Since most investors will be unable to comprehend the complex disclosure that accompanied SPEs, Schwarcz concludes that the most effective protection an investor can enjoy is a management team, unlike the one at Enron, that is "free of material conflicts of interest."³⁵²

In their respective eras, Insull and Enron are perhaps extreme examples of the uses and abuses of financial complexity. Both companies were highly leveraged enterprises that nevertheless enjoyed the status of being a "blue chip" investment. Yet, this image was largely the product of an opaque capital structure and a fawning financial press rather than the consequence of overtly fraudulent claims and representations. In the case of Insull, his empire pre-dated federal securities laws, and his investors were apparently not troubled by the lack of a consolidated balance sheet. In the case of Enron, the public had access to the company's voluminous SEC filings, though there was a broad consensus among even sophisticated investors and analysts that the presentation of this information was hopelessly complex. This complexity made it impossible to gauge Enron's true financial health.³⁵³ Yet, Enron's seemingly deliberate lack of transparency hardly dissuaded investors. This illustrates our second closely related point: During both the 1920s and 1990s, a (hypothetical) diligent and rational investor would have likely concluded that (a) there was insufficient information in the public domain to calculate the business risks of investing in either Insull or Enron, or (b) the copious information that was available was too impenetrable to allow a reliable assessment of risk. Thus, Insull and Enron stock should have sold at a discount rather than a premium.

In the case of Insull securities, the lack of adequate disclosure by utility

International). See also Palepu & Healy, *supra* note 277, at 10 (noting that "Enron's complex business model – reaching across many products, including physical assets and trading operations, and crossing national borders – stretched the limits of accounting.").

351. Schwarcz, *supra* note 339, at 1317.

352. *Id.*

353. Indeed, in a February 2001 story in *Fortune* magazine, which later became famous, Bethany McLean canvassed Wall Street analysts for an explanation for Enron's high stock price. Remarkably, even Enron's most avid supporters could not explain how Enron made its money. See Bethany McLean, *Is Enron Overpriced?*, *FORTUNE*, Mar. 5, 2001, at 123; see also Alex Berenson, *A Self-Inflicted Wound Aggravates Angst Over Enron*, *N.Y. TIMES*, Sept. 9, 2001, § 3, at 1 (observing, three months before the company's collapse, that "[t]he complexity of the company's businesses and the way it reports its results make understanding Enron's financial statements essentially impossible.").

holding companies was a frequent topic of discussion within the investment banking community. In 1926, a committee of the Investment Bankers Association of America commented that many of the prospecti for utility holding companies fell short of industry standards because they lacked “a clear statement of capitalization showing prior securities outstanding, including those of subsidiaries.”³⁵⁴ In his exhaustive 1927 critique of Wall Street, Professor Ripley commented on the opaque capital structure of many utility holding companies, including the pyramided Insull empire. In a table showing how much revenues must dip to wipe out dividends and earnings of various holding companies, the entry for Middle West (Insull’s flagship holding company) stated that the company issued “no consolidated statements”; as a result, the risk of a decline in revenues was “not calculable.”³⁵⁵

Seventy years later, it appears that the extensive disclosures required under the federal securities laws did little to shed light on the business operations that produced Enron’s fast and steady rise in earnings. Although some analysts wrote off Enron as a “black box,”³⁵⁶ they were in the distinct minority. Yet, as Jeffrey Gordon has observed, most analysts were keenly aware of their own ignorance: “No one on the outside really understood Enron’s financial condition, but they also knew they did not know.”³⁵⁷ However, in what Gordon regards as a blow to the efficient markets hypothesis, sophisticated investors did not respond to this abject uncertainty by discounting Enron’s stock—in fact, they were willing to pay a premium.³⁵⁸ Apparently, Enron had become the quintessential “faith”

354. WILLIAM Z. RIPLEY, *MAIN STREET AND WALL STREET 319* (Little, Brown & Co. 1932) (quoting disclosure standard of the IBA). This situation was also discussed among electric utility executives. In 1926, the president of one electric utility observed:

The outstanding dangers of the holding company situation center around the investor rather than the consumer. The purchase of common stock control of operating companies at prices that may be in excess of value and the sale to the public of holding company securities based on such inflated value is creating a financial hazard that may result in grief to the investing public. Repeated warnings on this point have been issued by the Investment Bankers Association of America.

CARL D. THOMPSON, *CONFESSION OF THE POWER TRUST 96-97* (1932) (quoting Samuel Ferguson, President Hartford Electric Co., *ELEC. WORLD*, Mar. 20, 1926).

355. RIPLEY, *supra* note 354, at 319. See also BONBRIGHT, *supra* note 89, at 26–27 (noting that investors bought utility stocks “on the basis of a future earning power estimated by projecting upward the rising trend of previous years” and that “even if an investor had wished to take account of actual construction costs or of so-called ‘physical values,’ he could not have done so” because “only in rare cases were reliable physical appraisals available”).

356. Southerland, *supra* note 349, at H1.

357. Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233, 1236 (2002). See also Susanne Craig & Jonathan Weil, *Most Analysts Remain Plugged in to Enron*, WALL ST. J., Oct. 26, 2001, at C1 (“Enron: Rarely have so many analysts liked a stock they concede they know so little about.”); McLean, *supra* note 353, at 123 (surveying the large number of analysts who were mystified by the company’s opaque financial statements, prior to Enron’s collapse).

358. See Gordon, *supra* note 357, at 1236. In asking what investors should infer from information asymmetry, Gordon notes the question is answered by Nobel Laureate George Akerlof’s lemon hypothesis: “in an efficient market, Enron should have been a ‘lemons’ stock instead of a ‘faith’ stock.” *Id.* at 1236 (citing George Akerlof, *The Market for Lemons: Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488, 489–92 (1970)). Going one step further, William Bratton argues that all the essential elements of transactions between Enron and the SPEs controlled by Enron’s CFO Andrew Fastow can be pieced together from the fa-

stock. It is difficult to envision the sort of securities regulation regime that could counteract this rather perverse dynamic.³⁵⁹

B. Politics, Speculation, Regulation

Undoubtedly, the public shock and horror that greeted the collapses of Insull and Enron are in direct proportion to the uncritical adulation that had been heaped upon these two energy superstars in the prior months and years. Although one's immediate impulse is to ascribe these disasters to fraud and malfeasance,³⁶⁰ a careful post-mortem of both eras suggests that a dispassionate observer could have foreseen the oncoming train wreck.³⁶¹ In hindsight, we realize that a handful of perceptive individuals realized the dangers and issued stern warnings. Yet, an indispensable key to the understanding of the Insull and Enron debacles is the insight that the explosive growth and high standing of both companies rode upon a massive stock market bubble.

The peculiar dynamics of market bubbles has generated an extensive literature. For example, in his classic 1978 book, *Mania, Panics and Crashes*, economist Charles Kindleberger observed that market economies usually function quite well, though they are periodically prone to periods of completely irrational investor mania followed by agonizing collapses.³⁶² Based on his survey of nearly four centuries of bubbles, Kindleberger argues that corrupt business practices inevitably proliferate during periods of soaring financial speculation. Further, it is often the revelation of some fraud or swindle that serves as the triggering event for an ensuing period of panic. But when the panic ends in a crash, Kindleberger observes, "the curtain rises on revulsion."³⁶³

If market bubbles are an inescapable feature of the economic landscape,³⁶⁴

amous footnote 16 in Enron's 2000 10-K and various other SEC filings. See William W. Bratton, *The Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275, 1312-13 (2002) ("[C]ontrary to the efficient market hypothesis, [the Enron disclosures show that] actors in the financial markets are selective so far as concerns assimilation of facts rendered in fine print sections of financials and other SEC documents.") (footnote omitted).

359. For a persuasive account of why sophisticated stock analysts succumbed to a herd mentality in the case of Enron stock, see John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 CORNELL L. REV. 269, 298-30 (2004).

360. The contemporary audience hardly needs a citation for the recriminations that followed the Enron collapse. However, for a shrill and intemperate account of the Insull collapse by a journalist of that era, see N.R. Danielian, *From Insull to Injury: A Study in Financial Jugglery*, ATLANTIC MONTHLY, Apr. 1933, at 497.

361. See, e.g., CORPORATE FIASCOS, *supra* note 9, at 98 (summarizing "red flags" in Enron's financial reporting and concluding that "the business media and sell-side financial analysts must have been in denial over Enron's financial fundamentals, which just didn't add up according to common profitability and valuation measures, regardless of how much debt was hidden in special purpose entities and masked from the public.").

362. See CHARLES P. KINDLEBERGER, *MANIAS, PANICS, AND CRASHES: A HISTORY OF FINANCIAL CRISES* (Basic Books, Inc. 1978).

363. Floyd Norris, *An Enron Legacy: Lower Reported Profits*, N.Y. TIMES, Jan. 18, 2002, at C2 (quoting the 91 year-old Kindleberger, who goes on to say, "I would love to be young enough to write a chapter on Enron."). The economist John Kenneth Galbraith reports a similar dynamic in his famous book, *The Great Crash, 1929*: "Just as the boom accelerate[s] . . . growth [of financial crime], so the crash enormously advance[s] the rate of its discovery. Within a few days, something close to universal trust [is] turned into something akin to universal suspicion." JOHN KENNETH GALBRAITH, *THE GREAT CRASH, 1929* 133-134 (Houghton Mifflin Co. 3d ed. 1972).

364. The economist Charles Kindleberger certainly believes that markets sometimes behave irrationally.

presumably the best policy prescription we can hope for is a government intervention that can bring about a soft landing. In this connection, the impulse to regulate is quite at odds with the speculative urge. Amid the giddy euphoria of a market bubble, the public would like to regard the heights scaled by a boom as a “normal” time expected to continue indefinitely—not some sort of unusual situation requiring the application of economic brakes. When the boom establishes its own crazy momentum, counsels of caution are angrily rejected as subversive.³⁶⁵ Not surprisingly, as the 1920s and 1990s progressed, many elected officials adopted the view that the primary role of government was simply to get out of the way, and let the magicians of the private sector work their wills.

In 1925, Calvin Coolidge summed up his party’s credo when he remarked, “[t]his is a business country . . . and it wants a business government.”³⁶⁶ These certainly must have been welcome words to Samuel Insull, who was at the time floating a huge volume of securities to acquire and rationalize one-eighth of the nation’s total electrical output. Notwithstanding clear evidence before the Investment Banking Association that (a) disclosure was manifestly inaccurate in many securities offerings and (b) use of the interstate mail was the primary method of avoiding state blue sky laws, Congress strongly resisted calls for federal action.³⁶⁷ Similarly, the Supreme Court’s decision in *Public Utilities Commission v. Attleboro Steam & Electric Co.*³⁶⁸ served to exempt interstate holding companies from regulation by state utility commissions. Despite overwhelming evidence adduced by the ongoing FTC investigation that *Attleboro* had become a shield for the most flagrant, abusive conduct occurring within the industry,³⁶⁹ Congress was loath to take action. The lobbying muscle of the NELA was too formidable. Moreover, utility stocks were incredibly popular with investors. When these circumstances were reversed near the height of the Great Depression, Congress filled the “Attleboro gap” by passing the Federal Power Act and the PUHCA.³⁷⁰

In a rebuke to the assumption held by younger economists that investors always act rationally, Kindleberger quotes Sir Isaac Newton, “I can calculate the motions of the heavenly bodies, but not the madness of people.” Floyd Norris, *Market Madness*, N.Y. TIMES, Oct. 29, 1989, § 7, at 39 (reviewing new edition of CHARLES P. KINDLEBERGER, *MANIA, PANICS, AND CRASHES: A HISTORY OF FINANCIAL CRISES* (Basic Books, Inc. 1978)).

365. For example, the memoir of Arthur Levitt, who served as Chairman of the SEC under President Clinton, is replete with anecdotes on how members of Congress reacted with hostility toward his various initiatives to curb conflicts of interest to toughen financial reporting. See ARTHUR LEVITT, *TAKE ON THE STREET: HOW TO FIGHT FOR YOUR FINANCIAL FUTURE* (Vintage Books 2003).

366. Daniel Gross, *Bad Business at the GOP*, WASH. POST, May 31, 1998, at C1 (alteration in original) (quoting Coolidge).

367. See, e.g., DE BEDTS, *supra* note 234, at 4–6 (discussing failed efforts to adopt federal securities regulation in the post-World War I decade); David S. Levin, *Regulating the Securities Industry: The Evolution of a Government Policy* (Columbia University Ph.D. dissertation, 1969), at 32–33 (noting that “[a]nalysis of the legislation enacted prior to the crash in 1929 reveals that it often was ineffective and that the securities exempt from control frequently outnumbered those covered” and that there were “many expressions of concern and remedial proposals [at the national level], but legislative accomplishments were meager.”).

368. Pub. Utils. Comm’n v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927).

369. *Duke Power Co. v. FPC*, 401 F.2d 930, 934 (D.C. Cir. 1968) (noting that “behind the *Attleboro* shield abuses became flagrant”).

370. *Id.*

Similarly, building upon the Reagan Revolution, the demand for free markets and deregulation became the mantra of the 1990s. In the realm of securities regulation, some of the nation's most prominent corporate law scholars were calling for a complete or partial repeal of the New Deal securities laws and a return to a system of piecemeal regulation by the states.³⁷¹ In 1993, when the Financial Accounting Standards Board (FASB) proposed rules requiring the valuation and reporting of stock options as expenses (a provision that would be given the force of law through SEC enforcement), corporate lobbyists, particularly from Silicon Valley's high-tech industry, besieged Washington and successfully headed-off the new rule.³⁷² In his memoir, former SEC Chairman Arthur Levitt vividly recalls the mood in Congress:

Senator Joe Lieberman, the Connecticut Democrat . . . led the charge against the FASB [stock-option] rule. He introduced legislation that would bar the SEC from enforcing the FASB stock-option rule. . . . Lieberman didn't stop there. He also sponsored a Senate resolution that declared the FASB proposal a cockamammy idea that would have 'grave consequences for America's entrepreneurs.' Joining Lieberman were numerous Republicans and a smaller group of so-called New Democrats who prided themselves on their probusiness [sic] positions, especially toward Silicon Valley, a fount of large campaign contributions. By saying that stock options were essential to growth, especially for one particular segment of the economy, these legislators essentially were arguing that transparent reporting should be secondary to other political and economic goals.³⁷³

Of course, one of the recurring themes in the Enron post-mortem is how the reward of stock options caused Enron management to adopt a purely short-term focus.³⁷⁴

Levitt's memoir also chronicles his seemingly prescient efforts to define

371. See, e.g., Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998) (arguing that a competitive system of securities regulation among states, similar to the market for corporate charters, could provide a more effective and efficient system of securities regulation than the current "monopolist" role served by the SEC); Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453 (1997) (arguing that a substantial number of regulatory duties currently performed by the SEC should be returned to the stock exchanges that performed them prior to the enactment of the New Deal securities laws); Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 CARDOZO L. REV. 909 (1994) (outlining theory of administrative agency obsolescence and applying it to the SEC); Jonathan Macey, *The SEC Dinosaur Expands Its Turf*, WALL ST. J., Jan. 29, 1992, at A12 (arguing that the advent of efficient capital markets and portfolio theory has rendered the New Deal disclosure regime obsolete and that "opportunities for manipulation and fraud are probably less now than at any time in history").

372. LEVITT, *supra* note 365, at 115-16.

373. *Id.* at 116.

374. See, e.g., Carol Dahl, *Pipe Dreams: Greed, Ego, and the Death of Enron*, 25 ENERGY J. 115, 126 (2004) (book review) (quoting from book by Robert Bryce that Enron "stock and stock options . . . drove the . . . bubble . . ."); John Cassidy, *The Greed Cycle: How the Financial System Encouraged Corporations to Go Crazy*, NEW YORKER, Sept. 23, 2002, at 64, 69, 75 (arguing that "[t]he rise of the stock option revolutionized the culture of corporate America" and that the partnerships managed by Enron CFO Andrew Fastow concealed the company's debt but "[j]ust as important . . . helped to maintain Enron's stock price long enough for the firm's senior management to cash in hundreds of millions of dollars of stock options"). As this Article was being prepared for publication, FASB announced its decision to require the expensing of stock options in the financial reports of publicly traded companies. See Associated Press, *FASB to Require Expensing of Options Starting Next Year*, WALL ST. J., Dec. 17, 2004, at C3.

more rigorously “auditor independence,” thus requiring the separation of auditing and consulting functions.³⁷⁵ In June 2000, Levitt convened a high-stakes negotiating session with the Big Five accounting firms, in which “Arthur Andersen CEO Bob Grafton [told Levitt] ‘if you go ahead with this, it will be war.’”³⁷⁶ When Levitt refused to yield, the accounting industry commenced a massive lobbying effort that reportedly generated \$14.5 million in campaign contributions for the 2000 federal election cycle³⁷⁷ (The lobbying campaign even included a letter from Enron Chairman Ken Lay to SEC Chairman Levitt opposing the proposed rules on auditor independence).³⁷⁸ Threatened with an appropriations rider that would prohibit the SEC from spending any funds to enforce the new rule, and the specter of a budget cut that would exacerbate the Agency’s “brain drain” to the private sector, Levitt relented and dramatically scaled back the scope of the new rule.³⁷⁹

Ironically, as the corporate scandals piled up after the Enron collapse, the Senate convened an investigation of Enron to find out why the nation’s securities watchdogs never barked.³⁸⁰ Several Senators expressed shock and outrage when they learned that the SEC staff had not reviewed Enron’s annual Form 10-K reports in over three years.³⁸¹ Further, in a classic example of hindsight bias, the Senate’s final report was critical of the “constrained nature” of the SEC’s review of Enron’s public filings, and “their limited power to detect serious wrongdo-

375. LEVITT, *supra* note 365, at 133–35 (discussing negotiations with accounting lobbyists and noting that in June 2000, “[t]he big sticking point was still auditor independence”).

376. *Id.* at 136.

377. LEVITT, *supra* note 365, at 139–40 (citing figures from the Center for Responsive Politics).

378. See Alexei Barrionuevo & Jonathan Weil, *Duncan Knew Enron Papers Would Be Lost*, WALL ST. J., May 14, 2002, at C1 (reporting testimony from David Duncan at his obstruction of justice trial on how Duncan and an Andersen lobbyist in Washington enlisted Ken Lay to write a letter to Levitt opposing the proposed auditor independence rules).

379. LEVITT, *supra* note 365, at 141–146 (discussing reductions in the scope of the proposed rule and acknowledging that the SEC “ended up accepting new independence rules that, quite frankly, did not go far enough but were important nonetheless”). Although the Enron debacle certainly casts Levitt’s legacy in a favorable light, at other junctures during the 1990s the SEC also seemed to embrace the deregulatory ethos of the times and take positions that were at odds with the text and history of the New Deal securities laws. See, e.g., John C. Coffee, Jr., *Re-Engineering Corporate Disclosure: The Coming Debate Over Company Registration*, 52 WASH. & LEE L. REV. 1143, 1144, 1152, 1153–1154 (1995) (commenting that “the SEC, itself, appears to be administratively repealing some of the Securities Act of 1933’s clearest prohibitions,” such as proposed Rule 135(d), which would allow “issuers contemplating initial public offerings to solicit indications of interest from potential investors *prior* to the filing of a registration statement,” and a reworking of Rule 430A and the adoption of new Rule 434, “which collectively seem to abandon the traditional idea of a single integrated prospectus in favor of a stream of documents from the issuer”).

380. The investigation was ultimately brought together in a published report. See SEC. EXCH. COMM’N, REPORT OF THE STAFF TO THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS, FINANCIAL OVERSIGHT OF ENRON: THE SEC AND PRIVATE-SECTOR WATCHDOGS (Oct. 8, 2002) [hereinafter SENATE ENRON REPORT], available at <http://news.findlaw.com/hdocs/docs/enron/senenron100702rpt.pdf>.

381. See, e.g., Jonathan Weil & John Wilke, *Senate Panel Chides SEC for Falling Short in Enron Regulation*, WALL ST. J., Oct. 7, 2002, at C1 (quoting letter signed by Senators Lieberman and Thompson, “[i]f the SEC had pressed Enron about [the off-balance-sheet partnerships] and other troubling disclosures when they first appeared in Enron’s 1999 annual report, some of the enormous losses suffered by workers and investors might have been prevented.”).

ing.”³⁸² Yet, one fact omitted from the Senate report was that throughout the 1990s the SEC was perennially underfunded and understaffed. This condition produced substantial morale and turnover problems at the same time that the initial public offering market was soaring.³⁸³

In a world in which speculative bubbles are inevitable, and the policy objective is to guide the economy to relatively smooth landings, it is at least plausible that an adequately staffed SEC could have accomplished that mission. According to the SEC Corporate Finance Division, the primary goal of a staff “desk audit” is to “ensure that required disclosures are set forth in the report and that the disclosures themselves are facially accurate and *comprehensible*.”³⁸⁴ If Enron’s opaque financials were so open and notorious as to be a true red flag, a rigorous SEC review presumably would have discovered the improper off-balance sheet debt in 1998 or 1999, thus “correcting” Enron’s stock price as the ’90s bubble was starting to froth.³⁸⁵ Yet, rigorous government oversight of the nation’s luminary companies would have been completely out of tune with the free market ethos of the times. Indeed, a comparison of the respective political climates of the Insull and Enron eras suggests that at the precise moment when increased supervision of the securities markets can do the most good, this is the very moment when the hand of government seems to be the most marginalized and irrelevant.³⁸⁶ Of course, a market crash galvanizes the legislature into adopting reforms, albeit too late to benefit the current generation of investors. In 2002, Sarbanes-Oxley added more evidence in support of the well-established thesis that major movements in securities regulation only occur in the aftermath of a market bubble.³⁸⁷

The free-market ideology of the Insull and Enron eras also had a major effect on the shaping of the nation’s electric industry. For example, as the deregulation movement in electricity was gathering momentum in 1991, former FPC Chairman Joseph Swidler offered the following reflections:

I entered law practice in Chicago in the Sam Insull era, just before the stocks of the

382. SENATE ENRON REPORT, *supra* note 380, at 39.

383. See Mark Maremont & Deborah Solomon, *Behind SEC’s Failings: Caution, Tight Budget, ’90s Exuberance*, WALL ST. J., Dec. 24, 2003, at A1 (reporting that the number of SEC filing grew eighty-one percent between 1981 and 2001 while the staff grew twenty-nine percent and that due to pay and morale problems “[a]bout 14% of the SEC’s staff left in 1999 and a like number in 2000, double the federal government average”); James Toedtman, *Senators Hide the SEC on Enron*, NEWSDAY, Oct. 8, 2002, at A57 (quoting director of investor protection for the Consumer Federation of America that the SEC may have made some policy errors, “but the agency has been grossly underfunded for two decades and that is Congress’ fault”).

384. SENATE ENRON REPORT, *supra* note 380, at 12 (emphasis added).

385. *Id.* at 40 n.139 (“It is possible that if the SEC had diligently insisted on the clarification of all instances of murkiness in Enron’s disclosures, it may have affected Enron’s future practices, even if it did not uncover fraud.”).

386. *Cf.* Maremont & Solomon, *supra* note 383, at A1 (quoting Professor Joel Seligman, “The greatest enemy of effective securities regulation and corporate accountability is a sustained bull market.”).

387. See Larry E. Ribstein, *Bubble Laws*, 40 HOUS. L. REV. 77, 77–78 (2003) (arguing that Sarbanes-Oxley is “only the latest turn in a centuries-old cycle of capital market booms followed by busts and regulation” and collecting sources of other scholars who have advanced the same thesis); Stuart Banner, *What Causes New Securities Regulation? 300 Years of Evidence*, 75 WASH. U. L.Q. 849, 850 (1997) (reviewing evidence that surges in technology do not cause securities regulation and asking, “what does? In a nutshell, crashes”).

pyramided holding companies collapsed and contributed to the Great Depression. It was sacrilege in 1930 to question the role of Insull . . . I know, because I tried it, and the Illinois Commerce Commission cited me for contempt . . . But now it approaches sacrilege to raise a question about the claimed benefits of 'competition' in electric power supply . . .³⁸⁸

Swidler wondered out loud how the movement toward independent power producers (IPPs) would lower the cost of capital financing, guarantee adequate capacity, or enhance (rather than undermine) system reliability. Yet, before providing answers to these questions, "the IPPs have stormed their way into the supply arena." Swidler continued,

It is [the IPPs] who are now forcing the pace of change . . . to facilitate expansion and . . . to make it easier to transfer assets . . . free from regulatory scrutiny. These are the very problems that helped to precipitate the Great Depression in 1929.³⁸⁹

The following year, Congress enacted the Energy Policy Act of 1992, which amended the PUHCA so that registered holding companies could enter the IPP market by owning EWGs without any geographic limitations.³⁹⁰ Yet, from the perspective of the SEC staff, additional deregulation was needed. For nearly three decades, the SEC has been calling for the full repeal of the PUHCA.³⁹¹ In 1997, Barry Barbash, the Director of the SEC's Division of Investment Management, which administers the PUHCA, commented that the current problems with the "'35 Act arise from the break-neck speed with which the gas and electric utility industries are moving from a monopoly structure into a more competitive energy marketplace with many diverse participants."³⁹² As a result, "[t]he solutions of the past have become barriers today."³⁹³ Barbash acknowledged that the SEC continued to rely upon "PUHCA pretzels" to twist and turn the Act's statutory text in order to legitimize a broader array of transactions.³⁹⁴

Barbash claimed that his Division could not "administratively repeal the '35 Act" before Congress acted on the SEC's calls for reform. However, it is certainly fair to ask whether the Agency's desire to accommodate the deregulation process did not have that precise effect. For example, in 2000, the eminent analyst Leonard Hyman observed that the SEC "seems to have lost interest in enforcing the letter of the law . . . and now approves the formation of holding companies that comply with the law in the most farfetched ways."³⁹⁵ Similarly, in 2002, the District of Columbia Circuit ruled that the SEC's approval of a merger

388. Joseph C. Swidler, *Deregulation: A Decade Later*, 139 PUB. UTIL. FORT., Apr. 15, 2001, at 50 (re-publishing excerpts from Swidler's earlier article, Joseph C. Swidler, *An Unthinkably Horrible Situation*, 128 PUB. UTIL. FORT., Sept. 15, 1991, at 14-18) [hereinafter Swidler] (alterations in original).

389. *Id.* at 50 (alterations in original).

390. HAZEN, *supra* note 241, at § 18.3 (noting that "the most important benefit of being classified an EWG . . . is the statutory classification which permits the ownership of one or more of these electric generating sources without . . . triggering the burdensome regulations of [the PUHCA].").

391. *Id.* at § 18.1 & nn. 26 & 27 (discussing long lineage of SEC's position).

392. Barbash, *supra* note 246.

393. *Id.*

394. Barbash, *supra* note 246.

395. HYMAN, *supra* note 45, at 102.

between Central and South West Corporation and American Electric Power, which were separated at their closest point by “hundreds of miles,” could not be reconciled with the PUHCA’s statutory requirement that a registered holding company be “‘confined in its operations to a single area or region’”³⁹⁶ Before 2002, however, it had become commonplace for the SEC to approve merger activity with virtually no regard for the Act’s geographic strictures.³⁹⁷

It is important to recognize that the maturation of the wholesale energy market – Enron’s bread and butter industry – was made possible not only by the Energy Policy Act of 1992, but also by the SEC’s loose interpretation of the PUHCA provisions that remained.³⁹⁸ In hindsight, it is all too easy to criticize the SEC’s position. Perhaps if the Agency had been less accommodating to Enron and other forces of deregulation, industry lobbyists would have more rigorously pursued the repeal of the PUHCA in Congress. Further, the SEC was far from alone in its willingness to facilitate the deregulation process. In 1996, the California legislature *unanimously* approved AB 1890, the state’s ambitious and ill-fated electric deregulation plan.³⁹⁹ Upon signing the bill into law, Governor Wilson declared that this “landmark legislation is a major step in our efforts to guarantee lower rates, provide consumer choice and offer reliable [electrical] service, so no one literally is left in the dark.”⁴⁰⁰ Of course, we all know how that ended.⁴⁰¹

C. How Do We Regulate Electricity?

Running through any study of Insull and Enron are the recurring questions of how should the provision of electric power be structured and how should it be regulated. Insull, of course, was the great proponent of regulated monopoly, the suppression of competition, and almost total reliance on economies of scale. Enron, on the other hand, was the “flagship of deregulation,”⁴⁰² the pioneer trader in deregulated electricity products and derivatives, which welcomed competition

396. Nat’l Rural Elec. Coop. Ass’n v. SEC, 276 F.3d 609, 618 (D.C. Cir. 2002) (ruling that Commission cannot “interpret the phrase ‘single area or region’ so flexibly as to read it out of the Act”).

397. See, e.g., Unicom, Peco File For FERC, Pa. Approval of Merger, Megawatt Daily, Nov. 23, 1999 (reporting on a proposed merger between Peco and Unicom that would satisfy the PUHCA’s contiguous system requirement through “‘a portfolio of transmission arrangements on third-party transmission systems’”). See also HYMAN, *supra* note 45, at 102 (noting that “[i]n the past, corporate executives would do anything to avoid falling under PUHCA. Today [i.e., 2000], they and their lawyers view it as an easily circumventable inconvenience.”).

398. See SENATE ENRON REPORT, *supra* note 380, at 49–57 (providing an exhaustive review of how the SEC responded to Enron on a variety of issues under the PUHCA); Enron Power Mktg, Inc., SEC No-Action Letter, [1994] Wash. Serv. Bureau File No. 011094057 (CCH) (Jan. 5, 1994) (concluding that a power marketer such as Enron is not a public utility under the Act).

399. Duane, *supra* note 297, at 497 (discussing fanfare surrounding the bill’s passage).

400. Morain, *supra* note 301, at A3.

401. For a chronology of the events leading up to California’s notorious rolling blackouts, see Richard D. Cudahy, *Electric Deregulation After California: Down But Not Out*, 54 ADMIN. L. REV. 333, 339–54 (2002).

402. See Laura M. Holson, *Californians See a Kind of Rough Justice for Enron*, N.Y. TIMES, Nov. 30, 2001, at C6 (quoting a member of the California Public Utilities Commission as stating, “Enron was the flagship for deregulation” and that its rapid downfall “is likely to hasten the end of California’s freewheeling experiment in energy deregulation”).

and abhorred regulation. Enron and other suppliers of generation, of course, proved themselves quite facile in gaming electric delivery systems and thereby abusing competition. Perhaps, the time has come for some interim observations about restructuring and deregulation, as well as, related aspects of the contemporary conventional wisdom.⁴⁰³

First, it seems fair to say that the major force driving the restructuring revolution has been ideology rather than empiricism. Both the elites and the masses have a strong preference, at least in the abstract, for competition over monopoly and a high level of approval of consumer choice.⁴⁰⁴ That these preferences would produce lower prices and more innovation was taken for granted, but, in the test of actual experience, lower prices have been elusive.⁴⁰⁵ Further, innovation has been more in evidence in telecommunications than in electric power. To some extent, the ideological basis of the deregulation movement has tended to inhibit regulatory interventions when market factors have led to “unsatisfactory” prices or service failures. Thus, during the California crisis in 2000 and 2001, the FERC, supported by many conservative politicians, held off imposing price caps for a long time in deference to free market ideology. In the end, the FERC’s regulatory approach became more aggressive, and most observers believed that change helped resolve the crisis.⁴⁰⁶

Deregulation has had other problems as well, one of which has been the difficulty of squaring equity with efficiency. Spikes in electricity prices based on (usually temporary) shortages have not accorded with what the public regards as “just and reasonable” pricing, although both the FERC⁴⁰⁷ and the courts⁴⁰⁸ have generally decided that market-clearing prices per se meet the “just and reasonable” definition. The public has simply not perceived as “just and reasonable” elevated electricity prices based on scarcity. But the equation of “just and reasonable” with market clearing has been the basis for competition as the “regulatory” force inherent in deregulation, since “just and reasonable” is the regulatory

403. For a superb analysis of restructuring and its prospects, see Jacqueline Lang Weaver, *Can Energy Markets Be Trusted? The Effect of the Rise and Fall of Enron on Energy Markets*, 4 HOUS. BUS. & TAX L.J. 1, 109 (2004).

404. Apart from ideology, there was strong practical and political support for deregulation and competition from large industrial users of electricity, which sought the right to “shop” for power outside their own states and localities. See generally Richard D. Cudahy, *Whither Deregulation: A Look at the Portents*, 58 N.Y.U. ANN. SURV. AM. L. 155, 161–172 (2001).

405. *Id.* at 161–72.

406. For an account of the California energy debacle and the FERC’s response, see Cudahy, *supra* note 404, at 172–85.

407. See *Nev. Sun-Peak Ltd. P’ship*, 54 F.E.R.C. ¶ 61,264, 61,769 (1991) (noting that “Market-based rates have been found just and reasonable when, among other things, the rates were demonstrated not to result from the exercise of market power by the supplier or its affiliates.”). But see Jeffrey L. Hess, Comment, *Sun-Peak – Over the Rate Regulation Edge: Are Market-Based Rates “Just and Reasonable” or De Facto Regulation?*, 28 IDAHO L. REV. 193 (1991) (arguing that the FERC’s advocacy of market-based rates ignores consumer interests and is impermissible under Supreme Court precedent).

408. The fountainhead cases in this area are *Smyth v. Ames*, 169 U.S. 466 (1898) and *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). For an excellent discussion of judicial and administrative attempts to clarify the just and reasonable standard, see *Verizon Communications, Inc. v. FCC*, 535 U.S. 467 (2002).

standard, and this is the mark toward which competition is deemed to be driving us. This analysis, of course, treats electricity prices like others in the market economy, where exchange value is the universally accepted standard of value. This approach also brings considerations of efficiency into line with notions of equity. But the public seems to be reluctant to make the transition from equity as traditionally determined on a cost-of-service basis to the new approach, which relies on the market.

Apart from the inertia of habit, the public sense about a standard of value for electricity is traceable to the marked volatility of electric prices attributable to the inability to store electricity and thus to the difficulty of smoothing out the available supply in periods of scarcity. Public reactions to sharp spikes in retail prices, presumably based on scarcity, were illustrated in San Diego in the early stages of the California crisis, when the FERC held a public hearing in that city and commissioners of the California Public Utilities Commission, as well as others, expressed their extreme unhappiness at the rise in retail electricity prices. Witnesses were vociferous in taking the FERC to task for not keeping rates to "just and reasonable" levels even though they were based on a competitive market in a situation of scarcity.⁴⁰⁹

Public attitudes about the meaning of "just and reasonable" may reflect the moral notions of the Middle Ages, which regarded a just price as one covering the costs of the supplier plus an amount that was "customarily sufficient for his economic support."⁴¹⁰ Interestingly enough, this is roughly analogous to the approach followed in regulated cost-of-service ratemaking when the approved rate is one that covers the expenses incurred by the supplying utility plus an amount sufficient to provide funds for the sources of capital to support production and growth. Admittedly, this formula is blind to market conditions and does nothing to bring supply into balance with demand, but, however much it may lack in regard to efficiency, it seems facially to be equitable. Computing price based on cost plus a reasonable profit leads to a result that squares with traditional concepts of equity: prices are high enough to keep the seller in a business with a prospect of growth, but not any higher. But, when market factors such as scarcity and superabundance enter the equation – however significant they may be for efficiency – they do not speak quite as directly to equity. The difficulty of dealing with electricity prices that are efficient, but not recognized by the public as "just and reasonable," may be a continuing problem for deregulation, as was revealed in San Diego in the California crisis. However, it is possible that this difficulty may disappear as people become accustomed to market pricing—which is likely to be volatile in the electric context.⁴¹¹

Another problem for electric restructuring may be the unalterable engineering realities of electricity. Deregulation, with its opportunity for "shopping" for power from distant sources, brings in its wake greatly increased power flows

409. See Cudahy, *supra* note 404, at 172–85.

410. See PHILLIPS, *supra* note 248, at 89–91 (quoting MARTIN G. GLAESER, PUBLIC UTILITIES IN AMERICAN CAPITALISM 196 (1957)).

411. See Cudahy, *supra* note 404, at 175–78.

over longer distances. This inevitably places increased demands on the transmission system; thus it is important to keep physical and engineering factors squarely in mind when experimenting with economic concepts. Reliability is so important to the functioning of an electric system that a purported increase in efficiency at the expense of reliability is hardly a desirable trade-off.⁴¹² The external benefits of a reliable electric system (in terms of the very existence of modern society) are so great that small decreases in the cost of power at the expense of reliability are not generally worthwhile in the view of the average citizen. Coordination and central planning, which may be required to foster reliability, are, of course, in principle somewhat incompatible with competition, and ways must be found to accommodate this incompatibility. It is doubtful that mere financial rewards for spending money on transmission infrastructure will be enough to guarantee reliability; mandatory measures will be required. Reliability and other physical attributes of the electric power system require close attention and provide limitations upon what may be attempted in the name of efficiency as indicated by economic theory.

Whatever we may have suggested negatively about restructuring and deregulation, it would perhaps be justified by its single outstanding feature—the provision of open access to the transmission system by all power generators. This aspect of wholesale deregulation, provided by the historic Order 888 of the FERC, is the most fundamental feature of the entire effort, and, in principle, gives every load access to the lowest-cost generators.⁴¹³ In effect, by its Order 888, the FERC transformed the electric transmission system of the country into a common carrier.⁴¹⁴ Thus came to an end the prolonged strife between privately and publicly owned power systems, which had blocked this development for many years. Up to the time of Order 888, publicly owned distribution entities had sought in vain to buy cheap power from large government hydro projects and to exercise a right to “wheel” the power to their loads over the transmission lines of privately owned utilities. Now the purpose of common carrier status has become much different: now the point is to enable electric generators as of right to transmit their power for a price over wires of diverse ownership to customers – wherever located – if the transmitted power is the cheapest available and therefore competitively preferred. An Independent System Operator (ISO) is to determine what sources of power are cheapest and to see to it that those sources are the first called upon—the power to be delivered over whatever transmission has access to the designated customer.⁴¹⁵ This right of open access is unequivocally beneficial and would be so even without other features of deregulation.

To make competition work (to provide a level playing field), the transmission functions of electric utilities had to be “unbundled” from their generation

412. See William L. Massey, et al., *Reliability-Based Competition in Wholesale Electricity: Legal and Policy Perspectives*, 25 ENERGY L.J. 319, 322 (2004).

413. Order 888, *supra* note 273. See also *New York v. FERC*, 535 U.S. 1, 5 (2002).

414. See Cudahy, *supra* note 404, at 155, 170.

415. Order 888, *supra* note 273, at ¶ 31,652 (“[W]e believe that ISOs have great potential to assist us and the industry to help provide regional efficiencies, to facilitate economically efficient pricing, and . . . to remedy undue discrimination and mitigate market power.”).

functions, and, increasingly, this was accomplished by utilities' divesting their generation. This aspect of the deregulation process, although justifiable within its own context, is less clearly an unqualified benefit in a broader perspective. Divestiture of generating plants by vertically integrated companies, of course, loses whatever benefits are provided by vertical integration. A more tangible difficulty arose during the California crisis when the power shortage was exacerbated by the inability of the utilities to call on their own plants for power since many of these plants had been sold to out-of-state generating companies. The real villain in that matter, however, was the restriction that had been placed on the utilities preventing them from entering into long-term contracts for power, which they could have called upon during the acute shortage instead of relying exclusively on the spot market. Future experience will have to provide guidance about the pros and cons of divestiture and the real need for level playing fields.

In general, wholesale deregulation, as provided by FERC Order 888, has met with deserved success, primarily, as has been indicated, because of the basic requirement of open access transmission. It is fair to say that competition, as such, has provided fewer measurable benefits. But open access (common carrier status) has been almost unanimously applauded. Competitive dispatch by an ISO, which is very similar to economic dispatch as it was regularly carried on for years in such tight power pools as PJM (the Pennsylvania - New Jersey - Maryland Power Pool), has certainly been acceptable since the economic benefits of this mode of operation, even without the competitive element, are clear.

The related problem of the role of independent generators in the system should also look to empirical results. Independent generators no doubt add a dimension to competition, but developments over the last ten years suggest reasons for some caution. The bulk of the independent plants recently built have used natural gas as a fuel amid extravagant praise of this development as economically favorable and environmentally pure. Now, with the price of natural gas rising sharply (partly in tandem with the price of oil), one must wonder how successfully these independent plants are going to compete. It is, of course, arguable that just as many gas plants would have been built by the utilities even if there had been no independents. But this is only conjectural, and it is in fact the independent generators—as the “new kids on the block”—which may have been predisposed to follow a superficially attractive, but ultimately questionable, course in plant selection. In any event, there is no better illustration of the most fundamental axiom of energy policy, “Don't put all your eggs in one basket.”⁴¹⁶

Thus, while wholesale deregulation is on balance a success and here to stay, at least for a while, retail deregulation may be another story, and the story is filled with irony. The cause of deregulation, although it struck an important ideological chord, had its practical origins in the demands of large industrial customers to take service from utilities in other areas and states where prices were

416. It is interesting that businesses in Portland, Oregon, apparently prefer municipal ownership of Portland General Electric, Oregon's largest electric utility now for sale by Enron in bankruptcy, to its acquisition by a group of Texas entrepreneurs. See David Cay Johnston, *Variations on Power to the People: Proposed Sale of a Utility in Oregon Is Raising an Uproar*, N.Y. TIMES, Dec. 11, 2004, at C1.

cheaper.⁴¹⁷ These demands arose at a time when, for various reasons, there were wide discrepancies in electric prices in different areas. The need of the large industrials was specifically for retail deregulation. But the problem has been that the great mass of retail customers, who are residential, have little demonstrated desire to shop for power outside their own area; the benefits of shopping, in cash terms, are not sufficiently great.⁴¹⁸ On the other hand, there has been some demand from residential customers for “green” power – electricity from non-polluting sources – a demand that provides support for a retail program.⁴¹⁹ Another aspect of retail deregulation – the effort to measure and modify retail response (retail load management) – seems less than promising because the costs of metering and administration tend to exceed the benefits. Even before there were thoughts of retail deregulation there were proposals for controlling retail loads by rate structure and other means. These proposals often seemed to founder on high metering costs.

In any event, the basic problem is to square the strong industrial demand for retail wheeling with the weak, or nonexistent, residential demand. The orthodox approach to squaring this conflict has been to grant regulated rate concessions to the residential while allowing the industrials to shop. There may be an effort to strike a legal balance by allowing all service classes to shop but to regard the residential aspect of this as merely a gesture. This approach, of course, may burden the residential by reducing the industrial contribution to available revenue. In time, however, it is possible that residential customers will also come to value retail wheeling.

One of the obvious problems in deregulation and competition has been the persistence and apparent ineradicableness of market power.⁴²⁰ There are empirical indications that the nature of the electric power industry is such that this battle can never be completely won, which is a good reason for allowing sensible price caps and other regulatory non-market interventions with some liberality in the interest of what seems just and reasonable. Regulatory non-market interventions are also necessary to protect environmental values.⁴²¹ A low price is not the only priority for nearly all forms of energy, including electricity.⁴²² And the overall impact of electric generation on the environment, in numerous, widely-recognized ways – including global warming – must be a very important consideration. Concern that too many or too vigorous nonmarket interventions will disrupt the workings of competition is not inappropriate, but it cannot occupy a con-

417. See Richard D. Cudahy, *Electric Deregulation After California: Down But Not Out*, 54 ADMIN. L. REV. 333, 337 (2002). See also Neela Banerjee, *States' Plans to Deregulate Get 2nd Look*, N.Y. TIMES, May 2, 2001, at A14 (noting that motivation for deregulation was greatest in states with high electricity prices).

418. See Robert A. Hamilton, *More Customers Switch Electric Service*, N.Y. TIMES, May 5, 2002, § 14, at 3 (discussing the slow move of residential customers to alternative retailers).

419. *Id.* (stating that most movement to alternative retailers has been to “green power” providers).

420. For a timely and in depth analysis of market power in the modern electrical industry, see Carolyn A. Berry et al., *Market Power Analysis of the Electricity Generation Sector*, 23 ENERGY L.J. 1 (2002).

421. See Richard D. Cudahy, *Retail Wheeling: Is This Revolution Necessary?*, 25 ENERGY L.J. 161, 165 (2004).

422. *Id.* at 166.

trolling role. Electricity is the last industry to be deregulated, and there is good reason to believe that it will be the most difficult to keep in that path.

V. CONCLUSION

Since the collapse of Enron in December of 2001, literally hundreds of books and articles have been written on how we can avoid another Enron. By placing Enron into a broader historical context, we argue that this sense of urgency is largely misplaced and misguided. A careful comparison of the Insull and Enron periods suggests that the rise and fall of these stellar performers depended upon a relatively rare confluence of events that is unlikely to repeat itself during the lifetime of any contemporary reader. Indeed, we conclude that Insull and Enron are emblematic of relatively rare moments in history when the birth of a new infrastructure industry (e.g., electricity and the Internet) creates an enormous surge in economic activity that captures the imagination of the investing public and, in the short term, rewards politicians who suppress the urge to regulate. Thus, it may be inevitable that two generations from now, as the tides of history wash away the collective memory of Enron, the seemingly heavy-handed provisions of Sarbanes-Oxley will be watered down and ignored during yet another “new era,” just as New Deal laws, passed in response to the Insull era, were watered down and ignored during the 1990s.

Aside from the general (and, as noted earlier, vain) admonition that our grandchildren ought to study their history, comparison of the Insull and Enron eras also reveals that we have yet to fully master the fundamental economic and engineering challenges that caused Samuel Insull to conclude that a government regulated monopoly is the best way to supply the public with cheap and reliable electric power. We continue to struggle for the perfect alternative to regulation. History shows that electric power, as an infrastructure industry that literally wires the nation together, is easy prey for corporate interests seeking their own advantage. During the 1920s, Insull deftly relied on ideology to ward off his only substantial competitor—public power. Seventy years later, Enron’s embrace of free markets and deregulation can be viewed as a brilliant public relations tactic to secure new laws and regulations that worked to its own advantage. Perhaps the most plausible recipe for an electric power system is to mix in equal parts economic theory and brash pursuit of power of the human sort. This is the volatile mixture that came to life but eventually led to death at Insull and Enron.