UTILITY RATES AND "TAKINGS"

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INTRODUCTION

During the 1960s, the nation's electric utilities embarked upon an ambitious program of expansion. In the belief that electricity sales would continue to double every decade, the industry planned to construct more than a thousand large power plants, half of them nuclear, by 1990.1 During the 1970s, this nuclear dream dissolved. Production costs and electricity prices increased, however, and forecast sales never materialized. In addition, the accident at Three Mile Island cast a dark shadow over the acceptability of nuclear power.2 As a result, scores of nuclear power plants were abandoned in the midst of construction.3 Others were completed, only to be placed in service on systems which required no additional capacity.4 In total, the economic losses resulting from these mistakes may reach the staggering sum of $100 billion.5

Allocating the burden of these losses has presented hard choices.6 On the one hand, many electric utilities were seriously weakened by the economic traumas of the 1970s and faced grave financial problems if they could not recover the costs of their unsuccessful investments in nuclear power through

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higher rates. Utility bankruptcies, once unthinkable, became a real prospect. On the other hand, consumers had just begun to recover from the energy price shocks of the 1970s and could ill-afford a new wave of dramatic price increases. Caught in this dilemma, most rate-regulators exercised their authority to fix "just and reasonable" rates by requiring that the huge losses associated with a failed nuclear power project be shared to some degree by both consumers and investors.

Many a shared loss remained difficult to bear. For example, by the time the Jersey Central Power & Light Company halted construction on its Forked River nuclear plant it had already sunk $397 million into the project. Although it was allowed to amortize the $397 million as a cost of service over a fifteen-year period, it was not permitted to earn a return on the unamortized portion of its investment. This arrangement split the after-tax losses associated with the Forked River project roughly 50/50 between the company's ratepayers and investors. The company was nevertheless left so financially weakened that it was forced to suspend its dividend and remained unable to gain access to long term capital.

The past decade has seen a number of judicial challenges to rate orders which, like the one received by Jersey Central, denied a utility full recovery of an unsuccessful but not imprudent nuclear investment. These cases invited

7. The first utility bankruptcy since the Great Depression has, indeed, already occurred. On January 28, 1988, Public Service Company of New Hampshire filed for protection under Chapter 11 after it was denied a rate increase needed to cover the costs of its completed (but not yet in service) Seabrook nuclear power plant. See Daniels, Bankruptcy Filed by Leading Utility in Seabrook Plant, N.Y. Times, Jan. 29, 1988, at A1, col. 1.


9. See Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168 (D.C. Cir. 1987) (en banc) [hereinafter Jersey Central III].

10. Id. at 1170-74.


12. Jersey Central III at 1174.

renewed attention to a question which the Supreme Court had not squarely addressed in the more than forty years since *Hope Natural Gas*\(^{14}\) established the framework for modern rate regulation: What substantive constraints, if any, does the Constitution impose on ratemaking? This question remains one of considerable importance to contemporary electric utility regulation even apart from the lingering problems of nuclear power. Current proposals to deregulate the production of electricity in order to take advantage of the recent emergence of effective competition in wholesale markets all involve some risk of "stranding" existing investment.\(^{15}\) The extent of any constitutional obligation to protect such investment is thus critical to any restructuring of the industry.

A constitutional framework for utility regulation was first established by the Supreme Court in *Smyth v. Ames*.\(^{16}\) Drawing an analogy from the law of eminent domain, the Court held that a regulated enterprise was entitled to a "fair return on the fair value of the property being used by it for the convenience of the public."\(^{17}\) Rates which failed to provide an opportunity for this level of earnings were said to be "confiscatory." Almost half a century later, close judicial supervision of utility rates under the "fair value" standard ended and an era of legislative hegemony over utility rates was inaugurated when *Hope* overruled *Smith*. *Hope* recognized that the regulation of utility rates was a legitimate exercise of the police power which involved a "balancing" of investor and consumer interests and, in keeping with the then-contemporary notion that economic regulation was entitled to no more than minimal judicial scrutiny, the balance struck by regulators was entitled to judicial deference. After *Hope*, the particular methodology employed in setting rates became constitutionally immaterial; it was only the "impact" of the rate order which mattered. If this "end result" reflected a "just and reasonable" balance of consumer and investor interests then, the Court held, "judicial inquiry . . . is at an end."\(^{18}\)

Under *Hope*, it was generally acknowledged that regulators enjoyed a great deal of discretion to fix rates within a "zone of reasonableness."\(^{19}\) There remained widespread disagreement, however, concerning the boundaries of that zone. In the most pro-investor view of the constitutional standard, which derived from the concurring opinion of Justice Brandeis in *Southwestern Bell*,\(^{20}\) it was argued that rates fell below the zone of reasonableness unless, at minimum, they provided a reasonable return on all capital prudently invested in the enterprise.\(^{21}\) Under this view, which came to be known as the "prudent

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17. *Id.* at 546-47.
investment” rule, the risk that a utility’s prudent investment may nevertheless prove unsuccessful is borne by the consumers. By contrast, in the most pro-consumer view of the constitutional standard, which was derived from Justice Harlan’s opinion in *Smyth*, it was argued that rates rose above the zone of reasonableness if they included charges for capital not actually used for the benefit of consumers. Under this view, which came to be known as the “used and useful” rule, the risk that a utility’s prudent investment may nevertheless prove unsuccessful is borne by investors. A third view held that the boundaries of the zone of reasonableness were established neither by the prudent investment rule nor by the used and useful rule, but simply by the judiciary’s relatively unguided sense of a “reasonable” balance between investor and consumer interests. In the words of Judge Bork, a balance intended to avoid “exploitation” of consumers at one extreme and “deep financial hardship” for investors at the other. Yet a fourth view was recently advanced by the nation’s largest utility regulator. According to the Federal Energy Regulatory Commission (FERC), its rate orders were not subject to any constitutional constraints unless a utility bankruptcy was threatened.

Until very recently the Supreme Court showed no interest in resolving this contrariety of views concerning the proper application of *Hope* to an electric utility’s prudent but unsuccessful investment in a nuclear power project, summarily dismissing a number of appeals raising the issue “for want of a substantial federal question.” Then, during its 1987 Term, the Court noted probable jurisdiction of appeals by two utilities contending that a Kansas rate order had effected an unconstitutional “confiscation” of their property by denying them a return on that portion of a concededly prudent investment in a nuclear power plant found to represent excess capacity. Although the case was settled before argument on the merits, the Court’s interest in revisiting *Hope* had became apparent, perhaps reflecting the Court’s current, and extraordinarily intense, interest in “takings” jurisprudence generally.

Any lingering doubt about the Court’s perception of rate regulation as an aspect of the “takings” problem was dispelled last Term by *Pennell v. City of*
San Jose. While the Court rejected, as not ripe, a "takings" challenge to a local rent control ordinance, it nevertheless indicated that in a more concrete factual setting it would address the issue by examining the "reasonableness" of specific rents, citing the Hope decision. Then, just two weeks later, the Court agreed to hear the appeals of two electric utilities challenging, as an unconstitutional "taking," a Pennsylvania statute which barred the companies from recovering any of their investment in an uncompleted power plant.

The stage finally appeared to have been set for a thorough re-examination by the Supreme Court of the constitutional constraints on the regulation of utility rates. The recent decision in Duquesne Light Co. v. Barasch appears, however, to have left open more questions than it resolved.

While the Court reaffirmed the continuing vitality of the Hope "end result" test, for the first time it cast the test as an instrument of the Takings Clause. Moreover, because the case presented no opportunity for this newly understood Takings Clause test to be applied, the Court had no occasion to reach the question of just when the "end result" of a rate order might be held "unjust" or "unreasonable," or to address the relevance to this question of its extensive Takings Clause jurisprudence. Hence, this Article endeavors to treat both of these questions.

Part I analyzes the theoretical underpinnings of the constitutional limits on utility rates, focusing on the relationship between the Hope "end result" test and the Court's "takings" jurisprudence. Part II examines the application of the constitutional standard to the problems presented by the electric utility industry's failed investments in nuclear power.

I. THE THEORY OF CONSTITUTIONAL CONSTRAINTS

A. From Munn to Hope—the Rise and Fall of the First Takings Analogy

The substantive constraints on utility rate regulation which derive from the Constitution have always been expressed in the language of eminent domain. Rates which are too low are said to be "confiscatory." This language has done little to promote analytic clarity, particularly since the original source of these constraints would appear to have been the Due Process Clause rather than the Takings Clause. The persistence of eminent domain terminology is nevertheless understandable; it reflects the pivotal role played by a "takings" analogy when the constitutional framework for judicial review of rate regulation was first established.

30. Id. at 858.
33. The eminent domain clause of the Fifth Amendment was first made applicable to the States through the Fourteenth Amendment in 1897, see Chicago, Burlington & Quincy R.R. Co. v. Chicago, 166 U.S. 226, 239 (1897), well after constitutional limits on state rate regulations were first recognized, see, e.g., Chicago, Milwaukee & St. Paul Ry. v. Minnesota, 134 U.S. 418 (1890); Reagan v. Farmers' Loan and Trust Co., 154 U.S. 362 (1894); Covington & Lexington Turnpike Road Co. v. Sandford, 164 U.S. 578 (1896).
The recognition of federal due process limits on state economic regulation during the late nineteenth century, a development marked by the retreat from *Munn v. Illinois* to *Smyth*, is a familiar chapter of constitutional history. In *Munn*, the Court had rejected a Fourteenth Amendment due process challenge to legislatively prescribed maximum charges by grain elevators. Rate regulation of businesses "clothed with a public interest," was held to be a legitimate exercise of a state's police powers. Moreover, Chief Justice Waite wrote for the Court, "[f]or protection against abuses by legislatures . . . the people must resort to the polls, not to the courts." Complete legislative autonomy over prices, however, was not a principle providing satisfactory security to the business and property interests of a then-burgeoning capitalist society and, in case after case, the Court was urged by railroad and utility lawyers to check the assaults of Western legislatures upon Eastern enterprise. The problem was to find some way around *Munn*. Chief Justice Waite took the first step less than ten years later in the *Railroad Commission Cases*. Continuing to uphold the right of the legislature to regulate railroad charges, the Court this time issued a warning:

> From what has thus been said, it is not to be inferred that this power of limitation or regulation is itself without limit. This power to regulate is not a power to destroy, and limitation is not the equivalent of confiscation . . . The State cannot . . . do that which in law amounts to a taking of private property for public use without just compensation, or without due process of law. What would have this effect we need not now say . . .

This analogy between rate regulation and eminent domain, which equated "due process" with "just compensation," was gradually elaborated by a series of cases culminating in *Smyth*. If the state were to take physical possession of railroad property, then its owners obviously would be entitled to a judicial award of its "present value" as just compensation. Rate regulation left the railroad's property in the hands of its owners but "took" the "use" of that property for the benefit of the public. In this context, "just compensation" would be rates which continued to provide the railroad with "a fair return upon the fair value of that which it employs for the public convenience."

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37. Id. at 134.
38. The pressure was such, according to one observer, that it "was bound eventually to bear fruit." *Corwin, The Supreme Court and The Fourteenth Amendment*, supra note 35, at 656.
40. Id. at 331.
42. *Smyth*, 169 U.S. at 546.
Munn was thus cast aside and judicially enforceable constraints on the legislative power to regulate rates were drawn out of the Due Process Clause of the Fourteenth Amendment, expressed as a limit against "confiscation."

Powered by Chief Justice Waite's analogy, "fair value" utility ratemaking persisted for almost half a century, involving regulators (and the courts which closely supervised them) in endless struggle with the "hodge-podge" of conflicting criteria by which Smyth had held "fair value" was to be determined. Decades of debate failed to resolve such basic questions as whether the "fair value" of a company's physical plant was better measured by its "original" construction costs, or by its "present" costs of reproduction, or even whether the capital invested in the company rather than its assets should be the subject of valuation. Determining "fair value" became so "laborious and baffling" and the confusing precedents proved so "unworkable" that rate regulation was said to have "broken down." Fair value ratemaking, its critics noted, was also flawed on a more fundamental level. It was entirely circular to fix rates by purporting to determine a company's "value" since the value of an enterprise could only be determined by capitalizing its earnings which, in turn, depended upon the rates it might be permitted to charge. "Fair value" was thus recognized as a "juristic illusion," designed to accommodate Munn by attempting to make ratemaking look more like a judicial exercise in finding facts than a legislative exercise in prescribing policy.

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43. Hope, 320 U.S. at 627 (Frankfurter, J., dissenting).
44. See generally, Hale, Conflicting Judicial Criteria of Utility Rates—The Need For Judicial Restatement, 38 COLUM. L. REV. 959 (1938). In spelling out the constitutional standard for prescribed rates, Justice Harlan had written:

   We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case.

46. See, e.g., Southwestern Bell, 262 U.S. 276, 289-312 (Brandeis, J., dissenting) (advocating an investment rather than an asset rate base).
47. Id. at 292.
49. Id.
50. See. e.g., Southwestern Bell, 262 U.S. 276, 292 (1923) (Brandeis, J., dissenting); Hale, The Fair Value Merry-Go-Round 1898 to 1938: A Forty-Year Journey From Rates-Based-on-Value To Value-on-Rates, 33 U. ILL. L. REV. 517 (1939).
These problems finally persuaded the Court, in two cases involving challenges to orders fixing rates under the Natural Gas Act of 1938, Federal Power Comm'n v. Natural Gas Pipeline Co., and Hope, to “lay the ghost of Smyth v. Ames . . .” Chief Justice Waite’s seminal analogy was interred as well. Justices Black, Douglas and Murphy, concurring in Natural Gas Pipeline, described “fair value” ratemaking as a “fallacious theory . . . deriv[ing] from principles of eminent domain . . . [which] . . . have no place in rate regulation.” Less than two years later these views were expressly adopted by the Court in Hope. This time writing for the majority, Justice Douglas observed:

Ratemaking is indeed but one species of price fixing. Munn v. Illinois, 94 U.S. 113, 134. The fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean that the regulation is invalid.

With this acknowledgement that rate regulation was an exercise of the police power rather than the power of eminent domain, the Court finally swept aside the pretense it had indulged for nearly fifty years in order to avoid a confrontation with Munn.

B. Hope’s “End Result” Test—A Constitutional Calculus

This is not to say that Munn’s doctrine of legislative primacy in the field of price fixing was being resurrected. To the contrary, Natural Gas Pipeline and Hope both suggested that rate regulation remained subject to constitutional constraints. In Natural Gas Pipeline, the Court upheld the constitutionality of section 5(a) of the Natural Gas Act, which authorized the Federal Power Commission (FPC) to fix “just and reasonable rates” and to order a decrease where existing rates were not the “lowest reasonable rates.” Writing for the Court, Justice Stone observed that this statute enacted a standard which “coincides with that of the Constitution.” In addition, he wrote, the courts cannot intervene in the “absence of a clear showing that the limits of due process have been overstepped,” and that these “limits” were not exceeded where a rate order “viewed in its entirety, produces no arbitrary result.” While Justices Black, Douglas and Murphy withdrew from the majority’s suggestion that a rate order could be invalidated under the Due Process Clause simply because a court “finds the charges to be unreasonable,” their objections seemed to focus not on the availability of judicial review but on the standard of review implied by the language of the majority opinion. To them, for due process limits on legislative power to be drawn in

53. Natural Gas Pipeline, 315 U.S. 575 (1942) [hereinafter Natural Gas Pipeline].
54. Id. at 602 (concurring opinion of Justices Black, Douglas and Murphy).
55. Id. at 602-03.
58. Natural Gas Pipeline, 315 U.S. 575, 586 (1942).
59. Id.
60. Id.
61. Id. at 599 (concurring opinion).
terms of "reasonableness" was simply too "elastic," too reminiscent of the by-then discredited *Lochner* doctrine which, they observed in a paraphrase of Justice Holmes, "makes the sky the limit of judicial power to declare legislative acts unconstitutional . . ." At the same time, the concurrence (and later, the majority in *Hope*) appeared to acknowledge that the police power was subject to some, albeit narrower, due process limits.

The location of these limits was sketched out by Justice Douglas in *Hope* in only the vaguest terms. Ratemaking, he wrote, "involves a balancing of the investor and consumer interests" and while regulators were "not bound to the use of any single formula or combination of formulae [such as "fair-value"] in determining rates," the balance struck between the investor interest in maintaining "the financial integrity of the company" and the consumer interest against "exploitation" could nevertheless be set aside if the "total effect" of the rate order was "unjust and unreasonable in its consequences." Justices Black and Murphy wrote a concurring opinion in which they continued to quarrel with Justice Frankfurter's insistence, in dissent, that broader review was available under the Due Process Clause. The majority opinion, however, declined to join in this discussion. Since the rates under review provided Hope's investors with a return "sufficient to assure confidence in the financial integrity of the enterprise", there was no need to engage in any "balancing" and no occasion to identify "the conditions under which more or less might be allowed."

*Natural Gas Pipeline* and *Hope* were thus clear in one respect. On judicial review of a rate order, the focus of the inquiry would be on the "end result" not on methodology. As Justice Douglas wrote in *Hope*, "[i]t is not the theory but the impact of the rate order which counts." The two decisions were far less clear, however, when it came to elaborating the applicable standard of review and there was even room for questioning whether the Court had retained its power to declare rates unconstitutional.

62. *Id.* at 600.
63. *Id.*
64. Due process limitations on the exercise of the police power to regulate prices had previously been recognized by the Court in *Block v. Hirsh*, 256 U.S. 135, 155-57 (1921) (rent controls), and *Nebbia v. New York*, 291 U.S. 502, 523-39 (1934) (milk price controls), and both the *Natural Gas Pipeline* concurrence and the *Hope* majority expressed their approval of these decisions; see *Natural Gas Pipeline*, 315 U.S. 575, 602-04 (1942) and *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 601 (1944) respectively.
66. *Id.* at 602.
67. *Id.* at 603.
68. *Id.* at 610.
69. *Id.* at 602.
70. *Id.*
71. *Id.* at 619-20.
72. *Id.* at 624-28.
73. *Id.* at 603.
74. *Id.*
75. *Id.*
76. *Id.* at 602.
77. See, e.g., Bernstein, *Utility Rate Regulation: The Little Locomotive That Couldn't*, supra note 35, at 250-60 (suggesting that judicial review under *Hope* became purely procedural).
All doubts on this score were removed, however, by the Court’s later decision in *The Permian Basin Area Rate Cases*. The FPC had prescribed maximum rates for natural gas producers in the Permian Basin on an “area-wide” basis, allowing a twelve percent return on investment calculated from composite cost compilations. The agency acknowledged that rates derived in this fashion might result in financial hardship for individual, high cost producers, but declared that in such cases it would consider “appropriate relief.”

The Court of Appeals set the rates aside on the ground that this was too “vague” an arrangement to meet the requirements of *Hope*, and in the Supreme Court the producers argued for affirmance on the ground, among others, that the Constitution entitled them to rates set on an individual cost-of-service rather than area-wide basis. Rejecting this argument as premised on too narrow a view of the balancing analysis permitted by *Hope*, the Court characterized that analysis as a “constitutional calculus of reasonableness.”

In addition, the Court elaborated on the larger constitutional context in which any balance struck under *Hope* was to be evaluated. Acknowledging that “[r]egulation may, consistently with the Constitution, limit stringently the return recovered on investment,” the Court nevertheless repeated Justice Waite’s warning in the *Railroad Commission Cases* “that the ‘power to regulate is not a power to destroy,’” and further observed that under the familiar due process standard laid down in *Nebbia v. New York*, “[p]rice control is unconstitutional ... if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt ...”

Although this dictum confirmed that *Hope* had enunciated a constitutional standard for rate regulation, the content of that standard remained unclear. The Court had never had the occasion to elaborate on just when the “end result” of rates fixed by a *Hope* “balancing” might be “unreasonable,” and after *Permian Basin* the Court showed no interest in addressing the question. By contrast, in the context of land use regulation, the Court showed considerable interest in elaborating the “regulatory takings” doctrine of *Pennsylvania Coal Co. v. Mahon*. Given what at least appears to be the functional similarity of the “regulatory takings” and “end result” tests, both of which purport to yield constitutional limits on the regulation of property interests under otherwise valid exercises of the police power the implications of the new “takings” jurisprudence for the problem of rate regulation deserve to be examined.

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79. *Id.* at 770.
80. *Id.* at 771.
81. *Id.* at 769.
82. *Id.*
83. *Id.*
86. Hanson and Davies, *Judicial Review of Rate of Return Calculations*, 8 WM. MITCHELL L. REV. 499, 535 (1982). (After promulgating the “end result” test, the Court simply “walk[ed] off stage.”)
C. Regulatory Takings—The Rise and Metamorphosis of the Second "Takings" Analogy

Prior to Pennsylvania Coal there was no such thing as a "regulatory taking." Regulation which did not involve a physical appropriation of property, but which merely restricted its use, was treated as a "deprivation" subject to the requirements of the Due Process Clause; but not as a "taking" implicating a right to compensation under the Takings Clause.\(^8\) Mugler v. Kansas\(^9\) was perhaps the leading precedent supporting this bright-line distinction. Kansas enacted a statute which prohibited the manufacture and sale of intoxicating liquors. Mugler had owned a brewery which the statute made practically worthless and he challenged the constitutionality of the law, contending that his property had been taken without just compensation. Rejecting this claim outright, the first Justice Harlan wrote an opinion for the Court which reasoned that exercises of the police power and takings were conceptually distinct:

The exercise of the police power by the destruction of property which is itself a public nuisance, or the prohibition of its use in a particular way, whereby its value becomes depreciated, is very different from taking property for public use, or from depriving a person of his property without due process of law. In the one case, a nuisance only is abated; in the other, unoffending property is taken away from an innocent owner.\(^0\)

The clarity of Mugler's distinction between exercises of the police power and takings remained undiminished until Pennsylvania Coal.\(^1\) Pennsylvania had enacted a statute prohibiting the mining of coal in a manner which caused the subsidence of support for surface structures. A coal company which held contract rights to both the subsurface coal and surface support contended that the statute made further mining "commercially impracticable" and thereby effected an unconstitutional taking of its property. Over a dissent by Justice Brandeis,\(^2\) who argued that the Pennsylvania statute was an exercise of the police power no different than that sustained in Mugler, the Court agreed. Justice Holmes' opinion explained the decision as follows:

Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law. As long recognized, some values are enjoyed under an implied limitation and must yield to the police power. But obviously the implied limitation must have its limits, or the contract and due process clauses are gone. One fact for consideration in determining such limits is the extent of the diminution. When it reaches a certain magnitude, in most if not in all cases there must be an exercise of eminent domain and compensation to sustain the act. So the question depends

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\(^0\) Id. at 668-69.
\(^1\) See, e.g., Powell v. Pennsylvania, 127 U.S. 678 (1888) (brushing aside simply as "without merit," id. at 687, the contention that a Pennsylvania statute outlawing the sale of oleomargarine violated the Takings Clause because it rendered a number of plaintiff's factories virtually worthless). See also Hadacheck v. Sebastian, 239 U.S. 394 (1915) (ordinance banning brickmaking within city limit upheld as exercise of police power to abate a nuisance even though it reduced the value of plaintiff's manufacturing plant—originally built outside the city's limits—by eighty-five to ninety percent).
upon the particular facts. The greatest weight is given to the judgment of the legislature, but it always is open to interested parties to contend that the legislature has gone beyond its constitutional power.93

With one stroke of his pen, Justice Holmes thus appeared to have transformed the distinction between valid exercise of the police power and takings into one of degree, not kind.94 In this respect, at least, his opinion seemed clear. The "general rule" he wrote "is, that while property may be regulated to a certain extent, if regulation goes too far, it will be recognized as a taking."95

Of course, the problem was where to draw the line and to this problem Justice Holmes suggested no answer: "So the question depends upon the particular facts."96 Nor was a better answer forthcoming over the ensuing years from the legions of judges and scholars who addressed the problem,97 recently prompting Justice Blackmun to observe that "[t]he attempt to determine when regulation goes so far that it becomes . . . a taking has been called the 'lawyer's equivalent of the physicist's hunt for the quark.' "98 Others on the Court have also acknowledged the unsatisfying quality of its "regulatory takings" jurisprudence, conceding that as a result of the "essentially ad hoc factual inquir[y]"99 involved in its takings analysis the Court had "been unable to develop any 'set formula' for determining when 'justice and fairness' require that economic injuries caused by public action be compensated by the government, rather than remain disproportionately concentrated on a few persons."100

One way out of the morass of the Court's contradictory decisions,101 according to some critics, was to interpret Pennsylvania Coal not under the Takings Clause, but rather, under the Due Process Clause. In this view, when Justice Holmes wrote that if a regulation of property goes too far, it will be

93. Id. at 413.
96. Id. at 413.
recognized as a "taking," he was using the term "taking" only as a metaphor for a substantive due process violation, and meant only to say that regulation which goes so far that it has the same effect as a taking by eminent domain is an invalid exercise of the police power, violative of the Due Process Clause. Should the government wish to accomplish the goals of such regulation, the proponents of this view continued, it must proceed through the exercise of its eminent domain power, and, of course, pay just compensation.

This was not an implausible reading of Justice Holmes' Pennsylvania Coal opinion; indeed, it seems far more compatible with the deference for legislative judgment otherwise characteristic of Justice Holmes' decisions. And while viewing a regulation that goes "too far" as an invalid exercise of the police power, rather than as a "taking" for which compensation has to be paid, does not resolve the problem of how to define "too far," it perhaps allows the problem to be addressed in a context more conducive to the development of a principled standard for judicial review. Any further hope for the adoption of this revisionist reading of Pennsylvania Coal appears to have been dashed, however, by two recent Supreme Court decisions.

The first, Keystone Bituminous Coal Ass'n v. DeBenedictus, presented a virtual replay of Pennsylvania Coal, except for the outcome. By a five to four vote, the Court upheld the constitutionality of a Pennsylvania statute which prohibited coal mining that causes subsidence damage to surface structures. No change was made, however, in the Court's approach. While the majority labeled much of Justice Holmes' opinion in Pennsylvania Coal as "uncharacteristically advisory," thereby shaking slightly what Chief Justice Rehnquist referred to in dissent as "the foundation of our 'regulatory takings' jurisprudence," the structure of that jurisprudence remained intact. All of the justices continued to view the difference between a valid exercise of the police power and a "taking" as one only of degree, and all, moreover, continued to locate the point at which regulation went "too far" by considering the "diminution of value" and impairment of "investment backed expectations"

103. For advocacy of this reading of Justice Holmes' opinion, see McGinley, Regulatory "Takings:"
    The Remarkable Resurrection of Economic Substantive Due Process Analysis in Constitutional Law, 17
    ENVTL. L. REP. 10,369, 10,374-75 (1987); Salmon, Of Regulatory Takings and Other Myths, 1 J. LAND
    USE AND ENVTL. L. 105 (1985); Agins v. City of Tiburon, 24 Cal. 3d 266, 279, 598 P.2d 15, 19, 157 Cal. Rptr.
    372 (1979), aff'd, 447 U.S. 255 (1980); Fred F. French Investing Co. v. City of N.Y., 39 N.Y.2d 587, 599,
104. See generally F. Bosselman et al. supra note 88, at 238-255; Comment, Testing the Constitutional
    Validity of Land Use Regulations: Substantive Due Process as a Superior Alternative to Takings Analysis, 57
    F. Bosselman et al., supra note 88, at 240-46; McGinley, supra note 103, at 10,374-75.
106. See McGinley, supra note 103, at 10,375 (concluding that the literal "misreading" of Holmes' Pennsylvania Coal opinion "has led to a 'jurisprudence' devoid of logic that threatens fundamental constitutional values."); Bender, supra note 101, at 735 (concluding that "distortion" of the Takings Clause has enabled political questions to be disguised as legal ones).
108. Id. at 484.
109. Id. at 508.
effected by the challenged statute,\textsuperscript{110} criteria which have become the familiar talismans of the regulatory takings cases.

In the second case, \textit{First English Evangelical Lutheran Church of Glendale v. County of Los Angeles},\textsuperscript{111} the Court decided a remedial question it had expressly declined to reach on a number of earlier occasions,\textsuperscript{112} and held that a landowner who claims that his property has been "taken" by regulation is not limited to a determination of the regulation's invalidity, but may recover damages, as just compensation, for the period of time before the regulation was struck down. The notion that Justice Holmes' "regulatory taking" was simply a metaphor for an exercise of the police power which was invalid because it exceeded substantive due process limits was thus squarely, albeit implicitly, rejected. Regulatory takings are now no less "real" than more formal exercises of the power of eminent domain; both implicate a right to just compensation under the Takings Clause.

\subsection*{D. Regulatory Takings and Confiscatory Utility Rates—The Two Takings Analogies Confused}

After \textit{First English}, it can no longer be doubted that the Takings Clause operates to impose limits of its own on police power regulation. It also appears clear that these limits are not necessarily coterminous with those imposed by the Due Process Clause. In recent cases where statutes have been challenged on both takings and due process grounds, the Court has been absolutely fastidious about treating those claims separately,\textsuperscript{113} and in one recent decision the Court has expressly declared that "there is no reason to believe . . . that as long as the regulation of property is at issue the standards for taking challenges, due process challenges, and equal protection challenges are identical. . . ."\textsuperscript{114} In the context of rate regulation, this raises two questions of

\textsuperscript{110} \textit{Id.} at 493-97.

\textsuperscript{111} \textit{Lutheran Church of Glendale}, 482 U.S. 304 (1987).


\textsuperscript{114} \textit{See Nollan v. California Coastal Comm'n}, 483 U.S. 825 (1987), where a five to four majority sustained a Takings Clause challenge to a condition included in a rebuilding permit which required the owners of beachfront property to provide lateral access across the beach to the public. Responding to Justice Brennan's contention, in dissent, that the permit condition met the standard of "rationality" previously employed by the Court in reviewing challenges to a State's exercise of its police powers to regulate property, Justice Scalia wrote for the majority:

Contrary to Justice BRENNAN's claim . . . our opinions do not establish that these [takings]
immediate concern here: (1) What constraints, if any, does the Takings Clause impose on utility rates, and (2) what is the relationship of these constraints to the due process constraints elaborated by Hope and Permian Basin?

There is reason to wonder why the "regulatory takings" doctrine should apply at all to utility rate regulation. The Court has repeatedly observed that the fundamental purpose of the Takings Clause is to "bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." While the principle that "public burdens . . . should be borne by the public as a whole" rather than "disproportionately concentrated on a few" seems unassailable, it is not at all clear that it is the least bit implicated by the regulation of utility rates. First, rate regulators do not allocate burdens between the "public" on the one hand and the "few" on the other. They are ordinarily concerned with the task of allocating the cost of utility service between large classes of investors and consumers. To the extent that the Takings Clause is seen as a required check against "politically attractive . . . wealth transfers . . . achieved 'off-budget'," it is simply not needed to mediate a choice between investor and consumer interests which is not being made in avoidance of "normal democratic processes." Second, the burdens of rate regulation are voluntarily assumed by utilities in return for substantial benefits, such as a monopoly franchise and the private power of eminent domain. This bargain distinguishes the regulation of utility rates from other exercises of the police power. This is not to say that rates in a particular case may not be challenged as "unfair"—like any mis-allocation of a burden, "public" or other-

standards are the same as those applied to due process or equal protection claims. To the contrary, our verbal formulations in the takings field have generally been quite different. We have required that the regulation "substantially advance" the "legitimate state interest" sought to be achieved, Agins v. Tiburon, . . . not that "the State 'could rationally have decided' the measure adopted might achieve the State's objective." Post, at 843, quoting Minnesota v. Clover Leaf Creamery Co., . . . Justice BRENNAN relies principally on an equal protection case, Minnesota v. Clover Leaf Creamery Co., supra, and two substantive due process cases, Williamson v. Lee Optical of Oklahoma, Inc., . . . in support of the standards he would adopt. But there is no reason to believe (and the language of our cases gives some reason to disbelieve) that so long as the regulation of property is at issue the standards for taking challenges, due process challenges, and equal protection challenges are identical; any more than there is any reason to believe that so long as the regulation of speech is at issue the standards for due process challenges, equal protection challenges, and First Amendment challenges are identical. Goldblatt v. Hempstead . . . does appear to assume that the inquiries are the same, but that assumption is inconsistent with the formulations of our latest cases. Id. at 834 n.3.


119. Id.

120. See Ruckelshaus v. Monsanto Co., 467 U.S. 986 (1984) (Takings Clause not violated by requiring Monsanto to give up property interests in trade secrets "in exchange for the ability to market pesticides," id. at 1007). See also R.A. Epstein, Takings: Private Property and the Power of Eminent Domain 274-82 (1985) (railroad and utility rate regulation do not effect unconstitutional "takeings" because these
wise. But if unfairness is to be found it is in regulation which upsets the "regulatory bargain," the terms of which have always been protected from legislative abrogation by the constitutional rule against rates which are "confiscatory." What this should mean today is that utility regulation which is found to satisfy the "end result" test of Hope, should not then be subjected to some additional test for a "regulatory taking."

Whether the Supreme Court would agree that its regulatory takings jurisprudence is not applicable to utility rate regulation is not at all clear. One recent decision seems at least to imply such a view. In FCC v. Florida Power Corp., the Federal Communications Commission (FCC), exercising its authority under the Pole Attachments Act to determine "just and reasonable" rates which utility companies may charge cable television systems for stringing television cable on utility poles, issued orders requiring Florida Power to reduce the pole attachment rates set forth in the agreements it had reached with cable television companies operating in its franchised service area. The Eleventh Circuit Court set aside the rate orders on the ground that the Pole Attachments Act authorized a permanent physical occupation of property, a per se taking under the Supreme Court's ruling in Loretto v. Teleprompter Manhattan CATV Corp., which held that the determination of just compensation was a judicial function which could not constitutionally be performed by the FCC. The Supreme Court subsequently reversed and held that the Pole Attachments Act did not give the cable companies any right to occupy space on utility poles, but merely authorized the regulation of rates charged by utility companies which agreed to lease that space. There was, accordingly, no per se taking under Loretto and the Court then turned to the remaining question which was "whether under traditional Fifth Amendment standards the challenged FCC order effected a taking of property." This question, the court began, "is readily answered," but it then turned for the answer not to the "multifactor inquiry generally applicable to nonpossessory governmental activity" under the regulatory takings doctrine, but to the Hope test.

It is of course settled beyond dispute that regulation of rates chargeable from the employment of private property devoted to public uses is constitutionally permissible. [citing Munn and Permian Basin]. Such regulation of maximum rates of prices "may, consistently with the Constitution, limit stringently the return

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123. Florida Power Corp. v. FCC, 772 F.2d 1537, 1542-44 (11th Cir. 1985).
124. Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982)(The Court held that a New York statute requiring owners of apartment buildings to permit installation of cable television facilities upon their property effected a taking without regard to any balancing of public benefits and private burdens).
125. Florida Power Corp. v. FCC, 772 F.2d 1537, 1544-46 (11th Cir. 1985).
127. Id. at 253.
128. Id.
129. Id. at 252.
recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness" [citing Permian Basin]. So long as the rates set are not confiscatory, the Fifth Amendment does not bar their imposition. 130

Application of the Hope-Permian Basin standard once again presented no occasion for reviewing the "reasonableness" of the balance struck by the regulator between investor and consumer interests because the FCC rate order, just like the FPC rate order reviewed in Hope, fully satisfied investor interests.

Respondents have not contended, nor could it seriously be argued, that a rate providing for the recovery of fully allocated cost including the actual cost of capital, is confiscatory. Accordingly, we hold that the FCC regulatory order challenged below does not effect a taking of property under the Fifth Amendment. 131

Justice Powell, joined by Justice O'Connor, wrote a short concurring opinion 132 which cautioned that "[t]he inquiry mandated by the Constitution is considerably more complex" 133 than reflected by the "single sentence" 134 quoted from Permian Basin, but then went on to note only that the Court's opinion in Permian Basin was "some 74 pages long" and that the Court's decision in Hope was a relevant precedent as well. 135 The Court was thus unanimous in regarding the Hope-Permian Basin "calculus of reasonableness" as the exclusive standard for measuring the constitutionality of utility rates.

Notwithstanding the Supreme Court's exclusive reliance on the Hope-Permian Basin standard in Florida Power, there are a number of reasons for continuing to believe that utility rate regulation will be drawn into the vortex of the Court's regulatory takings jurisprudence. First, the field occupied by that jurisprudence has recently undergone a vast expansion as a result of the positivist definition of "property" which emerged from the procedural due process "explosion" of the early 1970's. 136 Once confined primarily to the area of land use regulation, the regulatory takings inquiry now is so routinely being made across the entire spectrum of economic regulation 137 that one Court of Appeals has suggested that "the takings clause has become the 'last resort of constitutional arguments.'" 138 This development has very likely

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130. Id. at 253.
131. Id. at 254.
132. Id. at 254-56.
133. Id. at 255.
134. Id.
135. Id.
136. See, e.g., Ruckelshaus v. Monsanto Co., 467 U.S. 986 (1984) (State law protecting chemical ingredients of pesticide as a "trade secret" creates a "property" interest entitled to substantive protection under the Takings Clause). See also Connolly v. Pension Benefit Guaranty Corp., 475 U.S. 211 (1986) (treating employer's contractual limitation of liability to pension plan as "property" interest under the Fifth Amendment, but holding that statutory abrogation of limitation was not a taking).
137. See, e.g., Bowen v. Gilliard, 483 U.S. 587 (1987) (upholding under standard "regulatory takings" analysis, statutory transformation of support payment by non-custodial parent from one which is exclusively the child's to one which may be used for the entire family); Connolly v. Pension Benefit Guaranty Corp., 475 U.S. 211 (1986) (upholding, under standard "regulatory takings" analysis, imposition on employer withdrawing from multi-employer pension plan of retroactive liability for employee benefits).
been encouraged by the Supreme Court's willingness to give full consideration to Takings Clause arguments which appear to add little, if anything, to accompanying arguments under the Due Process, Equal Protection and Contract clauses. This will no doubt be even further encouraged by the Court's recent declaration in *Nollan v. California Coastal Comm'n* that "there is no reason to believe . . . the standards for takings challenges, due process challenges, and equal protection challenges are identical . . . "

Second, there are superficial similarities between the *Hope* "end result" test and the test for a regulatory taking which invite the two tests to be equated. Both purport to identify a point beyond which the regulation of property under an otherwise lawful exercise of the police power becomes invalid, both purport to do so by focusing on the severity of the economic impact or effects of the regulation in question, and both purport to protect interests which are described in substantially the same terms. In one case it is a "taking" which is to be avoided, in the other a "confiscation." Given these similarities, it is small wonder that some judges and commentators have incorporated the jurisprudence of the regulatory takings doctrine into the *Hope-Permian Basin* calculus.

Third, there are cases which raise doubts about whether, in the Court's view, the constitutionality of utility rate regulation is to be tested any differently than that of economic regulation in general. *Florida Power* itself provides little reassurance on this score, since the regulation of pole attachment rates in voluntary agreements between utilities and cable companies seems to more closely resemble the regulation of rents than it does the regulation of traditional utility service. The Court described the economic relationship between the utilities and cable companies as that of "landlords and tenants." This is not to say that the regulation of pole attachment rates was not justified by considerations of economic efficiency, but only that the pole space being rented by the utilities to the cable companies was not what the Court identified as "private property devoted to public uses," the hallmark of utility property and, consequently, *Florida Power* received no governmental benefits at all in exchange for governmental limits on the rates it could charge

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141. See, e.g., Judge Starr's concurring opinion in *Jersey Central III*, 810 F.2d at 1188-94 (whether the end result of rate order "reasonably balances" investor and ratepayer interests under *Hope* requires determination whether the order "works a taking," and this involves consideration of the three-factors which make up the regulatory-taking inquiry: "The economic impact of the regulation, the extent to which it interferes with investment-backed expectations, and the character of the governmental action" [citing cases], *id.* at 1192).

142. See, e.g., Drobak, *From Turnpike to Nuclear Power: The Constitutional Limits on Utility Rate Regulation*, 65 B. U.L. Rev. 65 (1985) (while acknowledging that *Hope* "did not adopt the regulatory takings doctrine" *id.* at 85, Prof. Drobak nevertheless contends that the "end result" and "regulatory takings" tests impose "equivalent" constitutional limits on rate regulation, *id.* at 98).


144. *Id.* at 253.
for such space, the hallmark of utility regulation. The constitutionality of the rates fixed by the FCC therefore should not have been determined by some test uniquely applicable to utility rate regulation. Utility regulation, as such, simply was not involved, and the constitutionality of the rates fixed by the FCC should have been determined, as the Court said, by the "multifactor inquiry generally applicable to non-possessory governmental [regulation]."\textsuperscript{145} The Court's later reference to the \textit{Hope-Permian Basin} "constitutional calculus of reasonableness"\textsuperscript{146} thus may suggest only that the Court sees no difference at all between that "calculus" and the "multifactor" regulatory takings inquiry.

Last Term's decision in \textit{Pennell v. City of San Jose}\textsuperscript{147} provided further evidence that the Court saw no real difference between \textit{Hope}'s "end result" test and the general test for a regulatory taking. San Jose had enacted a rent control ordinance which allowed "hardship to a tenant" to be considered, among other factors, when determining whether to approve a rent increase proposed by a landlord. The ordinance was challenged as "facially" unconstitutional under the Takings, Due Process and Equal Protection clauses. Each of those contentions was considered separately. The Takings Clause challenge was rejected as unripe. The other two challenges were rejected on the merits. While the separate treatment and different disposition of the Takings and Due Process claims might only seem to make it less likely in a future case involving rate regulation that Takings Clause considerations would be imported into a \textit{Hope} balance, the Court's opinion actually suggests otherwise. In rejecting the landlord's due process challenge to the ordinance the Court spoke of rate regulation as just one form of price control\textsuperscript{148} and drew almost entirely on its decisions in \textit{Hope} and \textit{Permian Basin} to support its holding that the protection of tenants from burdensome rent increases was a "legitimate" legislative objective and that the "balancing" of tenant and landlord interests called for by the challenged ordinance was a "rational" means for accomplishing this objective.\textsuperscript{149} There are, of course, fundamental distinctions between utility rate regulation and general price controls,\textsuperscript{150} distinctions which are relevant to whether it is "rational" to balance away a landlord's interest in a reasonable rent in order to alleviate a tenant's hardship. If these distinctions can be ignored today by making the due process standard concededly applicable to utility rate regulation also applicable to rent control, they can be ignored tomorrow by making the takings standard concededly applicable to rent control\textsuperscript{151} also applicable to utility rate regulation.

On the other hand, one feature of the \textit{Pennell} decision suggests that \textit{Hope}'s "constitutional calculus" and the regulatory takings "multifactor

\textsuperscript{145} \textit{Id.} at 252.
\textsuperscript{146} \textit{Id.} at 253.
\textsuperscript{148} \textit{Id.} at 857-58
\textsuperscript{149} \textit{Id.}
\textsuperscript{150} See discussion \textit{supra} at 243.
\textsuperscript{151} Cf. \textit{Block v. Hirsch}, 265 U.S. 135, 156 (1921) (rejecting a due process challenge to a municipal rent control ordinance \textit{per se}, but indicating in \textit{dictum} that an otherwise valid rent control law might go "too far" and "amount to a taking").
inquiry" might not simply be different expressions of the same constitutional standard: both Hope and Permian Basin were treated as decisions elaborating the requirements of the Due Process Clause rather than those of the Takings Clause. While these requirements tended to converge—particularly, the Court acknowledged, with respect to any challenge to the San Jose ordinance as it might be applied—\(^5\) the insistence, nevertheless, on treating the Due Process and Takings challenges separately suggested that the requirements of the two clauses were not coterminous.\(^5\) As an elaboration of due process requirements, then, Hope’s "calculus" might not in all cases yield the same results as the "multifactor" takings analysis.

Any further reason to suppose that some as yet unarticulated difference between Due Process Clause and Takings Clause values might lead to differences between the "end result" and "regulatory takings" tests seems, however, to have been ended by the Supreme Court’s decision this Term in Duquesne Light Co. v. Barasch.\(^5\) The case involved a challenge to a Pennsylvania statute\(^5\) which prohibited utilities in that state from charging consumers for the construction costs of a new facility until it was actually used to provide utility service.\(^5\) The state courts had construed this statutory version of the "used and useful" rule to bar recovery, even without a showing of imprudence, of more than $40 million invested by two utilities in four nuclear power plant construction projects which were later cancelled.\(^5\) On appeal, the disappointed utilities contended that the statute, so construed, effected an uncompensated "taking" in violation of the Fifth and Fourteenth Amendments.\(^5\) Two arguments were made. First, it was argued that the statute violated the requirements of Hope and Permian Basin because it categorically prohibited investors from recovering their investment in facilities not "used and useful" rather than allowing the treatment of such an investment to be determined by a case-by-case "balancing" of consumer and investor interests.\(^5\) Second, the companies argued that "[s]eparate and apart from . . . the Hope and Permian requirements," to disallow the recovery of a prudent investment so frustrated

152. Pennell, 108 S. Ct. at 858, n.7.
153. See discussion supra at 245-46.
156. The text of the statute provides as follows:
   Section 1315. Limitation on consideration of certain costs for electric utilities. . . the cost of construction or expansion of a facility undertaken by a public utility producing, generating, transmitting, distributing or furnishing electricity shall not be made a part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is used and useful in service to the public. Except as stated in this section, no electric utility property shall be deemed used and useful until it is presently providing actual utility service to the customers.
158. Brief for Appellants, at i.
159. Id. at 14-23.
“reasonable investor expectations” as to amount to a regulatory taking.\footnote{160} This separation of the Hope and “regulatory takings” arguments invited the Court to unravel the tangle of its Due Process Clause and Takings Clause precedents,\footnote{161} but it declined the invitation by rejecting both arguments without paying them separate attention. Chief Justice Rehnquist’s opinion for the majority did not even hint at the underlying confusion. To the contrary, the opinion acknowledged only that constitutional challenges to the sufficiency of utility rates raised a unique “set of questions under the Takings Clause of the Fifth Amendment.”\footnote{162} In addition, although the Court rested its decision on an explicit reaffirmation of the vitality of the Hope “end result” test,\footnote{163} Hope was implicitly treated as an instrument of the Takings Clause rather than, as previously recognized,\footnote{164} as an elaboration of the requirements of due process. This revisionist legerdemain was accomplished, as usual, with the aid of obscurantist language. Here, the critical word was “confiscatory,” perhaps the oldest verbal workhorse in the field of utility regulation. The “guiding principle,” said the Court, has been that “the Constitution protects utilities from being limited to a charge for their property serving the public which is so ‘unjust’ as to be confiscatory.”\footnote{165} Three cases were cited at this point, but not one had been decided under the Takings Clause.\footnote{166} That clause was invoked, nevertheless, in the very next sentence. For this connection, Chief Justice Rehnquist drew on no less venerable a source of obscurantism than the original “takings” analogy of Chief Justice Waite, “if the rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments.”\footnote{167}

With this resurrection of Chief Justice Waite’s analogy, “takings” have

\footnote{160. Id. at 26-33, relying on Kaiser Aetna v. United States, 444 U.S. 164 (1979).}
\footnote{161. Under Chief Justice Waite’s analogy, the Takings Clause was implicated by the early precedents, see, e.g., Smyth v. Ames, 169 U.S. 466, 546 (1898) (“just compensation” required for the use of property beneficial to the public) and the discussion supra 246-47. Later, the Due Process Clause was identified as the source of the constitutional limits on rate regulation, see, e.g., Natural Gas Pipeline, 315 U.S. 575, 586-99 (1942). More recently the Court has not explicitly named the source of the constitutional protection, see, e.g., Permian Basin Area Rate Cases, 390 U.S. 747, 791-92 (1968) (referring only to “constitutional” limitations on ratemaking).}
\footnote{163. Id. at 617.}
\footnote{164. See, e.g., Pennell v. City of San Jose, — U.S. —, 109 S. Ct. 849 (1988). See also Natural Gas Pipeline, 315 U.S. 575, 586-99 (1942). While Pipeline was decided before Hope, the two decisions were roughly contemporaneous and Justice Douglas’ opinion for the Court in Hope obviously adopts the views previously expressed by the concurring opinion he had joined in Pipeline.}
\footnote{165. Duquense Light, at 615.}
\footnote{166. The three cases were Covington & Lexington Turnpike Road Co. v. Sandford, 164 U.S. 578 (1896), FPC v. Natural Gas Pipeline Co., 315 U.S. 575 (1942), and FPC v. Texaco, Inc., 417 U.S. 380 (1974). Covington could not have been a Takings Clause case since it was decided one year before the Takings Clause was made applicable to the States; see Chicago, Burlington & Quincy R.R. v. Chicago, 166 U.S. 226, 239 (1897). Natural Gas Pipeline explicitly referred to the Due Process Clause, not the Takings Clause, as the source of constitutional constraints on utility regulation; Natural Gas Pipeline, 315 U.S. at 586, 599 and Texaco 417 U.S. 380, 391-92 mentioned neither clause, referring only to “constitutional limitations” on ratemaking.}
\footnote{167. Natural Gas Pipeline, at 616.}
once again assumed center stage in the field of utility regulation. However, the Court is no longer speaking metaphorically, but of real limitations on the power to regulate which spring from the Fifth Amendment. These limitations have been elaborated by an extensive, albeit confusing, body of precedent and now that Duquesne Light has paved the way it is perhaps vain to hope that this confusion will not spill over into the constitutional jurisprudence of utility regulation. The end result test of Hope remains in place, but it may well have been transformed from a real world appraisal of "stubborn facts" into a metaphysical exercise. This, of course, remains a matter for conjecture. While Duquesne Light elicited a reaffirmation of the vitality of the "end result" test, the case provided no opportunity for it to be applied. The utilities' arguments that their rates had been set without the required "balancing" and that they were entitled to recovery of all costs prudently incurred, were easily rejected as complaints about the "theory" and "methodology" of ratemaking rather than about the "effect" or "impact" (the "end result") of the rates in question. As the Court acknowledged, neither of the two appealing utilities had even alleged that the "total effect" of the rate order in question was "unjust or unreasonable." Just when might this standard, now understood to spring from the Takings Clause, be violated? Can it ever be consistent with this constitutional standard for a rate regulator to fix rates at a level which requires a utility to suspend its dividend indefinitely or which precipitates a utility bankruptcy? These questions are addressed in section II.

II. AN APPLICATION OF THE THEORY—THE CASE OF UNSUCCESSFUL NUCLEAR INVESTMENTS

When regulators refuse to permit the losses associated with an unsuccessful nuclear investment to be fully recovered from ratepayers, they invariably invoke the "used and useful" rule—the requirement that facilities actually be used in providing utility service before consumers can be required to pay for their construction or operation. Constitutional challenges to these decisions thus inevitably rest on the contentions that the "used and useful" rule is either unconstitutional on its face and/or as applied. Before undertaking an

168. Colorado Interstate Gas Co. v. FPC, 324 U.S. 581, 605 (1945) ("end result" test is a "standard of finance resting on stubborn facts.").
170. Id. at 617-18. No such allegation was even conceivable of course, since the amortization at issue amounted to about one half of one percent of the two companies' total revenue allowances; see id. at 618.
171. See, e.g., Jersey Central III, 810 F.2d 1168 (D.C. Cir. 1987).
173. See generally Nuclear Plant Cancellations, supra note 3, at 33-58 (discussing the regulatory treatment of nuclear plant abandonment costs); Commission Treatment of Overcapacity, supra note 8 (discussing the regulatory treatment of excess capacity costs); Pierce, The Regulatory Treatment of Mistakes in Retrospect: Cancelled Plants and Excess Capacity, supra note 6.
examination of these contentions, it may be helpful to consider the nature and function of the "used and useful" rule.

A. Used and Useful

The "used and useful" rule is a venerable one, dating back to the epoch of "fair value" ratemaking. Even today the rule continues to be described as a "bedrock principle of public utility rate regulation." At the same time, recent reliance on the rule as an instrument for allocating the losses associated with unsuccessful utility investments has been attacked as a "breach of the implicit and fundamental bargain between utility [investors and consumers]" and as a "per se violation of the federal constitution." These, obviously, are not easy positions to reconcile. The task may be considerably simplified, however, once it is recognized that the "used and useful" rule is not really a "rule" at all, but a rubric which has been repeatedly invoked in the service of a variety of distinct regulatory objectives. First, under the regime of "fair value" ratemaking, the phrase "used and useful" expressed the principle for inventorying a utility's "rate base," the aggregate investment on which it would be entitled to earn a "fair return." The theory of Smyth, it will be recalled, required that utilities receive as "just compensation" the "fair [market] value" of utility property "taken" by consumers, and under this analogy that property consisted only of the assets used in providing utility service. Second, even after the demise of "fair value" ratemaking, the "used and useful" rule continued to contribute to the design of "fair" rates by linking responsibility for the capital costs of service with its benefits. As one court has explained: "The principle is simple—it requires that costs associated with electric power plants be paid by the ratepayers who benefit from the plant." Third, the "used and useful" rule has also continued to provide regulators with an instrument for allocating the inherent risks of the utility business.

179. See Brief of Pennsylvania Electric Association as Amicus Curiae at 9-18, Id.
180. Smyth v. Ames, 169 U.S. 466, 466-67 (1898); see discussion supra at 246-47.
181. Economists generally agree that, broadly stated, the criteria of sound utility rates are "adequacy," "fairness" and "efficiency." That is to say, "the three primary objectives of utility ratemaking are (1) provide the necessary revenue requirements, (2) distribute the burden of meeting those requirements 'fairly' among customers and (3) design rates 'to discourage the wasteful use of public utility service..."" E. Priest, PRINCIPLES OF PUBLIC UTILITY REGULATION 329 (1969). See also Bonbright, PRINCIPLES OF PUBLIC UTILITY RATES 290-94 (1961).
182. Kentucky Util. Co. v. FERC, 760 F.2d 1321 (D.C. Cir. 1985). See also Jersey Central III, 810 F.2d 1168, 1190 (D.C. Cir. 1987) (Starr, J., concurring) (recognizing it to be "a matter of simple justice" that ratepayers not "be required to pay for that which provides the ratepayers with no discernible benefit."); Construction Work in Progress for Public Utilities: Inclusion of Costs in Rate Base, 48 Fed. Reg. 24,323, 24,335-37 (1983) (discussing the "fairness" implications of different regulatory treatment of the construction costs of new power plants in terms of "intergenerational ratepayer equity.").
183. See, e.g., Jersey Central III, 810 F.2d 1168, 1190 n.1 (Starr, J., concurring) ("The 'used and useful' rule operates as a restraining principle, reminding utility managers that they must assume the risk of economic forces working against an investment which is prudent at the time it is made.").
Rates which provided utilities with the same return regardless of the success or failure of their investments in new facilities would scarcely mimic the results of competition, generally regarded as the ultimate objective of regulation, and could only operate to promote indifference to efficient utility operations.

B. Facial Challenges to Used and Useful

Price controls are not per se unconstitutional. The Supreme Court has declared in the context of utility rate regulation and otherwise, unless "arbitrary, discriminatory, or demonstrably irrelevant to the policy, the Legislature is free to adopt..." The "used and useful" rule easily meets this standard. It is beyond cavil that efficient utility operations and the fair allocation among consumers of the costs of those operations are valid regulatory objectives. Since these are precisely the objectives served by application of the "used and useful" rule, it hardly seems that the rule would be constitutionally suspect.

The contention to the contrary focuses entirely on the use of the rule under Smyth to inventory a utility's "fair value" rate base. After the demise of Smyth and the interment of the "takings" analogy which animated "fair value" ratemaking, there no longer remained any conceptual need to link rate responsibility to consumer "use" of particular utility facilities. In addition, once ratemaking was freed from the shackles of Smyth most regulators responded by changing the basis for valuing rate-base property from "fair[market]value" to "original [prudent] cost." In light of these developments, it has been argued that there is no longer a "rational nexus" between "just and reasonable" rates and a rate base consisting of "used and useful" property. Furthermore, it is "inconsistent" to continue to employ the

184. See, e.g., I A.E. Kahn, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS 17 (1970) ("the single most widely accepted rule for the governance of the regulated industries is to regulate them in such a way as to produce the same results as would be produced by effective competition, if it were feasible."); Jersey Central III, 810 F.2d at 1190 (Starr, J., concurring) ("Rate regulation is, in theory, the substitute for competition.").

185. See generally Pierce, The Regulatory Treatment of Mistakes in Retrospect, supra note 6 (Rate base regulation promotes over-expansion by utilities and this tendency would be further exaggerated if unsuccessful investments could be fully recovered in rates.).


187. See Jersey Central III, 810 F.2d at 1175 (recognizing that "with the demise of 'fair value', 'used and useful' ceased to have any constitutional significance. . ."); see also Washington Gas Light Co. v. Baker, 188 F.2d 11 (D.C. Cir. 1950), cert. denied, 330 U.S. 952 (1951).

188. A recent survey of practices among regulatory commissions found that thirty-eight states and the District of Columbia use original cost or prudent investment, eleven use fair value or current value, and three consider all evidence submitted. See C. Phillips, Jr., THE REGULATION OF PUBLIC UTILITIES 308 (1984) (citing National Assoc. of Regulatory Utility Commissioners, 1981 Annual Report on Utility and Carrier Regulation, 430-31 (1982)). With one minor exception, federal regulators use original cost. See id. at 308 & n.80.


190. See, e.g., Brief of Pennsylvania Electric Assoc. as Amicus Curiae Id. at 9-21. See also Jersey Central III, 810 F.2d at 1181 ("[W]hen the regulated company is permitted to earn a return not on the
"used and useful" rule to inventory a rate base which is then valued on the basis of "original [prudent] cost."

There are three flaws in this argument. First, by focusing entirely on the "used and useful" rule as a constitutionally required feature of "fair-value" ratemaking, an admittedly obsolete function ever since Smyth was overruled, the argument ignores the rule's other functions: its continuing contributions to the achievement of equity in rates and efficiency in operations. These contributions are particularly significant today, in view of the absolutely staggering magnitude of so many of the industry's unsuccessful investments in new capacity—investments made amid mounting evidence that "efficient" (i.e., least-cost) plans for capacity expansion required that utility investments be shifted away from large generating stations toward small-scale power production and energy conservation technologies. The "used and useful" rule allocates the cost of these unsuccessful investments to utility investors and thereby "operates as a restraining principle, reminding utility management that they must assume the risk of economic forces working against an investment which is prudent at the time it is made." Such a "reminder" can scarcely be said to be "irrational." Under currently prevailing conditions, with the electric utility industry having just undergone a fundamental transformation from one of low risk to high risk capacity expansion, it would seem almost irrational for regulators to replace the "used and useful" rule with the "prudent investment" rule advocated by the utilities. Proof of imprudence in undertaking the construction of a new power plant is extraordinarily difficult. A "prudence only" standard for allowing full recovery of unsuccessful investments would thus make consumers virtual insurers against the risks of utility over-expansion. Since rate-base regulation may already provide a built-in incentive for utilities to over-invest in capital assets, the only effect of such an approach
might very well be a dramatic increase in consumer bills. The suggestion that such a result is compelled by the constitutional requirement of "rationality" in rate regulation, when it has been "long recognized that a legitimate and rational goal of price or rate regulation is the protection of consumer welfare," is simply not persuasive.

Second, there is nothing constitutionally impermissible about applying the "used and useful" rule to inventory the contents of a rate base which is then valued at "original [prudent] cost." To be sure, when the "used and useful" rule is applied in conjunction with the "fair[market]" valuation of rate base, the result, at least in theory, is a symmetrical allocation of the risks associated with utility expansion. That is to say, while investors will bear the risk of "bad" investments, those never or no longer "used and useful," will also get the benefit of "good" investments which are worth more than they cost because of changing price levels or increased demand. This symmetrical allocation of risk and reward is altered when the "used and useful" rule is used in conjunction with "original [prudent] cost" valuation, as such an approach again in theory, shifts the benefits of "good" investment to consumers while the risks of "bad" ones remain with investors. At first blush, this asymmetry would appear to involve utilities in a game of "heads you win, tails I lose." Even if this were so, however, such a scheme would not be irrational. Its consequence is simply a regulatory environment where utility earnings are at greater risk. Since capital markets are self-correcting, the costs of capital for a utility operating in such an environment will be greater and the company will recover these costs through a higher rate of return.


196. See Pierce, The Regulatory Treatment of Mistakes In Retrospect, supra note 6, at 506.


200. While allowing investors a "reasonable" return on an "original [prudent] cost" rate base in theory allocates all the benefits of good investments to consumers, in fact these benefits have been shared with investors. See, e.g., Thompson, Estimating Return Deficiencies of Electric Utilities 1963-1981; Crew, Analysing the Impact of Regulatory Change in Public Utilities (1984) (For decades, as a result of "regulatory lag," unlike actually earned returns in excess of their allowed, bare-bones cost of capital); see also J. Bonbright, A. Danielson, D. Kamerschen, Principles of Public Utility Rates 202 (1988) (relatively little ratemaking engaged in during long period of declining costs from 1926 to 1970).

201. See, e.g., Duquesne Light, 109 S. Ct. at 617-618, n.7 (noting that Pennsylvania's use of the "used and useful" rule in conjunction with an "original [prudent] cost" basis for rate base valuation "slightly increases the overall risk of investments in utilities over the pure prudent investment rule.").


203. See generally Kolbe, Reed and Hall, The Cost of Capital: Estimating the Rate of Return for Public Utilities (1984) (Each of the various methods used by regulators to calculate a utility's allowed rate of return implicitly reflects the utility's actual cost of capital in the marketplace). See also Duquesne Light, 109 S. Ct. at 617-18, n.7 (After noting that Pennsylvania's use of the "used and useful" rule in conjunction with an "original [prudent] cost" basis for rate base valuation "slightly increases the
a scheme may of course be *unwise*, since a regulatory regime which increases the cost of capital to utilities may result in higher costs for consumers in the long run than a regime in which the capital costs of service are reduced by insulating investors from the risks of a "used and useful" disallowance. The point is, however, that regulators could *reasonably* conclude otherwise, especially in view of the great uncertainty which currently surrounds "least-cost" capacity planning.

Third, the contention that the "used and useful rule" cannot be applied "consistently" in conjunction with "fair [current] market" valuation is essentially a challenge to a particular methodology of ratemaking and is thus one which fundamentally misconceives the teachings of *Hope,* teachings which the Court explicitly reaffirmed in *Duquesne Light.*

204. Under *Hope,* the focus of the constitutional inquiry shifted from the methodology employed by the ratemaker to the impact of the rate order.

205. In fixing rates, the Court wrote in *Hope* and, subsequently repeated in *Duquesne Light,* regulators would no longer be "bound" as they had been during the era of fair value ratemaking "to the use of any single formula." Instead, when a rate order was challenged

\[\text{[It is not the theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry . . . is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.}\]

208. Under this "end result" test, the claim that the "used and useful rule" could not be consistently employed in conjunction with "original [prudent] cost" valuation, unaccompanied by any claim that the "total effect" of the rate order in question was "unreasonable," is not constitutionally cognizable. It is simply a complaint about the methodology for determining the component of a rate calculation, the rate base, rather than the rate itself. Such a complaint, said the Court in *Duquesne Light,* focuses on a "subsidiary aspect of valuation for ratemaking purposes," and lacks any "constitutional dimension." In reaching this conclusion, the Court brushed aside both the suggestion that *Hope* had placed the Court's *imprimatur* on the "prudent investment" rule for rate base valuation and the argument that, if it had not, that such a rule


205. *See discussion supra at 243-44.


208. *Hope,* 320 U.S. at 602 and *Duquesne Light,* 109 S. Ct. at 617.

209. *Duquesne Light,* 109 S. Ct. at 617. The point was reiterated at 109 S. Ct. 619 ("[A]n otherwise reasonable rate is not subject to constitutional attack by questioning the theoretical consistency of the method that produced it.").

210. *Duquesne Light,* 109 S. Ct. at 616-17. This suggestion was implicit in appellants' observation that
should now be adopted.\textsuperscript{211} Acknowledging that "the economic judgments required in rate proceedings are often hopelessly complex,"\textsuperscript{212} the Court recognized that "[t]he adoption of a single theory of valuation as a constitutional requirement"\textsuperscript{213} would not only "be inconsistent with the view of the Constitution this Court has taken since \textit{Hope},"\textsuperscript{214} but would "unnecessarily foreclose alternatives which could benefit both consumers and investors."\textsuperscript{215} It is clear that the exclusive focus of the end-result test remains the "bottom line" and facial challenges to any of the vast variety of rules employed by ratemakers will fail, except in the unlikely event that it can be demonstrated that the rule in question is not rationally related to a valid legislative objective.\textsuperscript{216}

\textbf{C. Challenges to "Used and Useful" as Applied}

When a particular rate is claimed to be "unjust and unreasonable"—that is to say, when the "bottom line" is implicated by a "used and useful" disallowance, as it was in the \textit{Jersey Central}\textsuperscript{217} case—the fate of the rule remains more in doubt. On the one hand, it would seem obvious that "used and useful" cannot be invoked as a talisman, to shield all further constitutional inquiry. If it could, and the "fair return" guaranteed by the Constitution was nothing more than a fair return on investment first determined to be includible in an allowed rate base, the "end result" test would be reduced to a tautology. In Judge Bork's words, under such a scheme the end result would be tested "by the rate of return allowed on items for which a rate of return is allowable."\textsuperscript{218} On the other hand, before a return can be judged to be fair or not, the

\textsuperscript{211}Duquesne Light, 109 S. Ct. at 619-20.
\textsuperscript{212}Id. at 619.
\textsuperscript{213}Id. at 620.
\textsuperscript{214}Id.
\textsuperscript{215}Id.
\textsuperscript{216}See discussion supra at note 160.
\textsuperscript{217}The case has spawned three opinions. \textit{See} Jersey Central Power & Light Co. v. FERC, 730 F.2d 816 (D.C. Cir. 1984) (\textit{Jersey Central I}); Jersey Central Power & Light Co. v. FERC, 768 F.2d 1500 (D.C. Cir. 1985) (\textit{Jersey Central II}); Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168 (D.C. Cir. 1987) (\textit{en banc}) (\textit{Jersey Central III}).
\textsuperscript{218}\textit{Jersey Central I}, 730 F.2d at 823. This was the position taken by the Pennsylvania Supreme Court in Barasch v. Pennsylvania PUC, 516 Pa. 142, 532 A.2d 325 (1987) ("The 'just compensation' safeguarded to a utility by the fourteenth amendment of the federal constitution is a reasonable return on the fair value of its property at the time it is being used for public service." \textit{Id.} at 163, 335), and by no less sophisticated a regulator than the FERC, which argued in \textit{Jersey Central III} that "it is well-settled that the end result test
question must be asked: return on what? Justice Scalia addressed this question in his concurrence in *Duquesne Light*, and strongly suggested that the Constitution *required* the fairness of a return to be judged on the basis of a "prudent investment" rate base. Joined by Justices White and O'Connor, he came right to the point:

I join the Court in reaffirming our established rule that no single ratemaking methodology is mandated by the Constitution, which looks to the consequences a governmental authority produces rather than the technique it employs. [citations]. I think it important to observe, however, that while "prudent investment" (by which I mean capital reasonably expended to meet the utility's legal obligation to assure adequate service), need not be taken into account as such in ratemaking formulas, it may need to be taken into account in assessing the constitutionality of the particular consequences produced by those formulas. We cannot determine whether the payments a utility has been allowed to collect constitute a fair return on investment, and thus whether the government action is confiscatory, unless we agree upon what the relevant "investment" is. For that purpose, all prudently incurred investment may well have to be counted.\(^{219}\)

Consequently, if "all prudently incurred investment may well have to be counted" in determining whether a rate is confiscatory, then it would seem that the Constitution *does* impose a "single ratemaking methodology." The concurrence thus appears to be at war with itself.

The majority also has difficulty with this point, but its opinion is far more ambiguous:

[W]hether a particular rate is "unjust" or "unreasonable" will depend to some extent on what is a fair rate of return given the risks under a particular rate-setting system, and on the amount of capital upon which the investors are entitled to earn that return. At the margins, those questions have constitutional overtones.\(^{220}\)

Just what this might mean is perhaps anybody's guess. If the determination upon whether a rate is "unjust" or "unreasonable" requires an independent determination of either "a fair rate of return" or "the amount of capital upon which the investors are entitled to earn that return," and if these determinations have "constitutional overtones," then the end result test comprehends not only rates (the end result) but the components of rates, which are rate base and rate of return as well. Any such interpretation of the Court's opinion obviously would re-enshine the constitutional inquiry, when a particular rate was challenged, in "all of the subsidiary aspects of valuation,"\(^{221}\) and this hardly seems what the majority could have intended. Expressly addressing these "subsidiary aspects," the majority described them at one point as lacking "constitutional dimension,"\(^{222}\) and at another as "economic judgments . . . often hopelessly complex . . . [which] . . . [t]he Constitution is not designed to arbitrate."\(^{223}\) Moreover, *Hope* had disentangled the Court from these "eco-

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220. *Id.* at 617.
221. *Id.*
222. *Id.*
223. *Id.* at 619.

*Jersey Central III*, 810 F.2d at 1174.
nomie niceties” and if the Court was clear about anything in *Duquesne Light*, it was in reaffirming the vitality of *Hope*. Indeed, given *Hope*’s central teaching the majority opinion’s ambiguity is particularly puzzling. If the Constitution is concerned only with the “overall impact” or “net effect” of a rate order and not with the methodology of ratemaking it is difficult to fathom just why the calculation of rate components such as rate of return or rate base should have “constitutional overtones.”

At the very least, the internal inconsistencies of both the majority and concurring opinions in *Duquesne Light* reveal doubts about potential applications of the “used and useful” rule. While these doubts cannot be expressed consistently with the traditional end-result principles of *Hope*, they may very well reflect *Duquesne Light*’s transformation of *Hope* into a Takings Clause case. Given the huge costs of nuclear construction, application of the “used and useful” rule to exclude an unsuccessful nuclear investment from a utility’s rate base is likely to have a devastating impact on its financial condition, just the sort of impact to which the Court’s “regulatory takings” analysis seems to have been most sensitive.

Judge Starr’s concurring opinion in *Jersey Central III* is illustrative. While he stopped short of concluding that the FERC’s “used and useful” disallowance of a return on Jersey Central’s investment of $397 million in the Forked River nuclear generating station was a “taking,” he approached the question along the lines of the “multifactor” regulatory takings inquiry and very quickly concluded that two of the three “factors,” the “economic impact” of the regulation and the extent to which it interfered with “investment-backed expectations,” weighed in the utility’s favor. The size of the loss alone, given its “enormity,” was a consideration which, he wrote, “points powerfully in favor of Jersey Central . . . and must weigh heavily in the balance.” It was also obvious to him that investor “expectations” had been dashed by the Forked River disallowance, since he took it to be common knowledge that “investors purchase utility stocks as a mechanism for conservative, safe investments.” Consequently, Jersey Central’s investors faced “nothing but bleak days ahead.” The third factor, the “character of the governmental action,” weighed in favor of the agency, according to Judge Starr, as the challenged regulation “seem[ed] unintrusive in contrast to more typical takings cases.” It had merely forbidden a profit rather than effecting

[224. Id. at 617 (“Today we reaffirm [the] teachings of *Hope Natural Gas*.”).](#)
[226. Id. at 1194 (“[I] am unable to pass judgment on the ultimate issue in this case . . . .”).](#)
[227. Id. at 1192 (Observing that judges who must determine whether the end result of a rate order “reasonably balances investor and ratepayer interests . . . are, fortunately, not left completely in a web of subjectivity . . . [as] [w]e have been taught that several factors are worthy of consideration in determining whether regulation works a taking, including ‘the economic impact of the regulation, the extent to which it interferes with investment-backed expectations, and the character of the governmental action.’” (citations omitted)).](#)
[228. Id.](#)
[229. Id.](#)
[230. Id.](#)
[231. Id. at 1193.](#)
an invasion or dispossession. Nonetheless, Judge Starr remained "convinced that the FERC ha[d] completely failed to come to grips with the question" and he concurred in Judge Bork's opinion for the court which concluded that if Jersey Central's allegations about its financial condition were true, a taking had "probabl[y]" occurred. This conclusion was vigorously contested by the four dissenting judges, who noted that Hope's end-result standard of "just and reasonable" rates had never been understood to provide investors with a guaranteed return on their investment. While investors had an undeniable interest in rates which preserved the financial integrity of the company, Hope had held only that this interest had to be adequately considered by rate regulators, not that it had to be satisfied. There was therefore nothing inherently incompatible between Hope's principles and a rate order which left a utility facing deep financial hardship, perhaps even bankruptcy; indeed, the dissent emphasized, all this had been made "abundantly clear" by the Supreme Court within a year of its decision in Hope. The majority, by contrast, appeared to regard a Jersey Central bankruptcy as presumptively intolerable, perhaps because it threatened the equity investment in the company with virtual destruction.

It is hardly surprising that the regulatory takings test is more sensitive than the end-result test to a bankruptcy or some other apparently dire regulatory outcome. The function of the regulatory takings doctrine is, after all, to relieve individuals of regulatory burdens which, in "fairness," deserve to be borne by the public at large, and the failure of a major enterprise may strike some as just such a burden. The function of the end-result standard, by contrast, is simply to enforce the terms of the so-called "regulatory bargain" between utility investors and consumers, and it has long been recognized that the terms of that bargain are neither unique nor inferable a priori. There is thus no particular outcome of utility regulation, including a utility bank-

232. Id.
233. Id. at 1194.
234. Id., at 1169.
235. Id. at 1211 (quoting the observation made in Hope, 320 U.S. at 603, that "regulation does not insure that the business shall produce net revenues.").
236. Id. at 1210-11.
237. Id. at 1211 (discussing the Supreme Court's decision in Market St. R. Co. v. Railroad Comm'10 Cal., 324 U.S. 548 (1945)).
238. The presumption could be overcome only by a showing that rates required to avoid bankruptcy would "exploit" consumers; see Jersey Central III, 810 F.2d 1181, n.3.
239. The destruction (as opposed to mere diminution) of economic value has often been recited as the hallmark of a regulatory taking; see, e.g., Agins v. Tiburon, 447 U.S. 255, 260 (1980) (regulation can effect a taking if it "does not substantially advance legitimate state interests,... or denies an owner economically viable use of his [property]"); see also Keystone Bituminous Coal Assoc. v. De Benedictus, 480 U.S. 470 (1987) (statute restricting the right to mine coal did not effect a taking in part because "[p]etitioners may continue to mine coal profitably...." Id. at 504).
240. See discussion supra at 246.
241. See, e.g., Henderson, Railway Valuation and the Courts, 33 Harv. L. Rev. 902, 924-28 (1920) (there is no single, standardized form for the "regulatory bargain").
ruptcy, which necessarily violates or even suggests a prima facie violation of the regulatory bargain.

The majority in Duquesne Light appeared to recognize as much. The “impact” of rates, Chief Justice Rehnquist wrote, “[c]an only be evaluated in the context of the system under which they are imposed.”\(^{242}\) In the same vein, he also observed that “whether a particular rate is ‘unjust’ or ‘unreasonable’ will depend to some extent on what is a fair rate of return given the risks under a particular rate setting system . . . .”\(^{243}\) Where the “used and useful” rule is applied to deny investors any recovery of or return on an otherwise prudent utility investment, it is clear that the question whether the resulting rates afford “sufficient compensation”\(^{244}\) to provide investors a “fair return” can only be answered by determining whether under the “rate setting system” in question, investors took the risk of that disallowance.

Any attempt to identify specifically which risks are assumed by utility investors is, of course, just another way of endeavoring to ascertain the terms of the “regulatory bargain” and there is, as has been noted, simply no way to infer these terms ex post. Fortunately, there is no need to do so, as capital markets can be relied upon to identify the risks faced by utility investors and to compensate them ex ante for taking them. It is widely accepted today that when investors purchase publicly traded securities in a company they do so at a price which can be presumed to reflect all publicly available information.\(^{245}\) That price thus implies an expected return which is adequate by definition, to compensate investors for the known risks which the company faces. Can these risks be identified? For most companies it would seem virtually impossible to look back and identify the full array of business risks faced by the enterprise at any particular point in time. A public utility, however, is in a different position. As the Court noted in Duquesne Light, under regulation it is “relatively immune to the usual market risks” and instead, faces risks which “are in large part defined by the rate methodology employed” by the particular PUC with regulatory jurisdiction.\(^{246}\) These risks should be comparatively easy to identify.\(^{247}\)

Thus, for example, if a particular PUC operated under rules which made it clear that it employed “historical cost” as the basis for valuing utility prop-

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\(^{243}\) Id. at 617.

\(^{244}\) Id. at 616.

\(^{245}\) See generally J. Lorie, P. Dodd & M. Kimpton, The Stock Market: Theories and Evidence 55-79 (2d ed. 1985); Gilson & Kraakman, The Mechanisms of Market Efficiency, 70 VA. L. REV. 549 (1984) (“Of all recent developments in financial economics, the efficient capital market hypothesis (“ECMH”) has achieved the widest acceptance by the legal culture.”) Id.). See also Basic Inc. v. Levinson, — U.S. —, 108 S. Ct. 978 (1988) (accepting the ECMH as the basis for holding that a person who traded a corporation’s shares on a securities exchange after the issuance of a materially misleading statement by the corporation may invoke a rebuttable presumption that, in trading, he relied on the integrity of the price set by the market—the so-called “fraud on the market” theory.) (“Because most publicly available information is reflected in market price, an investor’s reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action.” Id. at 992).

\(^{246}\) Duquesne Light, 109 S. Ct. at 619.

\(^{247}\) Id. at 617, n.7 (describing the allocation of risks inherent in Pennsylvania’s “rate setting methodology” which, the Court noted, had been in effect “[a]t all relevant times.”) Id. at 619.
RATES AND "TAKINGS"

portunity and that it would not make adjustments for changing price levels either in its calculation of a regulated utility's rate base or its allowed rate of return, then subscribers to the common stock of that utility would "assume the risk" of inflation.248 If investors anticipated a period of inflation, presumably they would demand and receive a higher return on their investment; but even if they did not, and there ensued a sustained period of high inflation which drastically reduced the value of their securities, they could not on "fairness" grounds, demand additional compensation.249 A PUC would, of course, remain free to provide an "inflation allowance" in such circumstances, and it might indeed choose to do so in order to enable the company to attract further capital at a reasonable cost;250 if it chose otherwise, however, it could hardly be said that its rates were "confiscatory."

The same is true for the "used and useful" rule. When that rule is incorporated within a particular regulator's "methodology," it shifts the risk of unsuccessful, albeit prudent, utility investments to investors, who are automatically compensated for taking this additional risk by the operation of capital markets. Should the risk eventuate—that is, should a utility investment be excluded from rates because it failed to satisfy the "used and useful" rule—then there is nothing unfair in holding investors to their bargain. On the other hand, if the resulting rates were to be set aside on the ground that they were "confiscatory," investors would receive a windfall.251

The current financial plight of Public Service Company of New Hampshire (PSNH), the lead utility financing the beleaguered Seabrook nuclear power plant, provides a case in point.252 The Seabrook plant was controversial from its very start,253 in part because of fears that PSNH would be unable to finance the huge project. In 1979, these fears prompted the New Hampshire legislature to enact what came to be known as the "anti-CWIP" statute, a law which prohibited utilities operating in the state from charging consumers for the costs of constructing a new facility before it was actually used in providing service.254 On the new law's effective date, PSNH had already

248. See, e.g., Sherman, IS PUBLIC UTILITY REGULATION BEYOND HOPE, supra note 202, at 58 ("original cost" valuation allocates risk of inflation to investors).


250. During the 1970s, many PUCs did in fact provide investors with relief from the impact of inflation-caused erosion of a utility's achieved rate of return. This relief took a variety of forms, including "attrition allowances," the use of future test years and explicit "adjustments" for anticipated increases in costs. See J.C. Bonbright et al., supra note 249, at 349-350.

251. See, e.g., Washington Gas Light Co. v. Baker, 188 F.2d 11 (1951) (Approving in principle a rate order which departed from the "used and useful" rule by providing investors with a return on abandoned plant, but remanding for a determination of whether investors had already been compensated for the risk of abandonment. Judge Bazelon observed: "[i]t seems likely . . . , in view of the prevalence in the past of the doctrine that abandoned property would not be included in the rate base . . . that investors had been compensated for the risk of obsolescence." id. at 20).


254. New Hampshire RSA 378:30-a provides as follows:

378:30-a Public Utility Rate Base; Exclusions. Public utility rates or charges shall not in any manner be based on the cost of construction work in progress. At no time shall any rates or charges be based upon any costs associated with construction work if said construction work is
invested $214 million in the Seabrook unit. It persisted with construction and completed the project in 1986, at a total cost of $1.77 billion. Federal licensing difficulties continued to keep the plant from going into service, however, and in 1987 the company found itself unable to service its Seabrook debt without additional revenues. Its application for an emergency rate increase was nevertheless denied by the New Hampshire PUC on the basis of the anti-CWIP statute, and the company challenged the constitutionality of this action in the New Hampshire Supreme Court, arguing that under Hope it was entitled to rates which would enable it to maintain its financial integrity. The court found Hope apposite, however, “not for what it holds that the constitution promises, but rather for what it explains that the constitution declines to guarantee,” and concluded that the end result of the rate order before it could not be found “confiscatory,” because “the company and its investors [already] have received compensation” for the risks associated with a delayed return on the Seabrook investment. More particularly, the court noted that

PSNH in the face of an unchallenged anti-CWIP statute determined to proceed with construction. The risk of doing so was measured and calculated closely by the marketplace and investors, and was reflected in the interest rates charged on the company's bonds and notes and the market prices of its equity shares.

In attempting to be relieved from that risk now that it had materialized, the court further observed, the investors were simply seeking “to have it both ways.” The United States Supreme Court denied review.

It is clear that no application of any rate methodology will produce an “end-result” which is “confiscatory” as long as that methodology has been applied consistently. The majority tacitly acknowledged this in Duquesne Light when, in searching for an example of an impermissible rate, it was only able to hypothesize the unlikely scenario of “[a] state's decision to arbitrarily switch back and forth between methodologies in a way which required inves-

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256. Id. at 266 (“The PUC found . . . that PSNH needs additional revenues from a rate increase in order to meet its cost obligations. However, a sufficient adjustment of any one of the variables comprised by the traditional ratemaking formula would, in the opinion of the commission, violate § 30-a”).
257. Id. at 268.
258. Id. at 269.
259. Id. at 271.
260. Id. at 269.
262. Professor James Bonbright, with characteristic acuity, suggested this conclusion more than sixty years ago. See Bonbright, The Problem of Valuation: The Economic Merits of Original Cost and Reproduction Cost, 41 Harv. L. Rev. 593, 614-16 (1928) (“The general principle by which this question of ex post facto fairness should be tested is as clear as its application . . . is difficult. A fair rate base . . . is a rate base that does not unduly destroy property values which reflect the reasonable expectations of investors. It is a rate base that avoids too serious a break, at the expense of property owners, in the continuity of governmental policy.” Id. at 615).
tors to bear the risk of bad investments at some time while denying them the benefit of good investments at others..."263 One could hardly dispute the majority's conclusion that such a situation "would raise serious constitutional questions."264 If anything, however, such a far-fetched exception only serves to prove the rule: where rate regulators apply any rate methodology consistently, investors automatically receive a return commensurate with the risks they have assumed, and the end-result cannot offend the Constitution.

There is, of course, no reason to assume that it will always (or even often) be as simple as it was in the Public Service Co. of New Hampshire and Duquesne Light cases to ascertain the rate "methodology" in effect during the relevant investment period. For example, in Jersey Central III, it was precisely the difficulty of identifying the contours of the FERC's "used and useful" policy during the life of the Forked River project that divided the court.265 Where this is the case, and where a rate order has a significant impact on the financial integrity of a utility, then it remains entirely appropriate for a court to engage in a thorough review of the evidence supporting any claim by investors that their "reasonable expectations" had been impermissibly frustrated. The judicial inquiry should, however, focus on the consistency with which the relevant rate "methodology" has been applied rather than on the outcome of its application. In the end, the constitutional standard remains one of degree. Regulation which retroactively frustrates economic expectations has never, for that reason alone, been held to violate either the Due Process Clause or the Takings Clause.266 In addition, the "regulatory bargain" between utility consumers and investors itself leaves some room for changes in ratesetting methodology, as capital markets discount not only the risks to investors which are embedded in the "known" rules but also the risk that, to a degree, these rules may be altered to the disadvantage of investors.267

264. Id.
265. In the dissent's view, prior to its Jersey Central rate order, the FERC had "firmly established" as a matter of "general policy" that it would not permit the unamortized portion of an abandoned investment to be included in an electric utility's rate base. See Jersey Central III, 810 F.2d 1168, 1197-1200 (D.C. Cir. 1987). In the majority's view, the earlier FERC precedent which had first adopted this application of the "used and useful" rule had not announced an "ironclad rule" and FERC's policy "has never been clear or settled." Id. at 1183-86.
266. See, e.g., Connolly v. Pension Benefit Guaranty Corp., 475 U.S. 211 (1986) (statute overriding contractual limitation of liability and imposing retroactive liability for employee benefits on employer withdrawing from multi-employer pension plan did not violate Takings Clause); Pension Benefit Guaranty Corp. v. R.A. Gray & Co., 467 U.S. 717 (1984) (same statute did not violate Due Process Clause); Usery v. Turner Elkhorn Mining Co., 428 U.S. 1 (1976) (rejecting a constitutional challenge to a statute requiring mine operators to compensate disabled employees whose employment terminated before the act was passed) ("[O]ur cases are clear that legislation readjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations. [citations omitted]. This is true even though the effect of the legislation is to impose a new duty or liability based on past acts." Id. at 16).
There are limits, of course, and while their location remains imprecise, it simply cannot be logical to look for them in the wrong place.

**CONCLUSION**

The electric power and telecommunication industries are in the midst of major change, brought about in large part by technological developments which have increased the potential for competition in the supply of services once thought to be the province of "natural" monopolies. These changes have created an opportunity for regulatory reforms which promise, in turn, to facilitate even further technological progress. The "re-constitutionalization" of public utility regulation at this juncture would thus be a great mistake. The fifty years of stultifying judicial supervision under *Smyth* is not an experience which utility regulation needs to repeat. The mistake would be even greater if "re-constitutionalization" were to be attempted through the Takings Clause. The contemporary jurisprudence of "regulatory takings" is so confused that its field of influence should almost certainly not be extended.

The courts have always been uncomfortable in the field of public utility regulation. Indeed, the Supreme Court has just recently re-acknowledged that the determination of rate levels necessary to satisfy ill-defined constitutional standards "will always be an embarrassing question." This is so, of course, only if the Court persists in its endeavor to elaborate the constitutional limits on ratemaking in terms of a pretensive "taking." Such a pretense may have been necessary in the late nineteenth century, as the Court first worked out an acceptable jurisprudence under the Due Process Clause. It is hardly necessary today. Ratemaking can be candidly recognized as an exercise of broad legislative power. At the same time, an "end result" test properly administered as an instrument of the Due Process Clause, can safeguard the "reasonable expectations" of utility investors and thereby provide to utility investments the same degree of constitutional protection as that provided to other forms of private property.

supply contract must be taken to reflect awareness that the industry was heavily regulated and that contract rights were thus at greater risk of impairment).

268. See, e.g., M.A. Crew (Ed.), REGULATORY UTILITIES IN AN ERA OF Deregulation (1987); C. Mann and H.M. Trebing (Eds.), PUBLIC UTILITY REGULATION IN AN ENVIRONMENT OF CHANGE (1987).