PROCEDURAL VERSUS SUBSTANTIVE ECONOMIC DUE PROCESS FOR PUBLIC UTILITIES

Basil L. Copeland, Jr.*
Walter W. Nixon, III†

I. INTRODUCTION

The recent decision of the Court in *Duquesne Light Co. v. Barasch* (*Duquesne*),\(^1\) will be hailed by many as a significant reaffirmation of the continued relevance of the "end result" doctrine of *Federal Power Comm'n v. Hope Natural Gas* (*Hope*).\(^2\) In *Duquesne* the Court states:

Forty-five years ago in the landmark case of *Federal Power Comm'n v. Hope Natural Gas*, this Court abandoned the rule of *Smyth v. Ames*, and held that the "fair value" rule is not the only constitutionally acceptable method of fixing utility rates. *In Hope* we ruled that historical cost was a valid basis on which to calculate utility compensation. ("Rates which enable [a] company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risk assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so called 'fair value' rate base.") We also acknowledged in that case that all subsidiary aspects of valuation for rate-making purposes could not properly be characterized as having a constitutional dimension, despite the fact that they might affect property rights to some degree. Today we reaffirm these teachings of *Hope*: "[I]t is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unreasonable, judicial inquiry . . . is at an end. The fact that the method employed to reach that result may contain infirmities is not then important." (citations omitted)\(^3\)

If this strikes many as an unequivocal reaffirmation of *Hope*, it is only because few today understand what *Hope* really stood for. Contrary to the impression left by the *Duquesne* Court, *Hope* was not significant because it upheld historical cost as a valid basis on which to calculate utility compensation. What made *Hope* such a significant precedent was that it was founded upon a theory of *procedural* due process, and rejected the theory of *substantive* due process that underlay *Smyth v. Ames*.\(^4\)

---

* Basil L. Copeland, Jr. is Vice-President and Senior Economist for Chesapeake Regulatory Consultants, Inc. in Annapolis, MD. He received his M.S. in Resource Economics and Business Finance from Oregon State University. He is a member of the Faculty of the NARUC-MSU Regulatory Studies program.

† Walter W. Nixon, III is Senior Corporate Planner for Arkansas Power & Light Co. He received his B.A. in Economics from Vanderbilt University and his J.D. from The University of Arkansas at Fayetteville. He is a member of the Arkansas Bar. Special Counsel Arkansas Public Service Commission 1983-1990.

2. 320 U.S. 591 (1944).
4. Our thesis is hardly novel, as the following remarkably prescient case note in the 1942 *Yale Law Journal* makes clear:

   Underlying the concurring justices' opinion [in *Federal Power Comm'n v. Natural Gas Pipeline*] is
We fear that the Court has forgotten what really made Hope the precedent it was, and is beginning to shift back toward a theory of substantive economic due process for regulated firms and their investors. In language immediately following that already cited, the Duquesne Court states:

This ["end result"] language, of course, does not dispense with all of the constitutional difficulties when a utility raises a claim that the rate which it is permitted to charge is so low as to be confiscatory: 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, and on the amount of capital upon which the investors are entitled to earn that return. At the margins, these questions have constitutional overtones.\(^5\)

However, the Hope Court believed that the rule of law that it set forth—the end result doctrine—did, in the final analysis, address all of the constitutional issues arising out of claims of confiscation. Thus, if the Duquesne Court believes that the end result doctrine somehow fails to dispense with all constitutional difficulties raised by claims of confiscation, perhaps that is because the Court has forgotten the real meaning of the end result doctrine, and not because of any inherent constitutional deficiencies in it.

Rather than a decisive reaffirmation of Hope, we submit that Duquesne is a disturbing shift back toward a theory of substantive due process not at all unlike that which characterized Smyth v. Ames (Smyth).\(^6\) As we argue below, the current Court has adopted a concept of confiscation (or "confiscatory" ratemaking) that is radically different than the concept embodied in Hope, and one that is remarkably similar to the theory of confiscation underlying Smyth. This conviction leads us to believe that we are at a very critical juncture in the history of the constitutional oversight of utility regulation. At almost every turn we find confusion and turmoil over what actions taken by regulatory commissions in pursuit of the public interest are or are not consti-

---

5. Duquesne, 488 U.S. at 310. When the Court speaks of a certain amount of capital upon which investors are "entitled" to earn a certain return, it is clearly evoking some notion of a substantive economic right in law. Justice Scalia's concurring opinion in Duquesne is even more direct in suggesting substantive law concepts in the judicial evaluation of the reasonableness of commission determinations when setting rates: "We cannot determine whether the payments a utility has been allowed to collect constitute a fair return on investment, and thus whether the government's action is confiscatory, unless we agree upon what the relevant 'investment' is." Id. at 317 (Scalia, J., concurring). As we will show, this language is so alien to either the spirit or the letter of Hope as to be startling.

6. 169 U.S. 466 (1898).
tutionally permissible. We attribute this confusion to a blurring of the distinction between procedural and substantive due process. Duquesne not only did nothing to lessen this confusion, it seems to be itself the victim of it. The only way out of the confusion and turmoil we see is to once again reaffirm the fundamental due process distinctions between Hope and Smyth. Our objective is to explain those distinctions, and show how Duquesne not only fails to affirm Hope in this regard, but may signal an unwitting shift back to substantive economic due process for public utilities along the lines of Smyth.7

II. THE CONSTITUTIONAL RIGHT TO DUE PROCESS AS APPLIED TO JUDICIAL REVIEW OF UTILITY RATE REGULATION

A. Smyth v. Ames and the Rise of Substantive Economic Due Process

The standard of judicial review applied to utility regulation prior to Hope was the “fair value” standard of Smyth v. Ames. The distinction between the two eras is often treated as little more than a distinction in valuation techniques, between the “fair value” or “reproduction cost” technique of the earlier era, and the “original cost” or “prudent investment” technique of the later era.8 However, the distinction was far more fundamental, and did not actually involve a distinction in valuation technique at all. Smyth did not usher in an era in which legislatures or commissions were tied to a given method of valuation. During the decades following Smyth, the Court upheld the reasonableness of legislative and commission decisions reached under a variety of circumstances, including historical or original cost valuations. The significance of Smyth was not that a given method of valuation was required to be employed, but that some type of valuation was to be employed per se, and that without a valuation (embodying the valuation of a substantive economic right in property) the reasonableness of the rates could not be judicially tested. What Smyth set forth was a judicial test of the reasonableness of legislative or commission decisions that required a valuation to be made. The type of valuation to be made was not specified.9

7. We cover much of the same ground, and treat many of the same issues as Drobak, From Turnpike to Nuclear Power: The Constitutional Limits on Utility Rate Regulation, 65 B.U.L. REV. 65 (1985). While we agree with Drobak on many significant points, we disagree on others, not the least of which is the question of the fundamental nature of due process as applied to constitutional oversight of rate regulation. We believe that Drobak does not, in the final analysis, come to terms with the real meaning of the end result doctrine, and that he wrongly locates the constitutional limits of rate regulation in an application of the takings clause. We will note our agreements and disagreements more specifically as we proceed. For a more recent discussion of the application of takings arguments to utility regulation, which notes some of the difficulties associated with Duquesne, see Goldsmith, Utility Rates and “Takings,” 10 ENERGY L.J. 241 (1989).

8. See the language cited above from the Duquesne decision.

9. We do not deny that at times the Court’s opinions were construed, even by sitting justices, as requiring “reproduction cost” with “historical cost” considered of probative value only if price levels were unchanged, or as evidence of “reproduction cost” in the case of recent vintage construction. Cases could be cited where the Court involved itself in the details of the valuation made below in order to determine whether sufficient weight had been given to “reproduction cost.” Justice Butler’s decisions in Bluefield Water Works & Improvement v. Public Serv. Comm’n (Bluefield), 262 U.S. 679 (1923), and McCordile v. Indianapolis Water, 272 U.S. 400 (1926), could be cited as particularly notorious examples of an attempt to construe Smyth in the narrowest terms possible, i.e. as mandating reproduction cost. But it was never the
If we want to understand the real meaning of Smyth, we have to look beyond differences of opinion about valuation methodology, and focus on the Court's changing views toward the meaning of due process. The rule of Smyth arose during an era of judicial activism in which a laissez-faire Court liberally construed the due process clauses of the fifth and fourteenth Amendments to create substantive private economic rights as a basis for overruling state and federal regulation of economic affairs.\(^\text{10}\) Describing the history of Court intervention in rate matters, Justice Black (dissenting) wrote in *McCart v. Indianapolis Water Co.*:\(^\text{11}\)

For the first hundred years of this Nation’s history, federal courts did not interfere with state legislation fixing maximum rates for public services performed within the respective states. The state legislatures, according to a custom which this Court declared had existed “from time immemorial,” decided what those maximum rates should be. This Court also said that “for protection against abuses by legislatures the people must resort to the polls, not to the courts.” It was not until 1890 that a divided court finally repudiated its earlier constitutional interpretation and declared that due process of law requires judicial invalidation of legislative rates which the courts believe confiscatory (citations omitted).

In *Chicago. Milwaukee & St. Paul,\(^\text{12}\)* the Court decided that a railroad had a constitutional right, under the protection of due process, to judicial review of commission action in setting maximum rates pursuant to state legislative authority, thus ushering in an era of substantive economic due process that was to last nearly fifty years. Whereas *Munn v. Illinois\(^\text{13}\)* had left the question of the reasonableness of rates in the hands of the legislature, the Court now claimed the matter was “eminently a question for judicial investigation:”

---


\(^{11}\) *Id.* at 295. On the same day that Butler spoke for the Court in *Bluefield Water Works* (June 11, 1923, just three weeks following the *Southwestern Bell* decision), Brandeis spoke for the Court in *Georgia Ry. & Power Co. v. Railroad Comm’n*, 262 U.S. 625 (1923), in a case that upheld a commission decision that had considered but rejected replacement cost as the measure of “fair value.” Brandeis concurred in the *Bluefield* judgment, but dissented from the opinion for the reasons given in his *Southwestern Bell* opinion. The dispute on the Court over technique, with Butler pressing for the narrowest construction possible, merely represented an extreme application of the concept of substantive economic due process, not the norm. By the early 1930s the Court was returning to an earlier view, which emphasized the distinctive role of judicial review, with more and more deference paid to the expertise of the regulatory authorities, when it claimed “We do not sit as a board of revision, but to enforce constitutional rights.” *Los Angeles Gas & Elec. v. Railroad Comm’n*, 289 U.S. 287, 304 (1932) (citing *San Diego Land & Town Co. v. Jasper*, 189 U.S. 439, 446 (1903)). Long before *Hope*, the Court was allowing wide latitude in the choice of valuation technique and methodology.


\(^{13}\) 94 U.S. 113 (1877).
The question of the reasonableness of a rate of charge for transportation by a railroad company, involving as it does the element of reasonableness both as regards the company and as regards the public, is eminently a question for judicial investigation, requiring due process for its determination. If the company is deprived of the power of charging reasonable rates for the use of its property, and such deprivation takes place in the absence of an investigation by judicial machinery, it is deprived of the lawful use of its property, and thus, in substance and effect, of the property itself, without due process of law and in violation of the Constitution of the United States; and insofar as it is thus deprived, while other persons are permitted to receive reasonable profits upon their invested capital, the company is deprived of the equal protection of the laws.\textsuperscript{14}

Thus was forged an important link in the evolution of a system of substantive economic rights protected against government action under cloak of the due process clauses of the Constitution.\textsuperscript{15} Four years later, in Reagan v. Farmers' Loan and Trust\textsuperscript{16} the Court for the first time enjoined a commission rate determination on the grounds that the rates fixed were so low as to be confiscatory. Another four years later, in Smyth, the right to judicial review of commission ratemaking was considered a settled principle.

With the Court now active in protecting what it perceived to be a substantive private economic right from "unconstitutional" restriction by legislative or commission action, it needed a standard of judicial review that it could use in deciding whether or not substantive due process had been provided for in utility rate cases. It found that standard in the so-called "condemnation analogy," first introduced by Justice Brewer while sitting on the Federal Circuit Court in the case of Ames v. Union Pacific Railway.\textsuperscript{17} While Justice Brewer's decision did not lay down any hard and fast rules with regard to the appropriate valuation of utility property, the seed was sown for the standard that was to be adopted by the Court in Smyth.

\textsuperscript{14} Chicago, M. & St. P., 134 U.S. at 458. The concurring justices in Federal Power Comm'n v. Natural Gas Pipeline, 325 U.S. 575 (1942) understood the Court's views in the 1890s to be that "'due process' means no less than 'reasonableness judicially determined.'" Id. at 600 (footnote omitted; emphasis supplied). From the very beginning, then, the issue was one of the proper scope and standard for judicial review under the due process clauses, not the method of determining the rate per se.

\textsuperscript{15} The economist Irston Barnes, writing in 1942, succinctly summarized the evolution of the concept in the following manner:

Several intermediate links had to be forged before the due-process clause could be successfully invoked to stay state legislation aimed at the correction of faults in the economic system: a substantive meaning had to be grafted onto the procedural, so that due process came to apply to the thing taken as well as to the method of the taking: "rights"—especially freedom of contract and the prospect of future income—had to be assimilated to the concept of "property," and the corporation had to become a "person" entitled to protection under the due process clauses.

Barnes, The Economics of Public Utility Regulation 2 (1942). In a footnote, Barnes traced the evolution of these ideas in the following cases: The Slaughterhouse Cases, 83 U.S. 36 (1873); Davidson v. New Orleans, 96 U.S. 97 (1877); San Mateo County v. Southern Pac. Ry., 13 F. 722 (C.C.D. Cal. 1882); Butchers' Union v. Crescent City Landing Co., 111 U.S. 746 (1884); Santa Clara County v. Southern Pac. Ry., 118 U.S. 394, 404 (1886); Mugler v. Kansas, 123 U.S. 623 (1887); Chicago, M. & St. P. Ry. v. Minnesota, 134 U.S. 418 (1890); Allgeyer v. Louisiana, 165 U.S. 578 (1897); Adair v. United States, 208 U.S. 161 (1908).

\textsuperscript{16} 154 U.S. 362 (1894).

\textsuperscript{17} 64 F. 165, 177-78 (C.C.D. Neb. 1894).
In view of the widespread misconception about the "rule" of Smyth, it is engaging to take a first hand look at what the Court actually said:

...the basis of all calculation 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 of consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth.18

Note that the very first factor considered potentially relevant in ascertaining the value of the property was the original cost of construction. The "rule" of Smyth did not prescribe a given method of valuation, as the Court had to point out in the years that followed.19 The rule of Smyth was in fact not about valuation technique at all. Now that the underlying rationale for judicial review of due process in ratemaking was the condemnation (or eminent domain) analogy in which regulation was likened to the taking of property for public use, it was construed under the takings clauses that the owner of utility property was entitled to "just compensation," and that this entitlement required that a valuation of the properties be performed in order for the courts to have a basis for determining whether the compensation was "just." Rates which did not provide such "just compensation" were construed as confiscatory. The real meaning of Smyth, then, was not that it prescribed certain valuation methods, or proscribed others, but that a valuation was required per se in order to determine whether the property owner had been provided the equivalent of the "just compensation" to which he was entitled under the takings clauses.20

19. Los Angeles Gas & Elec. v. Railroad Comm'n, 289 U.S. 287 (1933); Railroad Comm'n v. Pacific Gas & Elec., 302 U.S. 388 (1938) (Upholding rates based upon historical cost, and stating in the latter: "We have frequently held that historical cost is admissible evidence of value." 302 U.S. at 398.)
20. In another case that strongly demonstrates the mind of the Court at that time with regard to role of the judiciary in determining "just compensation" in eminent domain cases, Monongahela Nav. Co. v. United States, 148 U.S. 312 (1893), Justice Brewer wrote:

There can, in view of the combination of those two words ["just" and "compensation"], be no doubt that the compensation must be a full and perfect equivalent for the property taken... But this is a judicial, not a legislative question. The legislature may determine what private property is needed for public purposes—that is a question of a political and legislative character; but when the taking has been ordered, then the question of compensation is judicial. It does not rest with the public, taking the property, through Congress or the legislature, its representative, to say what compensation shall be paid, or even what shall be the rule of compensation. The Constitution has declared that just compensation shall be paid, and the ascertainment of that is a judicial inquiry. Id. at 326-27.

In the area of ratemaking, the Court was to allow the legislatures and commissions to set the rates, but was
It is thus a serious misstatement of the history of the judicial oversight of ratemaking to suggest that historical (or "original") cost was something which became constitutionally permissible only after the "rule" of Smyth was overturned by Hope. In Los Angeles Gas & Elec. v. Railroad Comm'n,21 at the height of what has been called the "fair value" era, the Court said of its approach to determining whether the constitutional rights of utility property owners have been violated:

As the property remains in the ownership of the complainant, the question is whether the complainant has been deprived of a fair return for the service rendered to the public in the use of the property. This Court has repeatedly held that the basis of calculation is the fair value of the property, that is, that what the complainant is entitled to demand, in order that it may have "just compensation" is a "fair return upon the reasonable value of the property at the time it is being used for the public." [Citations omitted] ... And mindful of its distinctive function in the enforcement of constitutional rights, the Court has refused to be bound by any artificial rule or formula which changed conditions might upset.22

The Court then went on and discussed the permissible methods of valuation, including original cost, as well as reproduction cost. "The weight to be given to actual cost, to historical cost, and to cost of reproduction new, is to be determined in the light of the facts of the particular case."23 As if aware of the

---

22. Id. at 305 (emphasis supplied).
23. Id. at 308 (citation omitted). Drobak ignores Los Angeles in his analysis of the shift from Smyth to Hope. While the Court still adhered to the scope of judicial review claimed in Smyth (it was still concerned about "just compensation"), it had modified its self-understanding of that scope, and was half-way to a complete withdrawal from the substantive application of the constitutional protection of due process, a withdrawal completed in Hope. In Los Angeles the Court said:

We approach the decision of the particular questions thus presented in the light of the general principles this Court has frequently declared. We have emphasized the distinctive function of the court. We do not sit as a board of revision, but to enforce constitutional rights. San Diego Land & Town Co. v. Jasper, 189 U.S. 439, 446 (1903). The legislative discretion implied in the ratemaking power necessarily extends to the entire legislative process, embracing the method used in reaching the legislative determination as well as that determination itself. We are not concerned with either, so long as constitutional limits are not transgressed. When the legislative method is disclosed, it may have a definite bearing upon the validity of the result reached, but the judicial function does not go beyond the decision of the constitutional question. That question is whether the rates as fixed are confiscatory.

Los Angeles, 289 U.S. at 304-05. This represented a significant concession to the role of the legislature, when compared with the thinking of the Court in the 1890s (as expressed in Monongahela Nav. Co. and Chicago). But it still expressed a scope of judicial review that embodied substantive due process ("the legislative method may have a definite bearing upon the validity of the result reached"). When the Permian Court, noted infra, cited this passage from Los Angeles to demonstrate the wide deference to be permitted regulatory agencies, it omitted the language suggesting a substantive relationship between means (method) and ends (result). Drobak maintains that after Hope, substantive limits remained, but only those existing generally under the takings clauses. If that were so, there would have been no need for Hope; Los Angeles had sufficiently enlarged the role of the legislature, while retaining substantive limits. Hope went even further, though, abandoning judicial concern over the relationship between legislative means and ends, thus severing the Gordian knot that provided for substantive due process.
general inability of observers to keep the distinctions between the legislative and judicial functions clearly in mind, the Court stated:

It is necessary again, in this relation, to distinguish between the legislative and judicial functions. It is the appropriate task of the commission to determine the value of the property affected by the rates it fixes, as that of an integrated, operating enterprise, and it is the function of the court in deciding whether rates are confiscatory not to lay down a formula, much less to prescribe an arbitrary allowance, but to examine the result of the legislative action in order to determine whether its total effect is to deny to the owner of the property a fair return for its use.24

When the era between Smyth and Hope is described as the era of "fair value," such a description relates to the judicial test of reasonableness in determining whether constitutional rights were abrogated, not to the precise legislative or commission method of valuation—whether original cost, market value, or reproduction cost new.

B. Hope and the Demise of Substantive Economic Due Process

If the "rule" of Smyth was not that it dictated a particular method of valuation, neither was the "rule" of Hope that it now allowed methods of rate base valuation not previously permitted under the rule of Smyth. To contrast the two solely in terms of valuation technique not only trivializes Hope, it misses the point of Hope altogether. As the Court in Los Angeles Gas & Elec. noted, there is a tendency to confuse the judicial function in testing the reasonableness of agency rate determinations with the legislative or commission function of determining the rates themselves. Moreover, under Smyth, confusion between the two was almost inevitable. If the reasonableness of agency rate determinations devolves around whether they constitute a judicially "just" level of compensation, then the agency will inevitably find itself engaging in pre-judicial determinations of what is "just," and the courts will inevitably find themselves trying the facts of the case de novo in order to assure themselves that the compensation allowed was indeed "just."25

Hope changed the rules, not by allowing additional methods of determin-

24. Id. at 314.
25. Substantive economic due process for public utilities was carried to this "logical" extreme in Ohio Valley Water v. Ben Avon Borough, 253 U.S. 287 (1920), when the Court stated explicitly what it had been practicing implicitly:

In all such cases, if the owner [of the utility] claims confiscation of his property will result, the [State must provide a fair opportunity for submitting that issue to a judicial tribunal for determination upon its own independent judgment as to both law and facts; otherwise the order is void because in conflict with the due process clause, Fourteenth Amendment. Ben Avon, 253 U.S. at 289. While never explicitly overturned, this doctrine has not been followed since St. Joseph Stockyards v. United States, 298 U.S. 38 (1936). Authorities recognize that the doctrine is inconsistent with Hope. See SchwartZ, Administrative Law 626-29 (1984). Its force was also effectually repudiated by Alabama Pub. Serv. Comm'n v. Southern Ry., 341 U.S. 341 (1951) (holding that the earlier view was based upon the idea that "confiscation" depended upon "pure matters of fact" which had to be independently evaluated by the judiciary). As a legacy of this mischievous experiment in judicial activism, California and Maine have the Ben Avon doctrine codified in their regulatory statutes, and the Massachusetts Supreme Court has made it a matter of ruling precedent in a number of decisions. See Note, Reassessing "Confiscation" Under Section 305 of Maine's Public Utility Law, 29 Me. L. Rev. 194 (1977).
ing "just compensation," but by abandoning the judicial preoccupation with valuation as the measure of whether the due process provisions of the fifth and fourteenth Amendments had been satisfied. Henceforth, the test of the constitutionality of commission ratemaking was not to be determined by whether the valuation of rate base provided "just compensation," but by whether the end result was "reasonable." Investors were no longer "entitled" to "just compensation" because Hope abandoned the taking analogy that underlay Smyth. Under Hope a "reasonable end result" was framed in terms of the procedural standards of due process laid down by the Court in Nebbia v. New York,26 and not in terms of substantive economic rights in law. Any reasonable end result was constitutionally defensible regardless of the rate base employed, or even if no rate base was employed at all, as long as it was based upon substantial evidence, did not constitute an abuse of discretion, and the means employed were reasonably related to a legitimate public purpose which the agency was empowered to obtain.27

Just as the rule of Smyth had its origins in the rise of the Court's experiment with substantive economic due process, the rule of Hope had its origins in the demise of it, and in the return to a theory of judicial review that emphasized the procedural rather than the substantive. Of particular significance was the growing influence of philosophical pragmatism and instrumentalism on American jurisprudence.28 The pragmatists sought understanding in experience, and in the experiential or instrumental relation between means and ends. In a crude but meaningful aphorism, instrumental truth is "what works." Under their influence there was increasing attack upon the prevailing notion of substantive economic due process. Rather than the administration of substantive rights, which have a "natural-law" connotation about them, the focus of jurisprudence gradually shifted toward the assessment of the consequences of law, especially in terms of social ends and objectives. The year 1937 has been noted as a watershed in which the Court all but abandoned judicial review along lines of substantive economic due process.29 Upholding federal regulation prohibiting the interstate shipment of "filled" milk, the

27. The last of the requirements—a reasonable relationship between means and ends—imposed a threshold issue in terms of substantive due process. Is rate regulation a "taking?" If so, then the constitution requires "just compensation." By finding that rate regulation is not a "taking," but a "species of price-fixing," Hope was to dispose of this threshold issue by holding, in effect, that rate regulation raises no issue of substantive due process. In other words, once the Court found that rate regulation raised no per se substantive due process issue, this threshold issue was settled, and the remaining issues were procedural. It continued to speak of rates so low as to be "confiscatory," but it would look to the effect of the agency's procedures, rather than the substance of them, to determine when the rates were "confiscatory."
29. In addition to Tribe and Nowak, supra, note 10, see McCloskey, Economic Due Process and the Supreme Court: An Exhumation and Reburial, 1962 SUP. CT. REV. 34.
Court in *United States v. Carolene Products* stated that "where the legislative judgment is drawn in question, [the inquiry] must be restricted to the issue whether any state of facts either known or which could reasonably be assumed affords support for [the legislation]." But the Court was prepared to go even further and presume a rational basis for the legislation, unless there was clear evidence to the contrary that "... the existence of facts supporting the legislative judgment is to be presumed, for regulatory legislation affecting ordinary commercial transactions is not to be pronounced unconstitutional unless ... it is of such a character as to preclude the assumption that it rests upon some rational basis." Then, in the famous "footnote 4" at the end of the sentence just cited, Justice Stone elaborated on the circumstances which might warrant greater judicial scrutiny than this, including the need to insure that "discrete" and "insular minorities" are not discriminated against by the political process.

*Hope* fit the mold of *Carolene Products* remarkably well:

Moreover, the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences.

*Hope* embodied the same radical departure from substantive due process as

---

30. 304 U.S. 144 (1938).
31. Id. at 154.
32. Id. at 152.
33. Id. J. ELY, DEMOCRACY AND DISTRUST 73-104 (1980) interprets "footnote 4" to provide for a scope of review in which the Court "polices the process of representation." The themes of *Carolene Products*, set forth as follows,

ask us to focus not on whether this or that substantive value is unusually important or fundamental, but rather on whether the opportunity to participate either in the political processes by which values are appropriately identified and accommodated, or in the accommodation those processes have reached, has been unduly constricted.

**DEMOCRACY** at 77. With regard to the Fifth Amendment, he writes:

On the first reading, the Fifth Amendment's requirement that private property not be taken for public use without just compensation may appear simply to mark the substantive value of private property for special protection ... Again, though, we must ask why. Because property was regarded as unusually important? That may be part of the explanation, but note that property is not shielded from condemnation by this provision. On the contrary, the amendment assumes that property will sometimes be taken and provides instead for compensation. Read through it thus emerges—and this account fits the historical situation like a glove—as yet another protection of the few against the many ... [footnote omitted].

*Id.* at 97. Speaking of the Reconstruction Amendments (which would include the Fourteenth), Ely suggests that with the exception of the Thirteenth (prohibiting slavery), they "do not designate substantive values for protection from the political process." *Id.* at 98. The Fourteenth Amendment's due process clause, in particular "is concerned with process writ small, the processes by which regulations are enforced against individuals." *Id.*

We do not mean to suggest that there are no substantive values at all protected by the Constitution. Cf. L. Tribe, *The Puzzling Persistence of Process-Based Constitutional Theories*, 89 YALE L.J. 1063 (1980). But the standards of review of agency decisions in the wake of the demise of substantive due process after 1937 became increasingly procedural, giving at least some credence to Ely's arguments as applied to due process for utility corporations.

Carolene Products. It demonstrated extreme deference to the expertise of the agency (equivalent to the presumption of a rational basis to legislative action), and a burden of proof requiring those who would challenge the action to show that it is unjust and unreasonable in its consequences (equivalent to showing some fact or set of facts which would preclude a finding of a rational basis behind the legislation). As far as the "end result" test was concerned, it was affirming a standard of judicial review that would insure that the interests of an "insular minority"—the investor interest—would not be discriminated against, or deprived of due procedure, in the legislative process of ratemaking.35

Against this backdrop of the evolving constitutional landscape, we can begin to get a better idea of the constitutional theory that was adopted in Hope. The Court was not merely sustaining an agency determination based upon original cost. It was repudiating substantive economic due process as it had been applied historically to the regulation of utility rates. More specifically, it was rejecting the condemnation analogy and the accompanying notion of a substantive right to "just compensation." Rather than being a "taking" of property, the emphasis was now upon regulation as a form of price-control, and as such, a valid use of the police power of the state, and not an exercise in eminent domain. Relying in part on Nebbia, the Hope Court stated that "[t]he 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 the regulation is invalid."36 In Nebbia the Court had stated:

So far as the requirement of due process is concerned, and in the absence of other constitutional restriction, a state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare, and to enforce that policy by legislation adapted to its purpose. The courts are without authority either to declare such policy, or, when it is declared by the legislature, to override it. If the laws passed are seen to have a reasonable relation to a proper legislative purpose, and are neither arbitrary nor discriminatory, the requirements of due process are satisfied, and judicial determination to that effect renders a court functus officio.37

Later the Nebbia Court added: "Price control, like any other form of regulation, is unconstitutional only if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt, and hence an unnecessary and unwarranted interference with individual liberty."38 When rate regulation is viewed as price control, rather than as a "taking" of private property for public use, the constitutional standards of due process are no longer substantive, but procedural. The famed "end result" language of Hope stood squarely upon the foundations of procedural due process laid down in Nebbia.

35. The need for such protection would accord well with the progressive and New Deal spirit of the times. In other times and places, the ability of utilities to promote their "special interest" through lobbying and other activities aimed at influencing the legislative process would suggest that it is the public, rather than the utility and investor interest, that needs the protection of due process.
36. Hope, 320 U.S. at 601.
38. Id. at 539.
Under standards of procedural due process, the end result of agency action is reasonable, and raises no constitutional issues, if it meets these procedural standards. And if it meets these standards, then judicial inquiry is "at an end."39 There are no remaining issues "at the margins . . . [with] constitutional overtones."

The return of procedural due process to utility regulation was couched in language that recalls its pragmatic and instrumental origins, not the least of which is the "end result" doctrine:

It is not 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 under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.40

Here we have an explicitly instrumental and pragmatic view of the scope of judicial review, one that assesses the instrumental value of means entirely in terms of their usefulness in securing the desired end, or "end result."41 It is not the means themselves, or the "theory" that provides the rationale for choosing one set of means or instruments over another that matters. In reviewing the reasonableness of commission rate determinations, under Hope the function of the court is to assess the probable consequences of the commission’s order in terms of the objectives of the order, not in terms of the means employed. The legislature, and the commissions they create, must be free to experiment with methods and means, in order to make the "pragmatic adjustments" which the relating of means to ends necessarily requires, without having to answer to the courts with regard to the exercise of their judgment in the choice of methods and means.42 The only thing the courts need concern themselves with in reviewing agency action is whether the probable consequences of the means and methods employed bear a reasonable relationship to the intended objectives.43 Moreover, the objectives themselves are those statutory objectives established by the will of the people in the legislature, not the judg-

39. Or as the Nebbia Court put it, rendered functus officio. Id. at 537.
40. Hope, 320 U.S. at 602.
41. The desired "end result" is a rate which is statutorily "just and reasonable," and a rate is statutorily just and reasonable if it balances the competing interests of buyer and seller, consumer and investor.
42. Thus the Hope Court, relying on Federal Power Comm’n v. Natural Gas Pipeline, 315 U.S. 575, 586 (1942), noted that ratemaking involves the making of "pragmatic adjustments," another explicit reference to instrumentalism in relating ends to means. Hope, 320 U.S. at 602.
43. As Hope put it:
Moreover, the Commission’s order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. He who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences. Hope, 320 U.S. at 602. The Duquesne Court, and Justice Scalia especially, seem close to a total failure to comprehend these words. Under Smyth, the right to a judicial determination of "just compensation" was invoked merely by claiming a "taking." Hope was trying to get away from that, and leave the determination of the amount of revenues to be produced by the rate to the expert judgment of the ratemaking agencies. The right to judicial intervention was to be restricted to those cases where the judgment of the commission was so egregiously bad that it would be obvious in its consequences, i.e. in its effect upon the financial viability of the firm. Contrary to Justice Scalia, the courts do not need to ascertain a "fair return on investment" to make that determination.
ment of the court. When a commission sets a rate that is without substantial evidence, is an abuse of discretion, or is so palpably unjust in its consequences that it is obvious that even the most rudimentary elements of balancing and fairness have not been observed, then the court has a *procedural* foundation for holding that due process has been violated.44 But as long as the pragmatic and instrumental values of procedural due process are followed, judicial inquiry is at an end. To insist that it is not, as long as there remains some question about the resulting level of return on rate base, however calculated, is to return to a theory of substantive economic due process.

Thus the rule of *Hope* is procedural, not substantive. There is no substantive requirement under *Hope* that a certain return be allowed on a certain rate base. There is no substantive requirement under *Hope* at all other than the substantive right to procedural fairness, a substantive right that is enjoyed equally by consumers and investors, and adequately protected from the investor point of view by the "end result" test.45 The rule of *Hope* is that regardless of how the agency determines the rate, as far as method or technique is concerned, the requirements of due process will be served if the agency's determination was based upon substantial evidence, was not an abuse of discretion, and does not produce a result that is unjust or unreasonable in relation to the balancing of competing interests that regulation must entertain.

As we read it, though, *Duquesne* can be construed as upholding, "at the margins," a substantive right on the part of investors to a "fair return" on some valuation of the capital they have invested in the enterprise.46 The notion is common, but impossible to reconcile with a careful reading of *Hope*. What gives rise to this notion is the following language, frequently cited as liturgy in commission decisions on rate of return, and in the testimony of rate of return witnesses who claim that their testimony meets the "constitutional requirements" of *Hope*:

... the investor interest has a legitimate concern with the financial integrity of

44. Among the "fundamental rights as defined by the modern court" is the right "to fairness in procedures concerning individual claims against governmental deprivations of life, liberty, or property. ... This right is not reflected in a specific decision but is, rather, an implied recognition of the fundamental nature of the due process clause in those decisions dealing with 'procedural due process' rights." J. Nowak, R. Rotunda, & N. Young, *Constitutional Law* 371 (1986). By emphasizing that in setting rates competing interests must be balanced, the thrust of due process in rate regulation is toward procedural fairness, not the protection of constitutionally protected substantive economic rights.

45. In *Hope* the Court did not make a determination of what was "just" or "reasonable" in regard to either rate base or the return on rate base. It based its conclusion of the reasonableness of Commission-determined rates solely upon the basis of a consideration of the aggregate revenues that would be produced by the rates, and by assuring itself that there was credible evidence in the record that those revenues were adequate to enable the utility to continue to operate successfully and remain financially viable. And on the basis of this finding it could state "... we are of the view that the end result in this case cannot be condemned under the Act as unjust and unreasonable from the investor or company viewpoint," *Hope*, 320 U.S. at 603. It is this demonstration of the "end result" doctrine in action—without the need for a determination of "rate base" or "rate of return"—that makes Justice Scalia's concurring opinion so remarkable, and so utterly alien to either the letter or the spirit of *Hope*.

46. Justice Scalia, it would seem, would have a court examine the valuation in every instance that a claim of "confiscation" is made, and not merely "at the margin." This would resurrect the doctrine of the "constitutional fact," and makes a "reasonable return" a judicial determination rather than an administrative one. That is hardly what *Hope* had in mind.
the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. [Citation omitted.] By that standard the return to the equity owner should be commensurate with returns on investment in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.47

This language is then carelessly joined with similar language from the Bluefield Water Works48 case:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties . . . . The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.49

Though the language of the two cases is similar, the similarity is superficial, for the two cases rest upon totally different constitutional theories about due process. The concept of a “fair return,” even “at the margins,” as the ultimate meaning of reasonableness in the constitutional sense had its origins during the “fair value” era, and cannot be defended as a substantive right without accepting all of the baggage that went along with the era.

The origins of Bluefield are not without some significance for understanding why it has no place being cited with Hope. Bluefield was written by Justice Pierce Butler soon after joining the bench. An ideologue described as a “failure” on the bench, Butler was a former railroad counsel who had agreed, as a condition to Senate confirmation, to not hear railroad cases.50 Respecting the letter of his agreement, if hardly the spirit, he used non-railroad rate cases to push for his hard-line view of substantive due process as applied to utility rate cases. Bluefield was one of those cases. Notably, however, Hope makes no reference to Bluefield, relying instead on Brandeis’ separate opinion in Southwestern Bell. Nor does Hope ever speak of the investor return being something that the investor is entitled to earn. Hope carefully avoids the substantive language that infuses Bluefield. In fact, until Duquesne, the Court had not relied upon Bluefield as stating a controlling principle with regard to the constitutional issue since Justice Butler did—citing his own case—in 1938

47. Hope, 320 U.S. at 603.
49. Id. at 692-93.
50. The source for the description of Butler as a “failure” on the bench can be found in G. White, The American Judicial Tradition 178 (1988). Butler was one of the notorious “Four Horsemen” (along with Justices Van Devanter, McReynolds, and Sutherland) who personified judicial activism in the protection of presumed substantive economic property rights during the progressive and New Deal eras. Butler’s experience as a railroad counsel, and his role on the Court in cases dealing with rate matters, are chronicled in Siegel, Understanding the Lochner Era: Lessons from the Controversy over Railroad and Utility Rate Regulation, 70 Va. L. Rev. 187, 240-42 nn. 228-31 (1984).
in *Denver Union Stock Yard Co. v. United States*. 51

While *Hope* and *Bluefield* both talk about the investor's interest in the rate of return, *Bluefield* interpreted this return as a substantive right under the Constitution:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment. 52

This doctrine, however, was overturned with *Hope*. In *Hope* a "reasonable return" merely became a relevant consideration ("legitimate concern") in the balancing of investor and consumer interests, not the measure itself of what was "constitutionally reasonable." Those who join *Hope* and *Bluefield* succeed only by taking the familiar *Hope* language about the investor interest grossly out of context, both with respect to the language immediately preceding, as well as with respect to the language immediately following. Immediately preceding the language just quoted, Justice Douglas wrote:

The rate-making process under the Act, i.e., the fixing of "just and reasonable" rates, involves a balancing of the investor and consumer interests. Thus we stated in the *Natural Gas Pipeline* case that "regulation does not insure that the business shall produce net revenues." 315 U.S. 590. But such considerations aside, the investor interest has a legitimate concern . . . . 53

In the language that follows, which focuses only on the investor interest, Justice Douglas is not discussing the balancing of competing interests, nor the circumstances under which the investor interest might have to yield to the consumer interest. The language about the "investor interest" is merely a dis-

51. 304 U.S. 470, 475 (1937). In contrast, the case has been cited thousands of times in commission and lower court rulings as stating some kind of substantive ruling principle. It was a testimony to the depth of the Court's own understanding of the significance of the new due process standards in *Hope* that the Court itself resisted the temptation to concatenate *Hope* and *Bluefield*. Until now, that is. The *Duquesne* Court has descended to the muddled standards of the commissions and lower courts in citing *Bluefield*. If it were not for the claim of reaffirming *Hope*, we might suppose this was an intentional effort to resurrect substantive due process.

52. *Bluefield*, 262 U.S. at 690.

53. *Hope*, 320 U.S. at 603. It surprises many to find that the oft-cited "standards" of the investors' interest in *Hope* do not involve a discussion of constitutional standards at all, but the balancing of investor and consumer interests according to a statutory standard of "just and reasonable," under the Act (i.e., the Natural Gas Act). However, in *FPC v. Natural Gas Pipeline*, 315 U.S. 575, 586 (1942), the Court had concluded that the statutory standards "coincided" with whatever constitutional issues might be involved, and in *Hope* the Court claimed "Since there are no constitutional requirements more exacting than the standards of the Act, a rate order which conforms to the latter does not run afoul of the former." *Hope*, 320 U.S. at 607. *Hope* just made more explicit that the only real constitutional issue involved—assuming substantial evidence and no abuse of discretion—was that of procedural fairness, i.e. a balancing of consumer and investor interests. We cannot believe that even where a rate order was found to be unjust and unreasonable in its consequences that the *Hope* Court ever intended for judicial review to go further than to remand the case for more balanced deliberations. We think the *Hope* Court would have been incredulous at Justice Scalia's interpretation—if we read it correctly—that the Court would want to immerse itself in competing claims of what is a "fair rate of return" and remand the case with instructions to the effect "You must allow such-and-such a return on so many dollars of investment else there has been a taking without just compensation." Is this where we are headed? How would that be any different than the "reasonableness judicially determined" which *Hope* supposedly laid to rest?
The true standard in *Hope* of what is “fair and reasonable” is not the narrow one-sided litany of legitimate investor concerns which normally receives all the attention, but a proper balancing of investor and consumer interests. For reasons which relate to the fact that the Court was upholding a lower court ruling that was challenged as unfair from the investor’s point of view, the Court did not elaborate on the consumer’s interest. The *Hope* Court clearly implied, however, in language that immediately follows the discussion of the investor interest (“The conditions under which more or less might be allowed are not important here.”) that the balancing of consumer and investor interests might, at times, require less than what is necessary to attract capital or equal returns earned elsewhere on investments of comparable risks. These criteria, even at the margins, do not constitute the *sine qua non* of the due process under the theory adopted by the *Hope* Court. They are merely relevant considerations in the balancing process.

We would also call attention here to a piece of judicial history that is often ignored when interpreting *Hope*: the concurring opinion of Justices Black, Douglas, and Murphy in *Federal Power Commission v. Natural Gas Pipeline*, a case which figured prominently in *Hope* as precedent. After a long discussion of the history of the constitutional oversight of ratemaking, they addressed the question of a “just and reasonable” rate from the standpoint of the competing interests of consumers and investors in the following fashion:

The requirement of “just and reasonable” embrace, among other factors, two phases of the public interest: (1) the investor interest; (2) the consumer interest. The investor interest is adequately served if the utility is allowed to earn the cost of the service. That cost has been defined by Mr. Justice Brandeis as follows: “Cost includes not only operating expenses, but also capital charges. Capital charges cover the allowance, by way of interest, for the use of the capital, whatever the nature of the security issued therefor; the allowance for risk incurred, and enough more to attract capital.” [Citation omitted.] Irrespective of what the return may be on “fair value,” if the rate permits the company to operate successfully and to attract capital all questions as to “just and reasonable” are at an end so far as the investor interest is concerned. Justice Black subsequently added:

One caveat however should be entered. The consumer interest cannot be disregarded in determining what is a “just and reasonable” rate. Conceivably a return to the company of the cost of service might not be “just and reasonable” to the public. The correct principle was announced by this Court in *Covington & Lexington Turnpike v. Sandford*, 164 U.S. 578, 596:

> It cannot be said that a corporation . . . is entitled as of right, and without reference to the interests of the public, to realize a given percent, upon its capital stock. When the question arises whether the legislature has exceeded its constitutional power in prescribing rates to be charged by a corporation controlling a public highway, stockholders are not the only persons whose rights or interests are to be considered. The rights of the public are not to be ignored. It is alleged here that the

---

54. Happily, we note agreement with Drobak on this point. Drobak, supra note 7, at 86.
55. 315 U.S. 575 (1942).
56. Id. at 606-07.
rates prescribed are unreasonable and unjust to the company and its stockholders. But that involves an inquiry of what is reasonable and just for the public...

This problem carries into a field not necessary to develop here. It reemphasizes, however, that the investor interest is not the sole interest for protection. The investor and consumer interests may so collide as to warrant the rate-making body in concluding that a return on historical cost or prudent investment, though fair to investors, would be grossly unfair to the consumers.57

There are several things worth noting here. First, as already noted, the "investor interest" adopted in Hope is the same as that enunciated here, and both go back to Brandeis' seminal separate opinion in the Southwestern Bell case.58 No one can reasonably distinguish the discussion of the balancing of investor and consumer interests in the majority opinion of Hope from the concurring opinion of Justices Black, Douglas and Murphy, in Natural Gas Pipeline, except in the fuller treatment accorded the discussion of the consumer's interest in the latter. Second, the principle of Covington & Lexington articulated here has never been overturned, and in fact was reaffirmed by the Court in the Permian Basin Area Rate Cases.59 To whatever extent investors can be said to have a "substantive right," the public has one that is at least just as substantial. Third, when the two conflict, it is the will of the public, embodied in the statutory mandate that authorizes regulation, that governs how the competing interests must be "balanced."60 Fourth, note well the presumption of agency action based upon an historical cost or prudent investment rate base. Contrary to Justice Scalia and the Duquesne majority ("at the margins"), the balancing of consumer and investor interests "may warrant the rate-making body in concluding that a return on historical cost or prudent investment though fair to investors would be grossly unfair to consumers."

Justice Jackson's dissent in Hope is also often ignored for the insight it gives on the evolving state of constitutional doctrine with regard to utility regulation at the time. Jackson considered the "fair value" rule to have been overturned previously in Natural Gas Pipeline. His dissent was not over the

57. Id. at 607-08. Though concurring in the majority decision to uphold the constitutionality of the Natural Gas Act, these justices demurred with respect to the continued intrusion of the Court into the matter of rate regulation under cloak of the due process clause. Since the Natural Gas Act provided for judicial review, they would have limited the Court to a review of the agency's action under the provisions of statute, rather than invoke the right to judicial review under the Fifth Amendment.

58. Missouri ex rel. Southwestern Bell Tel. v. Missouri Pub. Serv. Com'n, 262 U.S. 276 (1923). Again, in view of the ubiquitous tendency to concatenate Hope and Bluefield, it is worth repeating the observation that the Justices chose to rely upon Southwestern Bell rather than Bluefield when searching out a precedent that would articulate their view of the investor interest.


60. In Covington & Lexington (in a portion cited by the concurring justices in Natural Gas Pipeline, but omitted above), the Court stated, "The public cannot properly be subjected to unreasonable rates in order simply that stockholders may earn dividends." While the Duquesne Court may have found precedent in Covington & Lexington for the protection against rates which are "so 'unjust' as to be confiscatory," Duquesne, 488 U.S. at 307, no one can read Covington & Lexington in its entirety and not conclude, as Justice Black did in the concurring opinion in Natural Gas Pipeline, that where the interests of the consumers (or the public) and those of the investors collide, that it is the latter that must yield. Nor is any other conclusion possible from the position of the Court in Permian Basin. The lengths to which the Duquesne Court seems willing to go to find a substantive investor right which must be satisfied at all costs are not encouraging.
constitutional permissibility of original cost, but over whether a rate for natu-
ral gas need be based upon any rate base methodology. He was quite prepared
to allow the Commission to set prices instrumentally, with a view toward con-
sumption objectives, without regard to rate base or rate of return, and did not
believe that any of the Court's prior "rules" regarding rate base should apply
to a natural gas case arising under the Natural Gas Act. As far as Justice
Jackson was concerned, the regulation of utility rates was little different than
the fixing of prices of oil, milk, coal and other commodities, and could be
without specific reference to the "synthetic value of a rate base of any individ-
ual producer." As for the possibility of a successful constitutional challenge,
he considered it unlikely:

The unfortunate effect of judicial intervention in this field is to divert the atten-
tion of those engaged in the process from what is economically wise to what is
legally permissible. It is probable that price reductions would reach economi-
cally unwise and self-defeating limits before they would reach constitutional
ones. . . . A producer would have difficulty showing the invalidity of such a fixed
price so long as he voluntarily continued to sell his product in interstate com-
merce. Should he withdraw and other authority be invoked to compel him to
part with his property, a different problem would be presented.62

Like his brethren, he had abandoned the notion of regulation as a "taking."
As long as a utility continued to offer service under a commission approved
rate, there could be no claim of a taking. Jackson's view was only a somewhat
more extreme view of the majority's "end result" doctrine. If the price is so
low that firms actually seek to withdraw from the market, then to force the
utility to continue service at such a price would indeed raise the issue of a
genuine taking. Jackson's "end result" test was to look at the success of the
agency in meeting its statutory and public interest obligations, which presum-
ably includes maintaining adequate supply as well as supply at a price that
prevents monopoly exploitation. The danger he saw in the majority's applica-
tion of the end result test was that it focused too much on financial ratios and
purported indices of financial integrity. In retrospect, though, we do not see
much difference between Jackson and the majority on this point. Perhaps the
difference could be summed up this way: Jackson was content to base the
constitutional test (from the utility point of view) on whether the supplier was
willing to offer supplies adequate to serve the public interest at the "fixed
price," whereas the majority based it upon whether it was financially able to.

The procedural interpretation of Hope received an important test and
affirmation in the Permian Basin Area Rate Cases.63 At issue was a decision
by the Federal Power Commission to employ area-wide rates in its regulation
under the Natural Gas Act. Under area regulation, rates were set on the basis
of broad area considerations, and not specifically upon the basis of the cost of
service for individual producers. Since the cost of service is higher for some
producers than others, the situation was created where some producers failed
to earn a "fair rate of return." In responding to the claim that this violated

61. Hope, 320 U.S. at 652.
62. Id.
the rights of individual producers to a fair rate of return on their investment, the Court stated that "regulation may, consistent with the constitution, limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness." 64 The "investors' interests" here are those the Court was concerned about in Hope. But rather than a substantive right, which must be satisfied in any event, the investors' interests here provide "only one of the variables in the constitutional calculus of reasonableness." Then, repeating the procedural standards of Nebbia, the Permian Court stated that "price control is unconstitutional . . . if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt . . ." 65 As for whether area regulation was permissible under the Natural Gas Act, the Court said:

This Court has repeatedly held that the width of administrative authority must be measured in part by the purposes for which it was conferred. [Citations omitted.] Surely the Commission's broad responsibilities therefore demand a generous construction of its statutory authority.

Such a construction is consistent with the view of administrative rate making uniformly taken by this Court. The Court has said that the "legislative discretion implied in the ratemaking power necessarily extends to the entire legislative process, embracing the method used in reaching the legislative determination as well as that determination itself." 66

The scheme of judicial review invoked here is clearly procedural, one in which there is a great presumption of validity attached to the actions of the agency. Under the Natural Gas Act, the Federal Power Commission had a statutory responsibility not only to regulate gas prices, but to stimulate and encourage the national supply of a scarce resource. In evaluating the reasonableness of area regulation, the Court's concern, following the procedural stands of Nebbia, was to assure that the method employed was reasonably related to a valid public purpose.

The method employed, however, came into direct conflict with legitimate investor concerns and interests, and it was inevitable that the investor interest would claim a substantive right based upon a narrow misreading of Hope. Thus, after citing Hope, and the criteria of investors' interests set forth therein, the Court found it necessary to say:

These criteria, suitably modified to reflect the special circumstances of area regulation, remain pertinent, but they scarcely exhaust the relevant considerations. The Commission cannot confine its inquiries either to the computation of costs of service, or to conjectures about the prospective responses of the capital market; it is instead obliged at each step of its regulatory process to assess the requirements

64. Id. at 769 (citation omitted). This language simply cannot be squared with any notion of a substantive investor interest. It first equates the investors' interest with the return they receive on their investment (as in Hope), and then asserts that regulation may limit this return on investment, i.e., allow something less. The Court is not talking here about allowing something less than a monopoly return, but something less than the fair rate of return from the investor point of view. Obviously, the agency would have to have good reason—a justifiable balancing of the public need or a legitimate public purpose against the private interest of the investor—in order to allow something less. But that the language means that something less may be allowed, "consistent with the Constitution," cannot be denied.
65. Id. at 770.
66. Id. at 776.
of the broad public interests entrusted to its protection by Congress. Accordingly, the "end result" of the Commission's orders must be measured as much by the success with which they protect those interests as by the effectiveness with which they "maintain credit . . . and . . . attract capital."

The "broad public interests" entrusted to the agency included the stated purpose of encouraging the development of adequate supplies of natural gas. That public purpose, and the advantage of area regulation as a means of securing that purpose in the opinion of the agency, were sufficient to outweigh the fact that area regulation in some instances produced less than the fair rate of return as defined in Hope. And according to the Permian Court, the agency's determination was not constitutionally infirm for want of satisfying the investor's interests.

C. The Procedural Theory of "Confiscation" After Hope

Hope was intended to put the nails in the coffin of substantive economic due process as it applies to rate regulation, and restrict the Court's role in judicial review to the procedural standards enunciated in Nebbia. With this change in focus from substantive to procedural due process, it was necessary to redefine the meaning of "confiscation." Whereas "confiscation" under the substantive due process standards of Smyth v. Ames focused on the right to "just compensation," under the procedural standards of Hope it focused on the "reasonableness" of a commission's action in setting a rate; therefore, a rate was so low as to be "confiscatory" only if it was unreasonably low in relation to the balancing that commissions must engage in when setting just and reasonable rates. In the Natural Gas Pipeline case, the Court developed the rationale it was to rely upon in later cases in fashioning this new concept of confiscation. It began by noting:

By long standing usage in the field of rate regulation the "lowest reasonable rate" is one which is not confiscatory in the constitutional sense. [Citations omitted.] Assuming that there is a zone of reasonableness within which the Commission is free to fix a rate varying in amount and higher than a confiscatory rate . . . the Commission is also free [under the section of the Act in question] to decrease any rate which is not the "lowest reasonable rate." It follows that the Congressional standard prescribed by this statute coincides with that of the Constitution, and that the courts are without authority under the statute to set aside as too low any "reasonable rate" adopted by the Commission which is consistent with the constitutional requirements.

As for the constitutional standards, the Court went on to say:

The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power

67. Id. at 791.
68. With the substantive issue—whether regulation was a "taking" that required "just compensation"—now settled by a return to the doctrine of Munn v. Illinois, 94 U.S. 113 (1876), the only standards remaining were procedural.
69. This is a very accommodative use of the term "confiscation," which has the unfortunate effect of preserving a superficial analogy to the concept of a "taking." However, the Court clearly abandoned the condemnation analogy in Hope, along with the associated concern for "just compensation." The evolution of the "confiscation" concept after Hope was an effort to give it new meaning in the light of the demise of substantive due process.
has been delegated are free, within the ambit of their statutory authority, to make
the pragmatic adjustments which may be called for by particular circumstances.
Once a fair hearing has been given, proper findings made and other statutory
requirements satisfied, the courts cannot intervene in the absence of a clear show-
ing that the limits of due process has been overstepped.\(^{70}\)

And as for determining whether the limits of due process have been over-
stepped, the Court said "if the Commission's order, as applied to the facts
before it and viewed in its entirety, produces no arbitrary result, our inquiry is
at an end."\(^{71}\) From this reasoning the Court fashioned a theory of "confis-
cation" that avoided references to "just compensation" and defined a confisca-
tory rate as a rate below the "zone of reasonableness." \(^{72}\) \(^{73}\) \(^{74}\) \(^{75}\) \(^{76}\) \(^{77}\) \(^{78}\)

Consistent with this procedural concept of confiscation, the Court said in \(^{79}\) \(^{80}\) 

The Texaco Court then quoted the language from the Permian Basin decision
as to how regulation may, "consistently with the Constitution, limit string-
ently the return recovered on investment, for investors' interests provide only
one of the variables in the constitutional calculus of reasonableness."\(^{74}\)

In keeping with the procedural focus of judicial review following \(^{56}\)
the Court in *Texaco* described a three-pronged scope of review with respect to the determination of whether commission action is confiscatory:

The Commission [1] may not exceed its authority under the Act; its orders are subject to judicial review; and reviewing courts must determine whether Commission orders . . . [2] are supported by substantial evidence and [3] whether it is rational to expect them "to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risk they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable." (citations omitted).75

The first two—within the limits of authority, and based upon substantial evidence—may be considered general procedural requirements applicable to the decisions of administrative agencies. The third—the balancing of investor and consumer interests—is a procedural requirement reflecting the unique requirements of rate regulation.

In focusing upon the reasonableness of the agency's actions in setting the rate, as opposed to the substantive content of the agency's findings with regard to the elements that go into the development of the rate (e.g., rate base or rate of return), attention shifted toward a scope of review that defined reasonableness in the constitutional sense as a result based upon substantial evidence. Rate regulation came to be viewed as no different than any other kind of administrative adjudication.76

Determining a "reasonable rate" was considered to be peculiarly within the expertise or "special competence" of the administrative agency vested with the responsibility of setting rates, and not within the judiciary, which was considered incapable of reviewing on substantive grounds. Whereas the era of *Smyth* and substantive economic due process gave rise to a theory of "confiscation" that viewed it as a "constitutional fact" to be adjudicated by the judiciary, *Hope* abandoned the "constitutional fact" doctrine as applied to the determination of reasonable rates, and placed the substantive fact-finding within the jurisdiction of the legislature, and the agencies they create to set rates. On review, the question of law became whether the actions of the agency were reasonable, not whether they were "right," and the standard of review for assaying reasonableness became the substantial evidence test. Since the facts often admit of more than one reasonable inference or conclusion, there is a "zone of reasonableness" which is defined by the substantiability of the evidence at its margins. An unreasonably low rate is one which at the bottom end of the range is not supported by substantial evidence. An unreasonably high rate is one which at the upper end of the range is not supported by substantial evidence.

Table 1 illustrates the spheres of special competence separating the powers of the judiciary from the setting of rates by administrative agencies. The "zone of reasonableness" is bounded at the upper end by administrative actions which fail to adequately protect the public interest, and which result in exploitation of the consumer by the utility.77 At the lower end, the "zone of

---

75. *Texaco*, 417 U.S. at 393 (annotation added).
76. More than that, the ratemaking agencies were actually the original models for administrative law and adjudication.
77. In *Permian Basin* the Court stated that "the consumer is . . . obliged to rely on the Commission to provide 'a complete, permanent and effective bond of protection from excessive rates and charges.'" 390
A Schematic and Syntactical Diagram of the Dimensions of Due Process in Utility Rate Regulation

<table>
<thead>
<tr>
<th>Confiscation</th>
<th>Zone of Reasonableness</th>
<th>Exploitation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unreasonably Low Rate</td>
<td>Just and Reasonable Rate</td>
<td>Unreasonably High Rate</td>
</tr>
<tr>
<td>Arbitrary</td>
<td>Rate Base</td>
<td>Arbitrary</td>
</tr>
<tr>
<td>Abuse of Discretion</td>
<td>Cost of Capital</td>
<td>Abuse of Discretion</td>
</tr>
<tr>
<td>Without Authority</td>
<td>Rate of Return</td>
<td>Without Authority</td>
</tr>
<tr>
<td>No Substantial Evidence</td>
<td>Risk and Return</td>
<td>No Substantial Evidence</td>
</tr>
<tr>
<td>Unfair</td>
<td>Operating Expenses</td>
<td>Unfair</td>
</tr>
<tr>
<td>Lack of Balance</td>
<td>Amortization</td>
<td>Lack of Balance</td>
</tr>
</tbody>
</table>

Table 1

"reasonableness" is bounded by administrative actions which fail to give adequate consideration to the investor interest, and which result in rates which are said to be confiscatory. The spheres of special competence are clearly delimited. Questions of method and technique, such as the appropriate rate base, rate of return, etc., fall entirely within the special competence and expertise of the regulatory agency. Reviewing courts, under the standard of review adopted by Hope and later cases consistent with it, are without authority to substitute their own judgment as to what is a proper rate base or rate of return. Their sphere of special competence extends to how the regulatory decisions were made, i.e., with regard to process, and not what decisions were made. The court reviews the "decisionmaking process" itself, not the decisions made (except as incidental to the process). If the decisions were made in the absence of statutory authority or without substantial evidence—questions which the judiciary is presumed competent to examine—then the resulting rate falls outside the "zone of reasonableness" and the reviewing court has an

U.S. at 794-95 (citing Atlantic Rfg. Co. v. Public Serv. Comm'n, 360 U.S. 378, 388 (1959)). The consumer interest is as much protected by the Constitution and the enabling legislation as is the property interest.

The term is not altogether satisfactory, but we are confronted with it as a residuum of the "fair value" era. A rate which is unreasonably low does not really "confiscate" property without due process. It is one which abuses the process on behalf of the public interest so as to discriminate against or exploit the property interest. The legal issues are really the same at both ends of the spectrum of "reasonableness," i.e. an abuse of the process to exploit one interest or the other. A focus upon regulation as a "taking" that requires "just compensation" obscures this symmetry, and focuses the attention of reviewing courts upon only one end of the spectrum.
obligation to set the agency decision aside and remand the case for corrective action.

The shift from a substantive concept of "confiscation" to a procedural one mirrored the realization that regulation is not a "taking," but is merely a "species of price-fixing." The setting of a "reasonable rate" is no different, in broad perspective, from any other form of economic regulation. Suppose, for instance, that an agency responsible for occupational health and safety promulgates a standard that raises a question of its economic feasibility. What is the standard of review to which such action will be subjected? The substantial evidence test. Determining a "reasonable rate" is also simply a question of economic feasibility. The rate setting agency has a number of objectives in setting a rate, including that of providing an adequate incentive to attract the capital necessary to provide for the public welfare. Whether a given rate will satisfy that objective is largely a question of economic or financial feasibility. The right to due process is not the right to a particular rate of return, or a particular return on some quantum of investment, but the right to be heard, and the right to a fair and impartial adjudication of competing claims of economic or financial feasibility. Under the distinction of law and fact and the judicial and legislative separation of powers embodied in the Hope end result doctrine, the utility does not have a right to a judicial determination that some other rate is more reasonable. It merely has the right to expect that the agency's decisions are supported by substantial evidence, and that reviewing courts will protect that right.

After Hope, then, "confiscation" came to be defined in terms of the reasonableness of the agency's actions, not in terms of the rate actually set by the agency. So when a utility sought to assert a "justiciable right" to a judicially determined "just and reasonable" rate in Montana-Dakota Util. v. Northwestern Pub. Serv., the Court replied:

The petitioner, in contending that they are so empowered, and the District Court, in undertaking to exercise that power, both regard reasonableness as a justiciable legal right rather than a criterion for administrative application in determining a lawful rate. Statutory reasonableness is an abstract quality represented by an area rather than a pinpoint. It allows a substantial spread between what is unreasonable because too low and what is unreasonable because too high. To reduce the abstract concept of reasonableness to concrete expressions in dollars and cents is the function of the Commission. It is not the disembodied "reasonableness" but that standard when embodied in a rate which the Commission accepts or determines that governs the rights of buyer and seller. A court may think a different level more reasonable. But the prescription of the statute is a standard for the Commission to apply and, independently of Commission action, creates no right which courts may enforce.

If the selling utility had a "constitutional right" to some level of "just compensation," it seems to us that the Court could find that "just" rate quite independent of Commission action. That, apparently, is what the court below thought also. But it was reversed, the Court adding:

81. Id. at 251.
We hold that the right to a reasonable rate is the right to the rate which the Commission files or fixes, and that, except for review of the Commission's orders, the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one.\textsuperscript{82}

If this case means anything, it stands for the proposition that a "reasonable rate" is nonjusticiable, i.e., is a "political question."\textsuperscript{83} Judicial review under the \textit{Hope} standard did not extend to whether the rate is reasonable \textit{per se}, but to whether the agency's actions in adjudicating competing claims in establishing the rate were reasonable. "Confiscation" came to be defined entirely in terms of procedural due process, and abandoned any pretense to substantive due process.\textsuperscript{84}

Nevertheless, the concept has lingered on in the minds of many, and seems to be implicit in \textit{Duquesne}, that if regulation goes too far, it becomes a taking subject to substantive protection under the takings clauses. That idea threatens to undo everything \textit{Hope} stood for. It is important to note the potential for semantic confusion with the "taking-regulation" distinction in cases involving eminent domain principles and the right to "just compensation" as a constitutional limit on how far regulation can go before it becomes a "taking." Due to a possible conceptual confusion, the \textit{Duquesne} Court is moving toward the theory that rate regulation is merely another form of economic regulation which has the potential, "at the margins," of being a "taking" with "constitutional overtones."\textsuperscript{85} It is important to keep in mind some

\textsuperscript{82} \textit{Id.} at 252-53.

\textsuperscript{83} \textit{Cf.} J. NOWAK, R. ROTUNDA, \& N. YOUNG, \textit{CONSTITUTIONAL LAW} 102 (1986). That, of course, was the view of the Court in \textit{Munn v. Illinois}, 94 U.S. 113 (1876). To define the upper and lower limits of the "zone of reasonableness" in terms of the reasonableness of a specific rate, rather than in terms of the reasonableness of the agency's actions, would involve the Court in an inherent contradiction by making a "reasonable rate" ultimately justiciable, even if only "at the margins." In other words, it would require the Court to substitute its judgment for the judgment of the agency as to what constitutes a "reasonable rate," something it has forcefully denied since \textit{Hope} that it has the power to do. Logically, then, the substantive limits of the "zone of reasonableness" can only relate to the reasonableness of the agency's actions, not the reasonableness of the rate.

\textsuperscript{84} In \textit{Ferguson v. Skrupa}, 372 U.S. 726, 730-31 (1963), the Court reiterated its belief that it had laid to rest the doctrine of substantive economic due process:

The doctrine . . . that due process authorizes courts to hold laws unconstitutional when they believe the legislature has acted unwisely . . . has long since been discarded. We have returned to the original constitutional proposition that courts do not substitute their social and economic beliefs for the judgment of legislative bodies, who are elected to pass laws . . . Legislative bodies have broad scope to experiment with economic problems. . . . We refuse to sit as a "superlegislature to weigh the wisdom of legislation," . . . (footnotes omitted).

The determination of "just and reasonable" rates has, since \textit{Hope}, been considered to be a proper exercise of legislative authority, embodying fundamental issues of a social and economic nature. The Court's rulings in \textit{Natural Gas Pipeline, Hope, Permian Basin,} and \textit{Texaco} all call for great deference to the agencies created by the legislature in determining what is "just and reasonable" in relation to the specific social and economic objectives of their empowering legislation.

\textsuperscript{85} For all his good intentions, Drobak jumps into the breach at this point, and tries to interpret constitutional principles as applied to utility regulation since \textit{Hope} as an example of modern takings principles. Attempting to explain the transition from \textit{Smyth} to \textit{Hope}, he writes:

The rejection of the eminent domain analogy was appropriate. Unlike eminent domain, ratemaking does not result in the transfer of title to property. Furthermore, like other kinds of regulation, ratemaking can decrease or even destroy the value of investments in the regulated firm.
The taking-regulation distinction has its origins in Justice Holmes noted opinion in Pennsylvania Coal v. Mahon. Justice Holmes was a frequent dis-senter during the Lochner era of substantive economic due process, holding that the Fourteenth Amendment should be construed narrowly, and the state police power broadly. Here, however, he found a limit to the police power, stating "The general rule at least is, that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking. Easier said than determined, the rub has always been how to recognize when regulation becomes a "taking." The most extensive modern treatment of this issue by the Court is Penn Central Transp. v. City of New York, in which the Court stated:

... the Court's decisions have identified several factors that have particular significance. The economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations are, of course, relevant considerations. So, too, is the character of the governmental action. A "taking" may more readily be found when the interference with property can be characterized as a physical invasion by government than when interference arise from some public program adjusting the benefits and burdens of economic life to promote the common good.

Rate regulation is distinguishable in important ways from this traditional dichotomy between taking and regulation. First of all, rate regulation does not constitute a taking of property for the public use, but a giving of it. In rate regulation, the real police power of the state begins not with the setting of the rate, but with the grant of a right to serve. Control over entry to a market subject to public control is obviously an exercise in police power, and raises no issue of taking or eminent domain. In exchange for access or entry to the market, the utility agrees to accept public control over its rates and services.

Consequently, the principles of the takings clause that constrain government regulation, not the eminent domain principles, are the foundation of the modern constitutional ratemaking doctrine.

Drobak, supra note 7, at 83. Frankly, we fail to see the distinction between "eminent domain principles" and "the principles of the takings clause that constrain government regulation." The modern legal doctrine of "takings" as a constraint on government regulation is an analogy to eminent domain principles, i.e., is an application of the "takings" concept to forms of regulation (e.g. zoning restrictions) which do not result in the transfer of title to property even if they go so far as to constitute a taking. In the text we explore the reasons why we do not consider the "taking" analogy to be apt in the case of rate regulation.

86. 260 U.S. 393 (1922).
87. Id. at 415.
89. Consistent with his view that the modern constitutional limit on rate regulation follows the principles of the takings clauses, Drobak reviews the evolution of the doctrine of the Court on the taking-regulation distinction at some length. We have no quarrel with his analysis of takings principles, as applied to non-rate regulation. But while there are some interesting parallels between the Court's treatment of the traditional takings-regulation cases and rate regulation, there are fundamental distinctions as well (which we go on to discuss) that make the "taking" analogy inapposite. Perhaps more importantly, neither Hope nor any of its descendants analogize rate regulation to a "taking" or discuss rate regulation as a form of "taking by regulation." Except for Duquesne—a fact which takes it well out of the mainstream of Hope and its descendants.
In order to fashion a truly "takings" theory of rate regulation, the Court would have to fashion a theory to the effect that the "taking" is in the restriction of access to the market to begin with, i.e., that investors' have substantive rights to markets, and that any restriction of access to those markets is a taking that requires "just compensation."

Second, in a true taking, the value of the property is effectively destroyed in relation to the use that was intended in the absence of regulation. The "rule" of Smyth and the eminent domain analogy failed on precisely this point, as the Hope Court took pains to note. "The heart of the matter is that rates cannot be made to depend upon "fair value" when the value of the enterprise depends upon earnings under whatever rates may be anticipated." Here regulation creates value, it does not destroy it. Third, and closely related to the second point, is the fact that once a taking has been established, due process requires "just compensation" in an amount equivalent to the value the property had before it was destroyed by government action. In utility regulation, however, the public asserts control over entry to certain markets precisely for the purpose of preventing the creation of monopoly values. If rate regulation is a "taking," and requires a "just compensation" sufficient to equate the value of the property to the value it would have in the absence of regulation, then rate regulation is per se unconstitutional because its very purpose is to prevent service providers from extracting from the market the compensation they could expect to earn in the absence of regulation.

Fourth, the "taking" concept as applied to rate regulation embodies a out-and-out fiction: that the property is used by the public. Public utility property is not used by the public; the public merely buys a service. What it "uses" is not the property itself, but the service or product produced by the property. What the regulator fixes is not a rate for the use of the property, but a rate for the product or service which the property produces, and which the utility sells to the public. Fifth, the concern for legitimate "investment-backed expectations" which the Court has acknowledged in traditional "takings" cases does not apply in the case of utility regulation. The "investment-backed expectations" under consideration in traditional takings cases relate to expectations formed before government regulations interfere with the use of the property. That is clearly inapplicable to utility investment, which is undertaken with the knowledge that the service produced will be subject to rate

---

90. L. Tribe, American Constitutional Law 592-93 (1988). Regulations reducing the value of property in excess of seventy-five percent have been held not to constitute "takings."
91. Hope, 320 U.S. at 601.
92. To be sure, rate regulation seeks to prevent the exploitation of monopoly values. But it is preventing the creation of such values, it is not "destroying" them.
93. This fiction, embodied in Chicago ("If the company is deprived of the power of charging reasonable rates for the use of its property . . .," 134 U.S. at 458,) and Smyth (". . . the basis of all calculation as to the reasonableness of rates charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property used by it for the convenience of the public . . .," 169 U.S. at 546) was perhaps understandable in a era when the property in question (turnpikes and railroads) was in fact physically "used" by the public. The Los Angeles Court, however, was astute enough to realize the difference between "use of property" and "service" ("As the property remains in the ownership of the complainant, the question is whether the complainant has been deprived of a fair return for the service to the public in the use of the property . . .," 289 U.S. at 305).
regulation. Finally, the traditional takings cases involve regulations which place restrictions on use which prevent the property from being used in the manner intended in the absence of the regulations. Rate regulation does not involve such restrictions on use; the use is the same whether the rate is $1.00 or $100.00.94 And not only is the use the same, the use is that which was intended in the first place.95 The “taking-regulation” distinction may be of some relevance in evaluating the effect of non-rate regulation, where government action has the effect, but not the purpose, of limiting values. It has no relevance, however, to rate regulation, where the limitation in value is not merely incidental, but is the reason for the regulation in the first place.

III. CONCLUSION

In the aftermath of Hope, “confiscation” was reinterpreted in terms of procedural due process. Duquesne, however, could not be more removed from the development of this procedural doctrine of confiscation. Though paying lip service to the principles of both Natural Gas Pipeline and Texaco, the Duquesne Court immediately follows its citation of these cases with the following language: “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.”96 This is the most remarkable statement to occur in a Court decision on the constitutional standards for due process in regulation in forty-five years! None of these earlier cases—Natural Gas Pipeline, Hope or Texaco—ever spoke of the violation of due process in terms of “paying just compensation” for property “taken” for the public use. On the contrary, these cases all stood for the demise of the very notion itself. A wolf in sheep’s clothing, the Duquesne decision has resurrected the language of substantive economic due process, and has the potential for undo-

94. One might come closer to a true “takings” theory of regulation by focusing upon conditions of service, which obviously affect the use of the property. But even that would be stretching it, since service conditions can be considered as conditions on entry, and it is hard to imagine how entry conditions could ever be construed as a “taking.”

95. In summarizing these points as they relate to Drobak’s thesis, we would submit that there is little in the way of support, either in the case law, or in scholarly analysis, for his proposition that Hope embodied neither explicitly or implicitly, a constitutional limit based upon modern takings principles. In our opinion the evidence is quite to the contrary. To sustain his thesis, Drobak would have to account for the following anomalies: a) the shift in terminology from “just compensation” to “a zone of reasonableness;” b) the shift from a description of rate regulation as a “taking” to “a species of price-fixing;” c) the shift from “reasonableness judicially determined” to what is statutorily “just and reasonable;” d) the language of “balancing” as opposed to the language of “adjusting the benefits and burdens of economic life to promote the following common good;” and e) last but hardly least, Hope’s own assertion that there are no constitutional standards more exacting than the legislative standards embodied in the Natural Gas Act, standards which have to do with administrative due process, not “takeings without just compensation.”

Drobak’s authorities for his thesis, other than his own noble effort, are remarkably thin, constituting the following footnote:

Confiscation by government regulation is often referred to as a “regulatory taking:” e.g., San Diego Gas & Elec. v. San Diego, 450 U.S. 621, 651 (1980) (Brennan, J., dissenting), and sometimes referred to as a “partial taking,” e.g., Taxation, Regulation and Confiscation, 20 OSGOOD HALL L.J. 433, 434 (1982).

Neither source deals specifically with rate regulation.

96. Duquesne, 488 U.S. at 308.
ing everything for which Hope stood. Equally alarming, and indicative of the resurgent influence of substantive due process concepts in the Court’s treatment of utility cases is its citation of Bluefield.\textsuperscript{97} As noted above, Hope did not rely upon Bluefield as setting forth any applicable principles with regard to the due process issues involved in review of utility rates. Under Hope, the investor interest was merely a relevant consideration, a “legitimate concern,” not a substantive minimum to which the investor was entitled. The Duquesne Court either overlooked this fact, or else is signaling a return to substantive due process.

The Duquesne Court also handled the facts of the case below in a way that is difficult to reconcile with Hope, and which is more reminiscent of the era of substantive economic due process. Unlike the Hope Court, which evaluated the “end result” of the agency’s rate determination in terms of aggregate revenues, and explicitly refused to state the effect of the rate order in terms of a rate of return, the Duquesne Court took the effect of the lower rates and restated that effect in terms of the rate of return on equity, claiming:

\begin{quote}
Given these numbers, it appears that the PUC would have acted within the constitutional range of reasonableness if it had allowed amortization of the CAPCO costs but set a lower rate of return on equity with the result that Duquesne and Penn Power received the same revenue they will under the instant orders on remand. The overall impact of the rate orders, then, is not constitutionally objectionable. No argument has been made that these slightly reduced rates jeopardize the financial integrity of the companies, either by leaving them insufficient operating capital or by impeding their ability to raise future capital. Nor has it been demonstrated that these rates are inadequate to compensate current equity holders for the risk associated with their investments under a modified prudent investment scheme.\textsuperscript{98}
\end{quote}

The similarities between this analysis and Hope are little more than superficial. Why did the Court find it necessary to restate the effect of the reduced rates in terms of their effect upon the rate of return on equity? The finding that “[n]o argument has been made that these slightly reduced rates jeopardize the financial integrity of the companies . . .” would have been dispositive under a true application of the Hope “end result” doctrine. What difference does it make to the constitutional question whether the rates are adequate to compensate current equity holders for the risk they incur? Is that now a fundamental, substantive, standard for assaying the reasonableness of rates? What if it had been demonstrated that the rates were inadequate to compensate the current equity owners for the risk associated with their investments? Would the result be unconstitutional for that fact alone? Not under Hope.

It is not a good sign that the Court finds it necessary to ascertain the “end result” in terms of the rate of return, or in terms of the relationship between risk and return. No less than the endless controversies over rate base methodology and valuation, the permutation of cost of capital methodologies and varying opinions about the required rate of return, and the relationship between risk and return, threaten to undermine the standard of judicial review adopted by Hope, affirmed in Permian, and given clearest enunciation in Tex-

\textsuperscript{97} Id. at 314.

\textsuperscript{98} Id. at 312 (footnote omitted).
If the real meaning of Hope is to last, it cannot be reduced to a judicially determined “reasonable rate of return.” The genius of Hope was to leave the adjudication of competing claims of reasonableness with regard to matters of technique and implementation to the expertise of the regulatory commissions. That is just as essential in matters pertaining to rate of return, as it is in matters pertaining to rate base.

Duquesne is also as remarkable for its omissions as it is for the resurgent use of substantive due process concepts and the language of takings. It makes no reference to Nebbia, or Hope’s insistence that rate regulation is merely “a species of price-fixing,” rather than a “taking.” As we have repeatedly noted, Hope and Smyth were based upon fundamentally different theories of what is constitutionally protected. Hope relied upon Nebbia for the theory that rate regulation is an exercise of the police power, and that all that is protected is that the regulation not be “arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt.”99 Smyth relied upon the condemnation analogy for the theory that investors are entitled to “just compensation” under takings clauses of the Fifth and Fourteenth Amendments. Duquesne appears oblivious to this fundamental distinction, and is silent with regard to the real constitutional analysis upon which Hope was predicated. Though Duquesne cites Texaco, it draws little more than dicta from it, and totally ignores the procedural standards of due process that Texaco enunciates. In short, while claiming to reaffirm Hope, Duquesne actually abandons the constitutional principles that Hope stood for. When it resurrects the language of substantive due process, and speaks of “just compensation” and the “taking” of utility property in violation of the Fifth and Fourteenth Amendments, it is resurrecting a theory of “confiscation” remarkably similar, if not indistinguishable, from that which underlay Smyth v. Ames.