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UNDERSTANDING THE *LOCHNER ERA*: LESSONS FROM THE CONTROVERSY OVER RAILROAD AND UTILITY RATE REGULATION*

Stephen A. Siegel**

THE Lochner era was a period of controversy and change in American constitutional law. During that period, economic forces challenged and ultimately overthrew traditionally accepted social beliefs and legal doctrines. The resolution of the struggle marked the beginning of modern constitutional law.

The controversies of the Lochner era focused on the place of private property in the Constitution's hierarchy of values. In the late 1800's, property firmly maintained its century-old position as the central value of American constitutional policy. By the 1940's, however, such civil rights as freedom of speech had completely dislodged property from its former preeminence. This shift was part of an evolution of legal thought that reflected a greater transformation of fundamental Liberal views about property, government,

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1 The era is named for Lochner v. New York, 198 U.S. 45 (1905), in which the United States Supreme Court, over strong dissent, voided maximum employment hours legislation for bakeries as violating the due process clause of the fourteenth amendment.

2 For general discussion of this period, which extended roughly from 1890 to 1940, see E. Corwin, Liberty Against Government 116-68 (1948); A. Paul, Conservative Crisis and the Rule of Law: Attitudes of Bar and Bench, 1887-1895, at 220-37 (1976); L. Tribe, American Constitutional Law 4-6, 427-50 (1978); B. Twiss, Lawyers and the Constitution, How Laissez Faire Came to the Supreme Court (1942).

3 See, e.g., L. Tribe, supra note 2, at 6-7, 453, 456.

4 See sources cited supra note 2.


6 Arising in the seventeenth-century struggle against feudal, aristocratic society, Liberalism has always been the dominant social philosophy in America and lies at the basis of its legal order. See, e.g., L. Hartz, The Liberal Tradition in America 1-32 (1955); R. Lustig, Corporate Liberalism, The Origins of Modern American Political Theory, 1890-1920, at 1-36
and society.\footnote{7}

All this has been observed before. This article, however, seeks to establish that the legal controversies of the \textit{Lochner} period were in fact a dual struggle. The debate involved fundamental substantive values, of course, but it also questioned traditional conceptions of judicial method. The substantive controversies involved challenges to Liberalism's longstanding distinction between rights of property and rights of privilege. The methodological controversies involved challenges to Liberalism's equally old and revered insistence on nondiscretionary judicial decisionmaking. Both of these challenges were products of the evolution of the economic basis of American life from small-scale, decentralized, individual enterprise to large-scale, concentrated, corporate undertakings.

This article illustrates the presence and importance of the property-privilege distinction and nondiscretionary legal method and their subsequent decline by demonstrating their role in one of the \textit{Lochner} era's extended controversies—the controversy over railroad and utility rate regulation.\footnote{8} This controversy began in the

\footnote{7} See, e.g., R. Lustig, supra note 6, at 109-50; E. Purcell, \textit{The Crisis of Democratic Theory} 74-115 (1973); W. Scott, \textit{In Pursuit of Happiness: American Conceptions of Property From the Seventeenth to the Twentieth Century} 137-80 (1977).

\footnote{8} Most studies of the \textit{Lochner} era focus on cases, such as \textit{Lochner} v. New York, 198 U.S. 45 (1905), and \textit{Hammer} v. Dagenhart, 247 U.S. 251 (1918), that arose out of the period's industrial regulation controversies. Yet, to a greater extent than any other segment of the economic system, railroads and utilities achieved the large-scale, concentrated, and interdependent form that made free market regulation impossible (in the eyes of many) and brought forth governmental intervention. The regulation of railroads and utilities therefore represented the cutting edge of the struggle between rights of property and the emergent administrative state.

Both the function and scale of railroad and utility undertakings meant economic and political power, power which was exercised and misused without hesitation. Corruption of public officials and discrimination among customers was endemic. Consequently, under pressure from their citizenry, in the 1870's state governments turned from promoting and subsidizing railroads and utilities to regulating them. The federal government subsequently joined the
1870's and antedated by at least a decade the struggle over the regulation of other forms of enterprise. The constitutional dimensions of industrial regulation were almost always an application or extension of debates first joined and largely resolved in the railroad and utility context.9 A study of the judicial approach to the railroad and utility cases therefore sheds light on the larger subject of the rise of modern constitutional law.

The article begins by briefly examining the historical background of the property-privilege distinction and nondiscretionary review in Part I. It then recounts the course of litigation over the scope and substance of railroad and utility rate regulation. Toward this end, Part II describes the United States Supreme Court's initial response to legislation regulating railroad and utility rates. Part III follows the evolution of this response up to the first authoritative paradigm for resolution of rate controversies, describes that paradigm, and traces the course of litigation following from it. Part IV analyzes the eventual overthrow of that paradigm as part of the general transformation of the substance and method of American constitutional law.

I. THE PROPERTY-PRIVILEGE DISTINCTION AND NONDISCRETIONARY METHOD

Until the twentieth century, the term "property" had a dual significance in Liberal thought. In one sense, property denoted, as it still does, all items of wealth.10 In the other sense, property de-
noted only those valuables whose acquisition was open to all, typically through work and saving. In this latter sense, property stood in contrast to privilege, which signified those assets which only specially designated individuals could acquire, characteristically through special governmental act. Property and privilege, in other words, were two different categories of wealth.

In Liberal thought, property was a beneficial and sacrosanct institution that secured both economic productivity and individual liberty. Privilege, in contrast, endangered equality, harmony, freedom, and the overall economic and political liberty that property established. Privilege corrupted government from a pursuit of the general good to a pursuit of individual self-interest. Wealth based upon privilege, in the Liberal view, threatened to undermine all that property accomplished.

The property-privilege distinction, in short, was a fundamental part of pre-twentieth-century Liberal economic, political, moral, and legal thought concerning wealth. Despite general acknowledgment of the dichotomy, however, its application to particular settings was bitterly controversial. Conflict over the implications of the property-privilege distinction was central to nineteenth-century American political strife and was the pivotal issue that divided American Liberals into conservative and liberal camps.

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Madison, Property, The National Gazette (Mar. 29, 1792), reprinted in 6 Writings 101-03 (G. Hunt ed. 1900-10).


14 See sources cited supra note 13.


This article uses the terms liberal and conservative as described infra text accompanying notes 15-19. The differences between the two groups concerned substantive values and not legal methodology. In particular, judicial activism was not involved as a distinction between
Both camps praised property and condemned privilege in general. But liberals, although never entirely proscribing the establishment of legal privileges, thought of them as a necessary evil, appropriate only when public policy could be met by no other means and requiring ongoing close public supervision and control. Conservatives, on the other hand, although never arguing for a pervasive establishment of privileges, perceived fewer types of wealth as privilege and found more occasions that properly called for the grant of a privilege. Conservatives were also concerned with the rights of the individuals who received privileges and consequently urged greater restrictions on the public's power of supervision and control. In sum, nineteenth-century American liberals and conservatives had similar attitudes towards property but differed significantly in their treatment of privilege. As a result, though there was little controversy in America over the place of common forms of wealth, there was continuous conflict over the creation and control of its elite forms.

The property-privilege distinction arose in a society in which small-scale enterprise typified the economy. The distinction was a sensible interpretation of experience at a time when enterprises large enough to dominate markets arose only in opposition to market forces. Only criminal activity or legal privilege enabled enterprises to achieve market dominance and thereby threaten economic and political liberty. Thus the late nineteenth century's technological advances that allowed large-scale enterprises to arise

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17. Siegel, supra note 13.

18. Common forms of wealth are illustrated by farms and business partnerships. All individuals had the right to own and operate them under the common law.

19. Elite forms of wealth include banks, canal corporations, and all forms of business corporations. A classic illustration of the differing liberal and conservative attitudes is the controversy over the Bank of the United States. President Jackson, southern plantation and slave owner, certainly had no qualms about the sanctity of private property, yet he and his followers warred incessantly against the Bank, which the Federalist and Whig parties had created and supported. See, e.g., A. Schlesinger, The Age of Jackson 73-131, 226-41, 334-37 (1945). See also Illinois Constitutional Debates of 1847, supra note 15.

20. See A. Chandler, supra note 8, at 13-78 (recounting that most enterprise was undertaken by sole proprietorships or partnerships with few employees).

through—rather than in opposition to—market forces\textsuperscript{22} posed a fundamental dilemma for Liberal thought. Both conservatives and liberals soon realized that the property-privilege distinction required rethinking. As a result, each variant of Liberalism strove to work out its own reapplication of the dichotomy. In time, however, the conceptualization itself was questioned and abandoned.

In adapting the property-privilege dichotomy to an economy characterized by large-scale, concentrated, and interdependent enterprise, both liberal and conservative jurists shaped their responses according to then-existing preconceptions of judicial method. Until the twentieth century, one axiom of Liberal legal thought was that government must be a government of laws and not men. Politics was conceived as the common pursuit of the public good; political philosophy was dedicated to devising governmental structures that would resist attempts to divert governmental power into the pursuit of individual self-interest.\textsuperscript{23} All branches of government, even the "least dangerous,"\textsuperscript{24} required containing. The constitutional provision for checks and balances among the various branches of government manifested this concern.\textsuperscript{25}

The demand for nondiscretionary adjudication rose to prominence as a fundamental Liberal strategem to forestall the possibility of a corrupt and arbitrary judiciary.\textsuperscript{26} The complete elimination of judicial discretion, of course, was not realistically obtainable.\textsuperscript{27}

\textsuperscript{22} See A. Chandler, supra note 8, at 12, 209, 235-44, 281-89.


\textsuperscript{25} See, e.g., The Federalist No. 83, supra note 23, at 500-01 (A. Hamilton); id. No. 58, at 359 (J. Madison); id. No. 52, at 327-30 (J. Madison). See generally id. No. 47, at 300-08 (J. Madison); C. Montesquieu, supra note 24, at 201-13.


The jury added an element of uncertainty and discretion to adjudication. Jury discretion, however, was random and for that reason would tend not to have the same repercussions as discretion in the hands of monetarily or politically corrupt judges.

\textsuperscript{27} The elimination of discretion was also considered undesirable in private law, where the legislature could supervise judicially determined rules. See Norway Plains Co. v. Boston &
Nevertheless, nineteenth-century jurisprudential norms envisioned adjudication according to preexisting standards discovered by judges and deductively applied to the controversy at hand. Convinced of the importance of this conception of judicial method, Liberal thinkers considered it an essential attribute of the rule of law.

Of course, nineteenth-century jurists differed greatly when identifying the appropriate standards and applying them to particular controversies. The disagreements represented differences in ultimate political and social values embraced by the liberal and conservative camps. Nonetheless, each side conceived the dispute to be over the correct nondiscretionary standard and its application just as physical or mathematical scientists might differ over the correct physical or mathematical law and its application. Mainstream jurists, however differing in their political commitments, believed in the necessity and possibility of discovered and deductively elaborated principles.

Thus, the liberal and conservative jurists who first faced the challenge of elaborating the constitutional guaranties of private property in light of the late nineteenth century's new economic conditions worked toward their disparate conclusions from within this shared methodology. But as the controversy shifted from a question of how to apply the property-privilege distinction to one of whether it should exist at all, jurists began to question and then to abandon the norm of nondiscretionary adjudication. In recounting the constitutional controversy over railroad and utility rate regulation, the following discussion focuses on the best example of this remarkable trend.


28 See, e.g., Carter, The Ideal and the Actual in Law, 13 Rep. A.B.A. 217 (1890); infra text accompanying note 280. Nondiscretionary adjudication in the nineteenth century was somewhat more discretionary than in the eighteenth century when jurists conceived the common law as consisting of a myriad of concrete rules that were fairly self-applicable to controversies. See, e.g., Hale, supra note 26; Siegel, supra note 26, at 51-54, 57-58. The transition in the early nineteenth century of the basis of nondiscretionary adjudication from rules to objective standards is an important, but so far undescribed, development in legal thought.
II. UNREVIEWABLE LEGISLATIVE POWER ESTABLISHED

A. The Granger Cases

After the Civil War, most American states, long involved in promoting and subsidizing railroads and utilities, turned to the task of their regulation. Various factors contributed to this momentous shift in public policy, and the states' responses varied according to differing conceptions of "the railroad problem" and its appropriate remedy. Many states statutorily prohibited railroads from secretly rebating charges to favored customers or otherwise engaging in "unjust discrimination." In the New England states, regulation principally took the form of enforced disclosure of corporate books on the theory that public opinion by itself was sufficient to stay corporate abuse. But in the upper Mississippi Valley, farmers felt they were unable to market their produce profitably in the distant eastern seaboard market due to exorbitant transportation charges imposed by the Wall Street-owned railroads, and they consequently pushed for far more intrusive regulation. Several midwestern legislatures enacted legislation directly regulating the rates charged by railroads and other transportation facilities.

The affected businesses strenuously resisted the menacing rate


30 Among the contributing factors was the belief that railroads abused their economic power by imposing rates that were exorbitant, discriminating among customers, and engaging in predatory behavior not only against the public but against each other. The economic depression of the early 1870's contributed to the public's protest. The rapid growth of the railroad system, which had forced both localities and stockholders to lose control, also alarmed the public. See generally State of New York, Legislature, Assembly, Proceedings of the Special Committee on Railroads (1879) (known as the Hepburn Commission); C. Adams, Railroads: Their Origins and Problems 141 (1878); S. Buck, The Granger Movement (1913) 9-16; A. Chandler, supra note 8, at 91-92; J. Hudson, supra note 8, at 24-106; W. Larrabee, supra note 8, at 124-62, 205-30; G. Miller, supra note 8, at 1-23; Ely, Social Studies (pts. 1-3), Harper's New Monthly Mag. 250, 450, 571 (1886); Hadley, Legal Theories of Price Regulation, 1 Yale Rev. 56, 63-64 (1892).

31 Responses also varied with the strength of the contending political interests. See, e.g., Hadley, supra note 30, at 66 (pointing out that regulation was more intrusive where the railroad investors lived out of state).

32 See A. Hadley, supra note 8, at 108-24. This was the English approach to railroad regulation. Hadley, supra note 30, at 62-63.

33 See C. Adams, supra note 30, at 140-44, 200-01; A. Hadley, supra note 8, at 138.

34 See generally S. Buck, supra note 30.
regulation of the midwestern states. True to de Tocqueville's maxim that in America political issues are often translated into matters of law, the constitutionality of rate regulation soon came before the United States Supreme Court in the form of seven cases from four different midwestern states. Known as the Granger Cases after the farmer organization most responsible for the laws' passage, they were decided together in 1877. Although six of the cases involved regulation of railroad charges, Munn v. Illinois involved Illinois legislation imposing a schedule of maximum prices on the grain warehouses and elevators located in Chicago. In Munn the Court gave its major opinion largely settling all the cases.

In challenging their conviction for nonobservance of Illinois' schedule of maximum charges, the partnership of Munn & Scott raised three related claims, all grounded in the recently enacted fourteenth amendment. That amendment, they argued, entirely proscribed governmental regulation of their charges. If, however, regulation was permissible, then their firm was exempt either because it embarked upon the business prior to the legislation's enactment or because its rates were subject only to a determination by the judiciary that they were unreasonable.

Reflecting the continued ascendancy of the liberal views that had achieved dominance with the rise of Jacksonian democracy some four decades earlier, a seven-justice majority responded to

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37 94 U.S. 113 (1877). For a thorough and enlightening review of the facts of the case, see Kitch & Bowler, The Facts of Munn v. Illinois, 1978 Sup. Ct. Rev. 313. One of the authors claims that "[t]he desire of the Chicago Board of Trade to impose an inspection system on the Chicago elevators led to the regulation in Munn. The price term entered the statute as a cosmetic adjunct to this program and became the focus of the case as a matter of litigation strategy." Id. at 320.
38 Plaintiffs in Munn also raised claims, which will not be discussed, that their regulation violated the commerce and antipreference clauses of the Constitution. 94 U.S. at 119. The Court decided these claims against them. Id. at 134-36. Eleven years later, the Court reversed the commerce clause decision, commenting it had not given sufficient attention to the interstate commerce aspects of the case due to the novelty and importance of the issues under the fourteenth amendment. Wabash, St. L. & Pac. Ry. v. Illinois, 118 U.S. 557, 566-69 (1886).
39 94 U.S. at 119-20, 133.
40 See Siegel, supra note 13.
Munn & Scott's claims with a ringing affirmation of legislative regulatory power. In his majority opinion, Chief Justice Morrison Waite sweepingly addressed the issue of whether the fourteenth amendment barred the Illinois scheme of price regulation. Waite first pointed out that the Constitution nowhere defined a "depriv[ation] . . . of . . . property without due process of law"; nonetheless, the concept "is old as a principle of civilized government."41 It dated back to the Magna Carta and for nearly a century had been part of nearly every state constitution. It was found, as well, in the federal Constitution's fifth amendment. Its meaning, accordingly, was ascertainable generally by political theory and specifically by "usage."42

In Waite's view, political theory taught that government may regulate for the common good the rights possessed by individuals. Although governmental power did not extend to "rights which are purely and exclusively private," it did authorize laws restraining individuals from exercising rights which "unnecessarily" injure others.43 In exercising this authority, England, the American colonies, and the states had historically regulated the charges of certain trades, such as ferries, common carriers, bakers, millers, and innkeepers. The federal government, in spite of the fifth amendment's due process clause, empowered the city of Washington, D.C., to prescribe the rates of private docks, chimney sweeps, common carriers, and auctioneers.44 Thus theory and history demonstrated that there was a common-law principle that legitimated close governmental regulation of private property, at least under some circumstances.

Waite also found historical precedent for including Munn & Scott's grain warehouse and elevator within that principle. He wrote:

Looking, then, to the common law, from whence came the right which the Constitution protects, we find that when private property is 'affected with a public interest, it ceases to be juris privati only.' This was said by Lord Chief Justice Hale more than two hundred years ago, in his treatise De Portibus Maris, . . . and has

41 94 U.S. at 123.
42 Id. at 123-24.
43 Id. at 124.
44 Id. at 125.
been accepted without objection as an essential element in the law of property ever since. Property does become clothed with a public interest when used in a manner to make it of public consequence, and affect the community at large.45

After pointing out that the thirty people who owned the nine business firms that owned all fourteen grain elevators in the Chicago area had a "virtual monopoly" of the grain trade between the midwestern states and the eastern seaboard, Waite unhesitatingly stated that "if any business can be clothed 'with a public interest, and cease to be juris privati only,' this has been. It may not be made so by the operation of the Constitution of Illinois or this statute, but it is by the facts."46

With this decided, Waite turned to Munn & Scott's claim that their property rights were being retrospectively infringed. It did not matter, Waite wrote, that no exact precedent existed for regulation of the grain warehousing and elevating trade. The business was new, but "[i]t presents . . . a case for the application of a long-known and well-established principle in social science, and this statute simply extends the law so as to meet this new development of commercial progress."47 Under the common law, owners of property affecting the community at large never had the right to charge whatever the traffic would bear; historically they had the right to no more than a "reasonable" charge. In adopting the new statute, the legislature had merely introduced a new system for ascertaining that allowable limit. It had, in effect, altered the remedy but not the right.48 Unlike "rights of property," the "rules of conduct"—regulations by which property was acquired, held, used, and transferred—"may be changed at the will, or even at the whim, of the legislature . . . [when doing so] establishes no new

45 Id. at 125-26 (citations omitted).
46 Id. at 132. But see Kitch & Bowler, supra note 37, at 316 (arguing against conclusion that elevators had an economic monopoly because there was competition between different railroads, and the economic fortune of each elevator was determined by the fortunes of the railroad with which it was associated).
47 94 U.S. at 133. The Chicago grain elevator system arose after 1864. See Kitch & Bowler, supra note 37, at 323.
principle in the law, but only gives a new effect to an old one."

As for Munn & Scott's final claim that the common-law principle legitimating governmental regulation required a judicial determination that their rates were unreasonable, Waite admitted that most frequently Anglo-American rate regulation had been effectuated through judicial process. Nevertheless, this was due to an absence of legislation. The traditional common-law rule limiting prices to a judicially determined reasonable charge was but one way of regulating property affecting the public interest. Legislatively or administratively set maximum charges were simply an alternative system that the legislature had discretion to impose. Neither the decision to impose a schedule of maximum charges nor the rates contained in that schedule were reviewable. Having determined both the abstract question of whether a principle permitting legislative regulation existed and the particular question of whether facts which rationally came within the principle were present, the Court had reached the limit of its constitutional role.

After this opinion, the Court, with Waite again as its spokesman, easily extended its conclusions to the six companion railroad cases. According to Waite, railroads have "the same rights, and [are] subject to the same control, as private individuals under the same circumstances." The railroads' single claim to different circum-

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49 94 U.S. at 134. This reasoning depends upon a conception of the constitutional right of property limited to security of title and possession. See infra text accompanying notes 108-14.

50 94 U.S. at 132-34. As Waite concluded:

The controlling fact is the power to regulate at all. If that exists, the right to establish the maximum of charge, as one of the means of regulation, is implied. . . . We know that this is a power which may be abused; but that is no argument against its existence. For protection against abuses by legislatures the people must resort to the polls, not to the courts.

Id. at 134. This was the conventional view. For other examples of this attitude, see Brown v. Maryland, 25 U.S. (12 Wheat.) 419, 431-33 (1827) (argument of Roger Taney as counsel); McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 428, 431 (1819).

51 Chicago, B. & Q. R.R. v. Iowa, 94 U.S. 155, 161 (1877). As the Illinois Attorney General was later to write:

That railway companies are common carriers, and as such exercise a public employment; that they are created to subservie a public purpose, and that they are authorized to construct their lines of road for public use, is so obviously true, and had been so frequently adjudged, that it is difficult to conceive how [Munn's application] could be seriously controverted.


Justices Field and Strong, however, dissented in all the railroad cases, filing their opinion
stances was their possession of charters, the “obligation” of which the federal Constitution’s contract clause protected from “impairment.” But the legislatures had power to regulate railroad rates, and Waite found none of the charter provisions sufficiently express, under the principle of Charles River Bridge v. Warren Bridge, to exempt the companies from it.

B. The Reaction to the Granger Cases

Waite’s Granger opinions set off a storm of controversy. Justice Field, joined by Justice Strong, authored a long and impassioned dissent. A welter of popular and scholarly commentators joined in and continued the debate. The controversy turned upon mat-

in Stone v. Wisconsin, 94 U.S. 181, 183 (1877) (Field, J., dissenting). Nonetheless, it is doubtful that they entirely opposed railroad rate regulation. See id. at 185 (Field, J., dissenting); McCurdy, Justice Field and the Jurisprudence of Government-Business Relations: Some Parameters of Laissez-Faire Constitutionalism, 1863-1897, in American Law and the Constitutional Order 246, 261-64 (L. Friedman & H. Scheiber eds. 1978); infra text accompanying notes 82-84.

In Charles River Bridge v. Warren Bridge, 36 U.S. (11 Pet.) 420 (1837), the Supreme Court established the rule that corporate charters were to be strictly construed in favor of the public and that nothing was to pass by implication. See B. Wright, supra note 48, at 63-65, 160-68.

In later cases, Waite, speaking for the Court majority, found that even charters allowing the railroads to set “reasonable” rates provided no bar to later statutory interference. See The Railroad Commission Cases, 116 U.S. 307 (1886). The Court never held, however, that rate regulation was part of the inalienable police power. Yet although no railroad charter was ever found definite enough to overcome the Charles River Bridge presumption, in the early twentieth century several utilities were successful. B. Wright, supra note 48, at 134-39, 209.

94 U.S. at 113; Stone v. Wisconsin, 94 U.S. 181, 183 (1877) (Field, J., dissenting).

See the review of the decisions’ reception in 2 C. Warren, The Supreme Court in United States History 574-96 (1922). For favorable judicial commentary, see People v. Budd, 117 N.Y. 1, 22 N.E. 670 (1889); People ex rel. Boston & A. R.R., 70 N.Y. 570 (1877).

The Granger Cases were also controversial while they were pending. Many published commentators anticipated a finding of unconstitutionality. See, e.g., 2 C. Warren, supra, at 576-78; The Potter Act at Washington, 9 Am. L. Rev. 212 (1875); Wells, How Will the United States Supreme Court Decide the Granger Railroad Cases?, 19 The Nation 282 (1874). One supporter of regulation estimated that before the decision professional opinion was 80% against upholding the legislation. Edsall, supra note 51, at 299.

As an indication of juridical attitudes towards the issues involved, it was reported that on initial consideration of Munn, the Illinois Supreme Court unanimously thought the regulation unconstitutional. See, e.g., 2 C. Warren, supra, at 298-99. Nevertheless, that judge and a majority of his colleagues changed their minds. Munn v. People, 69 Ill. 80 (1873). Two of the five judges still dissented.
ters of substantive law, not methodological technique. Most of the juristic commentators drew, as Waite had, from social theory and common-law precedent to determine the scope of the property right secured by the fourteenth amendment. Most analysts, agreeing with the abstract notion that under the Constitution neither government nor private property was omnipotent, assumed that American governments had spheres of rightful activity. When a government acted within its rightful sphere, but only when it acted within it, private interests must yield. The judicial function was to determine whether governmental action was within its appointed sphere, not to reassess the exercise of that power. Thus, Waite and most of those who commented on his decision shared the notion that if legislatures had power over rates, the exercise of that power was discretionary and not judicially reviewable. But Waite's critics turned these shared premises into the bases of two strands of substantive criticism.

1. The Controversy over the Sphere of Legislative Power over Rates

One strand of criticism of the Munn opinion involved the breadth of Waite's rationale. As Waite had used the term in his opinion, the "public interest" in Munn & Scott's grain elevator and warehouse was no greater, his critics claimed, than in housing, manufacture, construction, and printing. As Justice Field stated, "there is hardly an enterprise or business engaging the attention and labor of any considerable portion of the community, in which the public has not an interest in the sense in which that term is used by the court in its opinion." What differences existed were

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87 See, e.g., Cooley, supra note 12. See also sources cited supra notes 51, 56; infra note 60. Oliver Wendell Holmes, who wrote a brief comment in 1878, is the single exception to the comments made in this paragraph. Book Notice, 12 Am. L. Rev. 354 (1878). His analysis is discussed infra text accompanying notes 295-98.

88 See, e.g., Munn, 94 U.S. at 139-40 (Field, J., dissenting); Stone v. Wisconsin, 94 U.S. 181, 184 (Field, J., dissenting); Cooley, supra note 12, at 238-39.

89 See, e.g., Munn, 94 U.S. at 143 (Field, J., dissenting) ("If it be admitted that the legislature has any control over the compensation, the extent of that compensation becomes a mere matter of legislative discretion."); Editorial, The Right to Confiscate, 19 The Nation 199, 200 (1874). But see Cooley, supra note 12, at 256 (arguing that there should be limiting principles in rate regulation); infra text accompanying notes 94-95.

90 94 U.S. at 141 (Field, J., dissenting). A decade and a half later Justice Brewer, still protesting Munn, was to write: "There is scarcely any property in whose use the public has
matters of opinion, judicially unreviewable differences of degree and not of kind. To legitimate rate regulation "when[ever prop-
terty is] used in a manner to make it of public consequence, and
affect the community at large" threatened to legitimate unre-
reviewable legislative control over prices across the economy.

Even some liberal jurists took exception to this aspect of Waite's
opinion and argued for a limited reading of Munn's rationale. Rate
regulation, they argued, depended upon the presence of a "virtual
monopoly." Modern economic conditions gave rise to business
combinations that achieved market dominance through private
contracts and not through governmental grants of special privilege
as in the past. Even when not founded upon government act, this
monopoly power was coercive and subject to abuse, leading W. Frederic Foster to write:

Feeling . . . his impotence [against de facto monopolies] the indi-
vidualist turns to the State, and invokes its assistance as against an
enemy that is sapping the foundations of the national exis-
tence. . . . [T]he doctrine of Munn v. Illinois may be regarded
rather as an effort of individualism to stem the rising tide of com-
bination, than as socialistic; a stand made by the individual rather
than a move forward of socialism.

Thus, these liberals viewed Waite's rationale as overly broad.
Yet, in all other respects Waite's decision found favor with them.
Economic, political, and moral theory, as well as common-law
precedents, they said, proscribed de facto as well as de jure mo-
nopolies. Condemned by the common law, these monopolies were
not protected by the Constitution. Substantively correct when read

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61 Cooley, supra note 12, at 243-44; Foster, supra note 60, at 57.
62 94 U.S. at 126.
63 Edsall, supra note 51, at 295; Foster, supra note 60, at 62-63, 79, 80.
64 Foster, supra note 60, at 77. Foster pessimistically concluded, however, that even the
power of the state would prove insufficient to stem the tide of combination. Id. at 81.
65 On the common law and de facto monopoly, see Edsall, supra note 51, at 294-95. Fos-
ter's view was that the historic common law condemned only de jure monopolies, but that it
should evolve beyond that point. Foster, supra note 60, at 70.
in this limited fashion, Waite's opinion was also jurisprudentially acceptable. The existence of a "virtual monopoly" was, after all, a matter of fact. As Waite had written, the facts, not the mere assertion of legislative will, put Munn & Scott within a category where the legislature had power over the rates.66

Conservatives, however, went further in their criticism of Waite's decision. They rejected Waite's expansive view that all "business affected with the public interest" was subject to rate regulation. Moreover, they also rejected the more narrow view that "virtual monopolies" might properly be regulated. Instead, conservatives grounded the distinction between permissible and impermissible rate regulation in the traditional distinction between property and privilege.

Conservatives believed that economic theory pointed to the property-privilege distinction as marking the limit of government's power over rates. Since Adam Smith, economic theory had taught that monopolies were generally undesirable because their conduct was not subject to the discipline of competition and other market forces.67 Until the end of the nineteenth century, however, economic theory also distinguished between de jure and de facto monopolies. De jure monopolies, due to their possession of a legally granted and enforceable privilege, were not susceptible to market forces and could maintain themselves over time. De facto monopolies, in contrast, lacked a legal privilege and were subject to market forces and inevitably collapsed of their own accord.68 "A monopoly of fact," it was said, "anyone can break."69 Consequently, conservatives argued that, as market forces could rid society of de facto but not de jure monopolies, rate regulation was necessary in the latter

66 Foster refers to the presence of virtual monopoly as "[t]he only matter of fact that existed in [Munn]." Foster, supra note 60, at 59.
68 Budd v. New York, 143 U.S. 517, 550-51 (1892) (Brewer, J., dissenting). On this point, Judge Cooley argued that before the development of modern means of transportation "monopolies of fact" may have been possible and a serious evil. But he considered it "inconceivable" that any could maintain themselves in modern times, due to competition, except where illegitimate and criminal means, such as threats of violence, were employed. Cooley, supra note 12, at 259. Underlying this view was the belief that efficiency decreased as the scale of enterprise increased, and that therefore new entrants could be price competitive with de facto monopolies which typically were larger enterprises. See infra note 70.
but not the former case. It was privilege, and only privilege, that immunized enterprises from market forces and thus justified legislative control.70

Conservatives believed that legal theory also pointed to the property-privilege distinction as the appropriate limit of the legislature's power to regulate rates. Unlike wealth obtainable by common right (property), wealth obtainable by government act (privilege) was under the discretionary control of government.71 Government could condition its grants of privileges as it wished, just as the grantor of property could insert restrictions upon its use.72

Common-law precedents, conservatives maintained, reflected this economic and legal theory and similarly set the boundary of governmental rate regulation at the property-privilege dichotomy. In Munn, Waite had been methodologically correct in turning to history and common-law precedent to determine the meaning of property as used in the newly enacted fourteenth amendment. But

70 With the appearance of self-sustaining, large-scale industrial concerns at the end of the nineteenth century, economic theory reversed itself and began to teach that economic concentration was inevitable. Modern technology, it was said, had undermined the validity of traditional economic thought about de facto monopolies. Modern technology involved the efficiencies of scale and the economics of sunk costs that allowed large-scale de facto monopolies to defend themselves successfully against competition. See infra note 215. Even some conservatives quickly realized that market forces now favored the rise of de facto monopoly just as liberals like Foster maintained. These conservatives nevertheless continued to resist the "virtual monopoly" conception of Munn. They reasoned that with "virtual monopolies" arising across the economic landscape, to permit government to control their rates would effectively legitimate governmental power over all significant parts of the economy. The cure would not only be worse than the disease but also was unnecessary, as there were other, less intrusive strategies, such as selective antitrust enforcement, reliance on what J.P. Morgan called "a community of interest," and proscription of "unjust discrimination." See A. Hadley, supra note 8, at 100-24 (arguing against attempts to remedy railroad discrimination by statute); Hadley, supra note 30, at 66-67; Address by President Theodore Roosevelt, First Annual Message to Congress (Dec. 3, 1901), reprinted in 2 H. Commager, Documents of American History 20-22 (8th ed. 1968). Herbert Croly was a leading theorist of this response. See R. Lustig, supra note 6, at 128 (discussing Croly's thought).

71 See supra text accompanying notes 10-19.

72 Budd v. New York, 143 U.S. 517, 552 (1892) (Brewer, J., dissenting); Munn v. Illinois, 94 U.S. 113, 148-49 (1877) (Field, J., dissenting); T. Cooley, supra note 60, at 876; Cooley, supra note 12, at 254.

This of course raised the contract clause issue of whether the grant of privilege included or excluded rate regulation. See, e.g., Ruggles v. Illinois, 108 U.S. 526 (1883); Peik v. Chicago & Nw. Ry., 94 U.S. 164 (1877); B. Wright, supra note 48, at 134-39; McCurdy, supra note 51, at 263-64. But unless barred by the grant itself, rate regulation of enterprises that received legal privileges was acceptable. T. Cooley, supra note 60, at 876-77.
Waite had drawn incorrect conclusions from the common law in two ways. At times he simply had misread the precedents. For example, Waite's crucial references to Chief Justice Hale's seventeenth-century treatise *De Portibus Maris* and the early nineteenth-century case *Allnutt v. Inglis* actually established no more than that enterprises receiving privileges not accorded others were consequently subject to rate regulation. In addition to misreading the precedents, Waite had also forgotten that law is progressive. Precedent did exist for the close regulation of unprivileged enterprises. Although most of these precedents were medieval, a few of them, it was true, had been carried thoughtlessly up to almost the present day. Nevertheless, western society had recently abandoned the theory of mercantilist and paternalist government. Those ancient precedents, the product of ignorant times and inconsistent with "any system of free government," were to be abandoned thoroughly, or at least not extended.

Finally, conservative jurists asserted that traditional methodological norms argued for limiting rate regulation by the property-privilege distinction. Although appearing to involve the application of a preexisting standard to ascertainable facts, the concept of "virtual monopoly" was not certain enough in its application to be sufficiently nondiscretionary. The existence of facts supporting a

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73 *Munn*, 94 U.S. at 126-29.

74 Although written around 1670, Hale's treatise was first formally published in *A Collection of Tracts Relative to the Laws of England* 78 (F. Hargrave ed. London 1787).


76 94 U.S. at 149-52; T. Cooley, supra note 60, at 874-76; Cooley, supra note 12, at 247-49. Foster, who nevertheless supported rate regulation beyond these limits, agreed with the conservatives' analysis of the common-law precedents, Foster, supra note 60, at 62-63, except that he saw an additional principle of interference in cases involving the "necessaries of life." Id. at 70.

For a refutation of the other precedents used by Waite, see *Munn*, 94 U.S. at 152-54 (Field, J., dissenting); Cooley, supra note 12, at 249-56.


78 People v. Budd, 117 N.Y. 1, 46-48, 22 N.E. 670, 686-87 (1889) (Peckham, J., dissenting), aff'd, 143 U.S. 517 (1892). Judge Peckham later wrote the majority opinion in *Lochner v. New York*, 198 U.S. 45 (1905). Liberals and conservatives generally shared the notion that law was a progressive process and not entirely bound by the precedents of the past, especially in constitutional matters. See Foster, supra note 60, at 72-73, 76 (using progressive process of law in discussion of business affected with the public interest). See also *Hurtado v. California*, 110 U.S. 516, 528-29 (1884).
finding of monopoly power was so intangible and debatable that the standard invited uncontrollable legislative abuse.\textsuperscript{79} Conservatives claimed that the property-privilege distinction, which turned upon such notorious facts as the enactment of special legislation, did not call for this sort of judicial discretion.\textsuperscript{80} Accordingly, Field, Cooley, and other conservative jurists argued that government constitutionally could and often should regulate the rates of enterprises 1) that were not engaged in activity as a matter of right, but rather permitted by the state as a privilege or franchise; 2) that received special assistance from the state in the form of special taxation, grants or otherwise; or 3) that made some special use of public property.\textsuperscript{81}

Obviously, under this theory the rates demanded by Munn & Scott were not regulable, even if their enterprise was part of a virtual monopoly of the midwestern grain trade. Conservatives therefore bitterly decried Munn's rationale and result. Just as obviously, however, this theory indicated railroad rates were regulable. Railroads were uniquely and specially privileged enterprises. They exercised, for example, the sovereign power of eminent domain. They received governmentally granted largess\textsuperscript{82} in exchange for

\textsuperscript{79} Conservatives pointed to the successful use of the claim of "virtual monopoly" to support North Dakota's imposition of rate regulation on its over 600 grain warehouses and elevators as undeniable proof of their concerns. Brass v. North Dakota ex rel. Stroeser, 153 U.S. 391, 394, 403, 409-10 (1894). See also People v. Budd, 117 N.Y. 1, 63, 22 N.E. 670, 690 (1889) (Peckham, J., dissenting) (arguing that defendants' grain elevators and warehouses did not constitute "anything like what can be called a monopoly, virtual or otherwise"), aff'd, 143 U.S. 517 (1892). Even the liberal proponent of the de facto monopoly test, W. Frederic Foster, admitted that under public pressure legislatures sought to "squeeze" constitutional provisions and that some recent enactments justified a fear of just how unrestrained an omnipotent "half plus one" could be. Foster, supra note 60, at 55-59.

\textsuperscript{80} Thus the property-privilege distinction met the requirement of traditional methodological norms that the spheres of permissible and impermissible legislation be separated by "a clear line of distinction . . . ; one that the legislatures and the courts may clearly perceive and apply without danger of serious error." Cooley, supra note 12, at 243.

\textsuperscript{81} Id. at 256. See also Budd v. New York, 143 U.S. 517, 552 (1892) (Brewer, J., dissenting); Munn, 94 U.S. at 148-49 (Field, J., dissenting). In his treatise, Cooley added as another justification the grant of monopoly privileges. T. Cooley, supra note 60, at 876-77. In Budd Justice Brewer added as a justification of rate regulation that the business was engaged in a public function. He also included the mere grant of incorporation under the head of franchise. 143 U.S. at 548-50 (Brewer, J., dissenting).

\textsuperscript{82} See sources cited supra note 29. The railroads, for example, had received millions of acres of public land to subsidize their development as well as millions of dollars raised through taxation.
their performance of a vital public function. As a result, many conservatives who thought the Constitution forbade regulation of Munn & Scott's charges accepted the propriety and necessity of that power over railroads.

In other words, the reaction to Waite's analysis of the scope of legislative rate regulation was divided not only between political orientations but also between the cases. The Munn decision was controversial, even among liberals, and remained so for over sixty years. Conservatives never acquiesced in it and resisted its broad and narrow readings at every opportunity. The companion railroad cases, in contrast, generally met with approval. Liberals were far more insistent on the propriety of railroad regulation and many conservatives shared this belief. Indeed, although conservative jurists continued to contest fiercely Munn's extension to such businesses as insurance companies and rental housing, they re-

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83 Indeed, the receipt of all of their privileges would be unconstitutional absent this public obligation. See, e.g., State ex rel. St. Joseph & D. R.R. v. Commissioners of Nemaha Co., 7 Kan. 335, 339 (1871) (Brewer, J., dissenting); Allen v. Inhabitants of Jay, 60 Me. 124 (1872).

84 Field and Cooley, for example, did. Munn, 94 U.S. at 148-49 (Field, J., dissenting) (state has right to prescribe conditions on which the privileges it grants should be enjoyed); T. Cooley, supra note 60, at 873 n.1 (the right to fix railroad charges by amendment to charters would probably be claimed on the ground that railroads receive special privileges from the state). See infra text accompanying note 102. But see infra text accompanying notes 96-102 (qualifying their acceptance of this view).

85 See, e.g., Budd v. New York, 143 U.S. 517, 548 (1892) (Brewer, J., dissenting); German Alliance Ins. Co. v. Lewis, 233 U.S. 389, 418 (1914) (Lamar, J., dissenting); Wilson v. New, 243 U.S. 332, 364, 373 (1917) (Day, Pitney, J., dissenting); Block v. Hirsh, 256 U.S. 135, 158 (1921) (McKenna, J., dissenting); Tyson & Bro. v. Banton, 273 U.S. 418, 447 (1927) (Stone, J., dissenting); Nebbia v. New York, 291 U.S. 502, 539 (1934) (McReynolds, J., dissenting). Munn was to remain at the center of controversy until the overthrow of the substantive and methodological paradigm upon which it was based. Nebbia v. New York marked that overthrow and after that case the doctrine of "businesses affected with the public interest" disappeared from constitutional jurisprudence. For a review of the doctrine, written while it was still controversial, see Finkelstein, From Munn v. Illinois to Tyson v. Banton, A Study in the Judicial Process, 27 Colum. L. Rev. 769 (1927).

86 Their efforts, though intense, did not bear fruit until after the turn of the twentieth century. Not until Adkins v. Children's Hosp., 261 U.S. 525, 546-47 (1923), and Charles Wolff Packing Co. v. Court of Indus. Relations, 262 U.S. 522, 534-41 (1923), did the Court strike down regulatory legislation on the ground that the particular business did not "affect the public interest." Commentators nevertheless correctly observed that the Court could only have decided cases such as Lochner v. New York, 198 U.S. 45 (1905), by ignoring Munn sub silentio.

87 See infra text accompanying note 102.

88 Block v. Hirsh, 256 U.S. 135 (1921); German Alliance Ins. Co. v. Lewis, 233 U.S. 389
corded little protest to bringing utilities within its ambit in 1884.89 Many conservatives genuinely accepted railroad and utility rate regulation.90 Even the railroads, one contemporary commentator observed, soon ceased "pretend[ing] that their business is just like any other business [and] deny[ing] in toto the right of public authorities to say something about rates."91 Thus, close regulation of railroads, the paradigmatic example of privileged enterprise, became deeply entrenched as a norm of Liberal society.

2. The Controversy over the Exercise of Legislative Power over Rates

In addition to debating the appropriate breadth of the Granger precedents, commentators also controverted their depth; that is, the extent to which government could regulate an industry. Property values, they knew, were totally dependent upon rates.92 Where legislatures had power over rates they thereby had complete and unreviewable power over value. Rate regulation, in effect, involved total control of productive property.93

These observations underlay part of the criticism of the breadth of Waite's rationale in Munn, for they showed that it placed all business property entirely at the "mercy" of legislative majorities.94 But these observations were just as applicable to railroads, where legislatures incontrovertibly had rate regulatory power. As

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91 Hadley, supra note 30, at 65. See also G. Kolko, supra note 8, at 5 (arguing that railroads sought regulation that they could control).
92 When property is owned for productive use, its value, except for scrap, is simply the income stream that it can produce. See infra text accompanying note 253.
93 In this regard, rate regulation was unlike other police power regulation involving such subjects as health and physical safety. Their effects on property value and conduct were indirect, controllable, and usually partial because they were confined to health and safety concerns. See Siegel, Illinois Zoning: On The Verge of a New Era, 25 DePaul L. Rev. 616, 621-27 (1976).
94 Munn, 94 U.S. at 140 (Field, J., dissenting); Wells, supra note 56, at 284.
with all forms of wealth held for exchange, railroad stocks, bonds, mortgages, and other obligations, as well as the corporation's underlying assets, could all be "practically confiscated" by legislation setting rates so unremuneratively low as to render them valueless.95

Thus, although conservatives generally conceded the constitutionality of legislative power over railroad rates, they were deeply troubled by the implications of their concession. Even if limited to railroad and other forms of privileged enterprise, the Granger precedents still placed vast amounts of private wealth and the nation's most significant economic enterprises entirely "at the mercy of the legislature of every state."96 Morally, there was the problem of the retrospective application of the legislature's rate regulations to investments made without knowledge of the ability of the state to seize them.97 Economically, there was the problem of attracting investment without even minimal guaranties of security.98 Politically, there was the problem of further exacerbating incentives for special interests to capture the government. Should railroad rates become a subject of politics, conservatives feared as much for the survival of public interest legislation as for railroad property. As one popular commentator observed:

Does any man seriously believe that four thousand millions of property, with revenues of five hundred millions yearly ... can be controlled by a free government? ... If ever the United States makes it necessary for railway property and railway managers either to control the Government or be controlled by it, the end is sure. The necessity of self-protection ... will band together instantly all railway owners and managers, not to resist but to "run" the Government.99

Thus, to protect investments already made, to foster economic development, and to preserve individual liberty (premised as it was in Liberal thought upon the continued separation of the public and

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95 See Munn, 94 U.S. at 142-43 (Field, J., dissenting); Editorial, supra note 59.
96 Stone v. Wisconsin, 94 U.S. 181, 185 (1877) (Field, J., dissenting).
97 Wharton, Retrospective Legislation and Grangerism, 3 Int'l Rev. 50 (1876).
98 See Munn, 94 U.S. at 184 (Field, J., dissenting); Hadley, supra note 30, at 64. Although liberals, too, were concerned about the need to attract capital into railroad and utility enterprises, they claimed that regulation did not necessarily interfere. See, e.g., W. Larrabee, supra note 8, at 86.
private realms\textsuperscript{100}, conservatives sought to limit legislative power to regulate rates. Although the broad scope of Waite's rationale in \textit{Munn} partially motivated them, the conservatives' concession of the propriety of railroad rate regulation was the primary impetus for their efforts to find a means to constrain the exercise of this power within its rightful sphere.\textsuperscript{101}

Faced with the inevitability of state rate regulation, conservative jurists began to question the accepted notion of judicial nonreviewability. As Justice Field stated, there must be some means to define the limits of the power of the State over its corporations after they have expended money and incurred obligations upon the faith of the grants to them, and the rights of the corporators, so that, on the one hand, the property interests of the stockholder would be protected from practical confiscation, and, on the other hand, the people would be protected from arbitrary and extortionate charges.\textsuperscript{102}

Confronted with the conservatives' concerns, the same Court which refused to rein in \textit{Munn}'s broad scope\textsuperscript{103} began to retreat from the previously fundamental notion that, if a legislative power existed, its discretionary exercise was not judicially reviewable. Seven years after \textit{Munn}, Chief Justice Waite himself signaled the retreat;\textsuperscript{104} and its abandonment was complete by the early 1890's.\textsuperscript{105}

\textsuperscript{100} Horwitz, supra note 6, at 1423-28; McCurdy, supra note 51, at 264-65.
\textsuperscript{101} Justice Field's struggle with this issue is recounted in McCurdy, supra note 51, at 261-64. See also Cooley, supra note 12, at 256.
\textsuperscript{102} Some conservatives, such as Arthur T. Hadley, favored free market regulation of railroads. See A. Hadley, supra note 8, at 100-08; Hadley, Principles and Methods of Rate Regulation, 16 Yale Rev. (n.s.) 417, 426 (1927). Even if imperfect competition persisted, legislative action should be limited to compelling railroads to open their books and refrain from extortionate and discriminatory pricing. Smyth v. Ames, 169 U.S. 466, 505-09 (1898) (argument of counsel); C. Adams, supra note 30, at 140-44, 200-01; A. Hadley, supra note 8, at 138, 143; Hadley, supra note 30, at 67.
\textsuperscript{103} Stone v. Wisconsin, 94 U.S. 181, 184-85 (1877) (Field, J., dissenting). Field never attempted the analysis he called for because he felt that as long as \textit{Munn} stood, to do so would be a "waste of words." Id. at 186. For a penetrating analysis of Field's thought, see McCurdy, supra note 51, at 261-65.
\textsuperscript{104} See sources cited supra notes 85-86.
\textsuperscript{105} Spring Valley Water Works v. Schottler, 110 U.S. 347, 354 (1884). See also The Railroad Comm'n Cases, 116 U.S. 307, 331 (1886); infra text accompanying note 116.
C. The Retreat from the Granger Cases

In their attack on the unreviewability of rate regulations, conservatives relied in part on the traditional constitutional proscription of confiscations as well as precedent discussing the allocation of power among the branches of government. But the success of their attack on the unreviewability of rate regulations was due most fundamentally to the fact that the traditional conception of the constitutional guaranty of private property—the conception that underlay Waite’s entire analysis—was anachronistic in the late nineteenth century. Constitutional protection of property had always served a political function: it guarantied individuals freedom both from the pressures of other citizens and from the state. The parameters of a right sufficient to accomplish these ends without unduly confining public power, however, originated in a past where politically significant wealth usually took the form of largely self-sufficient agrarian holdings. Though nonlanded, and therefore nonelite, wealth had been subjected to

106 Proscriptions against confiscation had historically extended to legal privileges as well as ordinary forms of property. Precedents on the “reserve” clauses that all states adopted in one form or another after Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819), were most apposite. Although the clauses literally allowed “any amendment, alteration or repeal” of the grant, the judiciary never construed them that broadly. By spinning a fine web of doctrine to distinguish between alterations affecting the franchise and those affecting “vested rights acquired under the franchise,” even liberal jurists strove to interpret the “reserve” clauses as not permitting direct or indirect seizures of title or possession of the corporation or its assets. B. Wright, supra note 48, at 168-78. But conservatives, and even some liberals such as Justice Harlan, feared that the rise of the police power rate regulation threatened to undo the delicate stasis of contract clause litigation. See, e.g., The Railroad Comm’n Cases, 116 U.S. 307, 339-42 (1886) (Harlan, J., dissenting); Ruggles v. Illinois, 108 U.S. 526, 537-41 (1883) (Harlan, J., concurring).

107 Courts had long said that legislation had to be “bona fide” and “really” within the categories of legislative power; “mere pretexts” that it was would not do. See, e.g., Hepburn v. Griswold, 75 U.S. (8 Wall.) 603, 614-15, 617-18 (1870); McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 423 (1819). For Waite’s use of this concept in the Granger Cases, see supra text accompanying notes 46, 50.

108 In other words, the courts had long recognized the necessity of a “rational means” test to evaluate the legitimacy of legislative action; that is, whether the chosen means rationally related to the permissible end. As the courts said, without this type of scrutiny judicial review was meaningless. See Hepburn v. Griswold, 75 U.S. (8 Wall.) 603 (1870); Toledo, W. & W. Ry. v. City of Jacksonville, 67 Ill. 37 (1873); Capen v. Foster, 29 Mass. (12 Pick.) 485, 493-94 (1832); Daggett v. Hudson, 43 Ohio St. 548, 3 N.E. 538 (1885). Nevertheless, this review had been used sparingly. See infra note 125 and accompanying text.

close regulation, the state had interfered with landed wealth only by physical seizure.\textsuperscript{109} In such a setting, proscription of confiscation seemed sufficient to guaranty personal freedom.\textsuperscript{110}

Thus, until the debate on the \textit{Granger Cases}, constitutional protection of private property extended only to its title and possession.\textsuperscript{111} With the rise of nonlanded wealth to economic and political significance, however, the traditional constitutional acceptance of regulation threatened the security and independence of its holders.\textsuperscript{112} There was no refutation to Justice Field's contention, in his \textit{Munn} dissent, that "[i]f the constitutional guaranty extends no further than to prevent a deprivation of title and possession, and allows a deprivation of use, and the fruits of that use, it does not merit the encomiums it has received."\textsuperscript{113} Common experience, in

\textsuperscript{109} See supra text accompanying notes 43-44.

\textsuperscript{110} Holders of nonlanded wealth rarely invoked constitutional protections of property in pre-Civil War America, see infra notes 111-12, where governments were much more active in promoting entrepreneurial activity than in regulating it. Consequently, the disjunction between traditional constitutional doctrine and its functional effects remained latent.


There are numerous cases illustrating this point. One of the leading cases is Callender v. Marsh, 18 Mass. (1 Pick.) 418 (1823), where no taking of property was found when the regrading of a Boston street caused extensive damage to an adjacent house through the removal of lateral support. So strong was the requirement of a trespassory invasion that it was not until the 1870's that legislatively authorized permanent floodings were definitively held to be compensable. See McCurdy, supra note 51, at 248-49.

The only pre-Civil War case to dwell at length on the importance of protecting property value eventually rested its decision on the deprivation of title and possession. See Wynehamer v. People, 13 N.Y. 378 (1856) (voiding a prohibition statute for making continued possession of existing inventories of liquor a criminal offense), discussed in E. Corwin, supra note 2, at 101-10. See also Scott v. Sandford, 60 U.S. (19 How.) 393 (1857), discussed in E. Corwin, supra note 2, at 110-15.

\textsuperscript{112} The existing precedents confining constitutional protection to title and possession were only occasionally critically commented upon before the \textit{Granger Cases}, but even then the criticism cut across party lines. The conservative jurist James Kent seems to have been the first in the 1840 edition of his \textit{Commentaries on American Law}, but his only significant antebellum follower was Theodore Sedgwick, a leading Jacksonian. See 2 J. Kent, Commentaries on American Law *339; T. Sedgwick, supra note 111, at 462-63.

\textsuperscript{113} 94 U.S. at 141 (Field, J., dissenting). The following year Judge Cooley, in criticizing the notion that "profits are not property" wrote:

That is as much as to say, the constitution protects a man in his property, but not in the enjoyment of his property; he may have his farm, but the state may take away his profits by limiting his sales to the cost of production. A constitutional protection of
short, had made it impossible for a Liberal thinker to deny that value was as essential a component of a viable constitutional conception of property as title and possession. Continuing in the Granger Cases to confine the constitutional protection of property to security against deprivations of title and possession thus appeared to be a fundamental error.

Due to the intimate relation between regulation and value and the similarly close relation between value and a contemporarily meaningful right of property, constitutional law assimilated the conservatives’ concerns with surprising speed. With attention focused on the anachronistic state of the constitutional notion of property, the Court quickly began to rethink the position taken in the Granger Cases. In the early 1880’s when the southern and midwestern states imposed a new round of severely restrictive limitations on railroad charges, the Court, with Waite once again as spokesman, upheld them. But in reaffirming legislative power over railroad rates, the author of Munn paused to state:

From what has been said, it is not to be inferred that this power of limitation or regulation is itself without limit. This power to regulate is not a power to destroy, and limitation is not the equivalent of confiscation. Under pretence of regulating fares and freights, the State cannot require a railroad corporation to carry persons or property without reward; neither can it do that which in law amounts to a taking of private property for public use without just compensation . . . .

Other justices immediately took up this warning. Even the Court’s most liberal member, Justice Harlan, reiterated this view

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114 Waite’s opinion implied this throughout. The Illinois Supreme Court in upholding Munn & Scott’s regulation had expressly said so. Munn v. People, 69 Ill. 80, 86-90 (1873). This view of the Granger Cases and of the development of the constitutional notion of property is discussed in J. Commons, Legal Foundations of Capitalism 11-21 (1924 & reprint 1974).

115 This sort is a mere mockery.

116 The Railroad Comm’n Cases, 116 U.S. 307, 331 (1886). Two years earlier, Waite had already written: “What may be done if the . . . authorities do not exercise an honest judgment, or if they fix upon a price which is manifestly unreasonable, need not now be considered, for that proposition is not presented by this record.” Spring Valley Water Works v. Schottler, 110 U.S. 347, 354 (1884).

Finally, in 1890, in Chicago, Milwaukee & St. Paul Railway v. Minnesota, the Supreme Court took the momentous step of ruling that the Constitution mandated judicial review of the "reasonableness" of governmentally imposed rates. Due to the shared concern for the implications of modern economic conditions on the continued effectiveness of the Constitution's protection of property, this decision was as well received among liberals as conservatives. Conservatives initially troubled by Munn's application to railroads were largely vindicated. The Court had adopted the conservatives' notion that the Constitution both allowed legislative control of the charges of privileged enterprises and protected the private wealth invested in them from spoilation.

Commentators appreciated this expansion of the constitutional notion of property as a portentous event, even though it appeared to grow organically and almost necessarily out of traditional constitutional concerns for individual independence and the new economic conditions. They knew that the principle underlying the Chicago, Milwaukee & St. Paul decision applied not only to rail-

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119 134 U.S. 418 (1890).

120 Id. at 456-58. See also Reagan v. Farmers' Loan & Trust Co., 154 U.S. 362, 398-99 (1894) (reaffirming the Chicago, Milwaukee & St. Paul decision and making clear that it is constitutionally compelled).

121 See, e.g., Lewis, Can Prices Be Regulated by Law?, 41 Am. L. Reg. 9 (1893). In reviewing the reaction to the Chicago, Milwaukee & St. Paul case, Charles Warren wrote: "While it was generally felt that the opinion of the dissenting Judges was the more correct as a matter of strict law, nevertheless, this decision of the Court in 1890 was undoubtedly the more in accord with the general trend of judicial decisions and the temper of the times." 2 C. Warren, supra note 56, at 592.

The few unfavorable comments related to concerns over how the Court was to implement the decision. Apparently this was even the concern of the dissenting justices. See Lewis, The Work of the Late Mr. Justice Bradley, 40 Am. L. Reg. 270, 276-80 (1892). But another commentator concluded:

[T]he result of this decision is to subject legislation of the State to judicial superintendence upon the mere question of reasonableness. This is an overturning of the fundamental principles upon which all our American governments are founded. Those principles are that the three co-ordinate departments of these governments . . . are independent of each other, within their respective spheres of jurisdiction, and that, within those limits, no power resides in one of these departments to control the other.

Notes of Recent Decisions, 24 Am. L. Rev. 516, 522 (1890) (emphasis in original).
roads and utilities but everywhere *Munn* applied. By the early 1890's, large-scale industrial combinations were sufficiently established to make it clear that even if *Munn's* scope were limited to "virtual monopolies," it still potentially applied across the economy.

In addition, the debate over the expansion of the constitutional definition was significant because it was unprecedented. No acceptable test existed which clearly bounded the mutually exclusive spheres of governmental power and private property. Although the constitutional conception of property now included its value, a guaranty of full value could not be required because that would effectively bar all rate regulation. Neither could judicial inquiries into legislative motive be the proper means to adjudicate rate challenges, for such inquiries were too impressionistic. Nor could analysis of whether the rates were rationally related to declared

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122 Commentators also realized that this decision had implications beyond *Munn* to all instances of police power regulation. By the late nineteenth century, conventional descriptions of the police power included the notion that legislation enacted under its umbrella had to bear a reasonable relation to promotion of the public health, safety, morals, or general welfare. If "reasonableness" was essentially a judicial question and therefore reviewable in the rate regulation context, it was in theory, and immediately became in fact, reviewable in the police power context. See, e.g., Toledo, W. & W. Ry. v. City of Jacksonville, 67 Ill. 37 (1873); People v. Ringe, 197 N.Y. 143, 90 N.E. 451 (1910); E. Freund, The Police Power, Public Policy and Constitutional Rights § 63, at 57-61 (1904); B. Twiss, supra note 2, at 110-40; Wickersham, The Police Power, A Product of the Rule of Reason, 27 Harv. L. Rev. 297 (1914). Indeed, federal substantive due process review quickly followed upon *Chicago, Milwaukee & St. Paul*. See, e.g., Allgeyer v. Louisiana, 165 U.S. 578 (1897); Reagan v. Farmers’ Loan & Trust Co., 154 U.S. 362 (1894).

123 Arthur Hadley warned in 1892:

> The character of railroad discriminations and railroad legislation is only in a moderate degree due to special physical conditions affecting the industry alone. It is due to the combination and consolidation of capital which is making itself felt in other lines of industry. The technical conditions of the railroad have simply caused things to develop a little earlier here than they do anywhere else.

Hadley, supra note 30, at 66. See also A. Hadley, supra note 8, at 124. The economic theory upon which Hadley based his observation, the inability of competition to control prices where capital requirements are large and sunk as opposed to small and fluid, is discussed infra text accompanying note 215.

Consider also Professor Wyman’s suggestion that regulation of the great trusts of the late nineteenth and early twentieth centuries as "businesses affected with the public interest" was an alternative to antitrust prosecution. Wyman, The Law of the Public Callings as a Solution to the Trust Problem (pts. 1-2), 17 Harv. L. Rev. 156, 217 (1904).

124 Precedent strictly abjured this approach. See *Soon Hing v. Crowley*, 113 U.S. 703, 710-11 (1885); T. Cooley, supra note 60, at 257-79.
public policy ends be allowed, because that approach required reliance on judicial discretion and opinion. 125

Still, jurists turned to the task of distinguishing rate regulation from confiscation with confidence that the new substantive law could be developed according to established jurisprudential canons. Part of the acceptance of the enlarged constitutional conception of property was the belief that the new substantive law involved no concomitant methodological evolution. Jurists were confident that they could devise a test to distinguish the values secured by the Constitution from those that were not through the deductive application of a preexisting standard to the facts at bar.

III. REVIEWABLE LEGISLATIVE POWER ESTABLISHED

A. The Road to Smyth v. Ames

As the Supreme Court decided the post-Munn cases, judges began facing the problem of marking, theoretically and practically, the distinction between regulation and confiscation. Two lines of authority soon emerged. They differed greatly in the extent to which they subjected rates to public control, and as a consequence, the extent to which they protected railroad and utility wealth from depreciation by rate regulation. Accordingly, each line of authority had distinct political inspiration and appeal. But they were jurisprudentially similar and traditional; both sought to establish a “rule” that turned upon “facts” and not discretion. 126

Both the conservative and liberal lines developed in response to dissatisfaction with the test proposed in the late 1880's and early 1890's by Supreme Court Justice David Brewer. 127 As one of the

125 In Hepburn v. Griswold, 75 U.S. (8 Wall.) 603 (1870), the Court held that when Congress made paper money legal tender for debts contracted before the passage of the law, it was not a “necessary and proper” exercise of its power to coin money. After much adverse comment, the Court reversed itself one year later in the Legal Tender Cases, 79 U.S. (12 Wall.) 457 (1871). See, e.g., M. Howe, Justice Oliver Wendell Holmes: The Proving Years 1870-1882, at 50-58 (1963) (reviewing the controversy over the Legal Tender Cases); Summary of Events, 4 Am. L. Rev. 586, 604-13 (1870).


127 Justice Brewer’s leadership in adjudicating the boundary between regulation and confiscation was in part fortuitous because, although a member of the Supreme Court, he also sat on the Eighth Circuit, which covered many of the central western states where the renewed regulatory fervor was most intense. For a contemporaneous assessment of Brewer’s contribution, see San Diego Water Co. v. City of San Diego, 118 Cal. 556, 582, 50 P. 633, 642 (1897) (Garoutte, J., concurring). Other examples of the use of Brewer’s opinions are San
most conservative members of a notoriously conservative bench, he was obsessed with the importance of private property to the preservation of a free and just society.\textsuperscript{128} Brewer saw individual, free market enterprise as the central institution of the economic, political, moral, and constitutional order.\textsuperscript{129} Accordingly, he unhesitatingly embraced the post-\textit{Munn} precedents' mandate to define substantive limits to the state's power to regulate rates. Yet despite his partisanship, the traditional norm of the nondiscretionary judicial role clearly and significantly shaped the immunity he found for property.

The touchstone of Justice Brewer's analysis was the concept of eminent domain.\textsuperscript{130} As Justice Brewer knew, "takings" had always been associated with, and indeed limited to, seizures of title or

Diego Land & Town Co. v. City of National City, 74 F. 79, 82 (C.C.S.D. Cal. 1896); Capital City Gaslight Co. v. City of Des Moines, 72 F. 829, 839-40 (C.C.S.D. Iowa 1896).

\textsuperscript{128} For a portrait of Brewer's general political commitments, see A. Paul, supra note 2, at 70-72, 74, 121-22, 217.

\textsuperscript{129} See, e.g., Budd v. New York, 143 U.S. 517, 548-52 (1892) (Brewer, J., dissenting); State ex rel. St. Joseph & Den. C. R.R. v. Commissioners of Nemaha Co., 7 Kan. 542, 549-75 (1871) (Brewer, J., dissenting); see also supra note 128.

Rate regulation was, therefore, generally constitutionally proscribed because the common-law principle of property allowed everyone to "make the most of his own." Brewer's adherence to this view prompted his adamant opposition to the doctrine of \textit{Munn v. Illinois}. He agreed entirely with the conservative critique of that opinion. See Brass v. North Dakota ex rel. Stoeser, 153 U.S. 391, 405 (1894) (Brewer, J., dissenting); Budd v. New York, 143 U.S. 517, 548 (1892) (Brewer, J., dissenting). Yet due to their privileges, Brewer not only never questioned the propriety of railroad regulation but would have accepted government ownership of them upon payment of just compensation. See Ames v. Union Pac. Ry., 64 F. 165, 175-76 (C.C.D. Neb. 1894).

\textsuperscript{130} That government should not "take" property without "just compensation" was a universally acknowledged political and moral norm; in the United States, it was also a fundamental juridical norm. See M. Horwitz, The Transformation of American Law, 1780-1860, at 64-65 (1977) (pointing out that the expression of the principle was a slow growth). Although the eminent domain and "just compensation" principle was not officially incorporated into the fourteenth amendment's concept of due process until Fallbrook Irrigation Dist. v. Bradley, 164 U.S. 112 (1896), the concerns of that case were part of the struggle over railroad and utility rate regulation and, indeed, that case is one outcome of the struggle.

The "just compensation" principle was the first substantive due process right. Until Meyer v. Nebraska, 262 U.S. 390 (1923) (parental control of children's education), and Gitlow v. New York, 268 U.S. 652 (1925) (speech), it was the only one. Liberty of contract, so prominent in the industrial regulation cases such as \textit{Lochner}, was necessarily implied by and followed from the incorporation of the "just compensation" principle. It was a generalization of the conclusion that the line between railroad and utility rate regulations and confiscations lay in the difference between monopoly and free market profits. See supra note 9; infra text accompanying notes 312-14.
physical dispossession. He argued that governmentally imposed rates if set low enough accomplished the same result. If revenues did not cover operating expenses, or fixed charges such as bond and mortgage interest, seizure of the shareholders’ title by bankruptcy and foreclosure sale would inevitably follow. To prevent “practical destruction” of the shareholders’ property rights, Brewer argued, the takings clause necessarily protected against rates set too low to cover operating expenses and necessary charges. A clear, factual test to distinguish permissible from impermissible rate regulations was therefore implicit in the traditional protection from seizure.

Of course, Brewer did not mean that railroads and utilities had a constitutional entitlement to rates sufficient to cover all operating and interest expenses in fact incurred. Loss might result from competition or insufficient market demand for a particular railroad’s or utility’s services. Expense might also have been extravagant or indebtedness wastefully assumed. But the law required railroads and utilities to provide the public with adequate and safe service. Operating and capital expenses necessary to provide such service were therefore legitimate. Constitutional protection extended no further than prudentially incurred costs, where there was adequate market demand for service.

If rates covered operating expenses and interest charges, the shareholder’s ownership right was secured. What dividend that right might earn, though intimately connected with the value of that right, was unconnected with a continuation of title. Consequently, the extent of dividends was a matter of policy, a discretionary question involving estimations of what profit would attract further capital and whether further capital ought to be attracted. It was a matter entirely within the province of the legislature. Thus, Justice Brewer argued that the Constitution guarantied railroad and utility stockholders the bare right of ownership and not

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131 See sources cited supra note 111.
Brewer perceived no inconsistency in insisting that rates cover interest charges but not dividends. The traditional distinction between property and privilege justified his differing treatment of bond interest and stock dividends. It was true, Brewer acknowledged, that

often the stockholder and the bondholder are regarded and spoken of as having but a single interest; but the law recognizes a clear distinction. A mortgage on a railroad creates the same rights in mortgagor and mortgagee as a mortgage on my homestead. The legislature . . . cannot interfere with [that] contract . . . or reduce the stipulated rate of interest . . . .

Bonds were, in other words, a creature of the common law, a form of wealth and investment available to all as a matter of right. The contract clause of the Constitution protected bonds, a form of civil contract, from state interference. In contrast, because incorporation required governmental permission, railroad and utility stock was the creation of governmental policy. Although that privilege could not be seized without compensation, the health of the body politic depended upon its prerogatives being closely regulated.

In short, Brewer's analysis was a cunning application of traditional substantive and methodological legal thought to the circumstances of his day. On the one hand, in the early 1890's bonds accounted for slightly over fifty percent of the wealth invested in railroads. Their complete protection was a substantial accomplishment, as was the protection of the shareholder's bare right of possession, given the alternative liberal analysis which in application would deprive many shareholders of that right also. On the other hand, all of this extension of judicial protection was fully

135 Indeed, in a case where the evidence suggested that after covering appropriate operating and interest expenses the shareholders might realize a dividend of 0.35% on the value of their property, Brewer upheld the rates. Chicago, B. & Q. R.R. v. Dey, 38 F. 656, 663 (C.C.S.D. Iowa 1889). See also San Diego Water Co. v. City of San Diego, 118 Cal. 556, 582, 50 P. 633, 642 (1897) (Garoutte, J., concurring) (quoting and following Brewer).
139 See infra text accompanying note 156.
compatible with, indeed consciously made to appeal to, the traditional norm of the nondiscretionary judicial role.\footnote{140}

Nevertheless, Brewer's theories were anachronistic even as he devised them. The ownership of stock in railroads and utilities no longer meant what it had a half century before. The separation of stock ownership from active control, so apparent in twentieth-century corporations, was already manifest in railroads and utilities in the late nineteenth century.\footnote{141} Because it no longer carried with it the active control of the underlying assets, stock effectively had been transformed into a species of bond.

As a result, Brewer's distinction between the treatment of bond and stock holders had a hollow ring. Accordingly, the complete absence of meaningful protection for shareholders proved unacceptable to Brewer's fellow conservatives. Conversely, liberal opponents criticized the total protection of bondholders. Even Brewer apparently was troubled with his own analysis.\footnote{142} Yet he never was able to articulate a logically coherent and ethically satisfactory alternative. Others assumed that task.

According to his conservative critics, Brewer's error was in thinking that the rate of return on invested capital was a discretionary matter. By the end of the nineteenth century the ancient moral objection to interest had so withered that it was widely accepted that money had a market value. Though some judges and railroad and utility attorneys suggested the courts set either the legal rate or the lowest current rate of interest as the value of money invested in railroad bonds and stock, others argued that even such arbitrariness was unnecessary. To them, money's value was a "question of fact . . . susceptible of more or less exact ascertainment" through comparison to the return available from investment in "other kinds of business involving a similar degree of risk."\footnote{143} Of course, as Brewer recognized, wasteful or foolish invest-
ment did not deserve protection. Some distinction between bondholder and shareholder was appropriate due to their different exposures to risk. But in general no distinction needed to be drawn between "those who construct works with their own money and those who do so with borrowed money."\textsuperscript{144} Both were entitled to the competitive rate of return existing at the time of their investment.\textsuperscript{145}

Although this development of Brewer's original thought, known as the "prudent investment" rule, appealed to conservatives because of the extensive protection it gave all investors, it still received a mixed reception from them. Adopted by some,\textsuperscript{146} it was not generally embraced. Perhaps this was because the theory so emphasized the public character of railroads and utilities, and through them the public character of all large-scale corporations,\textsuperscript{147} at a time when many conservatives were bent on establishing and securing these corporations as essentially private enterprises.\textsuperscript{148}

Conservatives split over the prudent investment rule, but it was anathema to their liberal opponents. If the consequence of Brewer's thought was to immunize a great amount of railroad and utility wealth from state control, the prudent investment rule went even further. In the economic circumstances of the late nineteenth century, this immunization was not just theoretical, but a real, immediate consequence. For over three decades, railroad and utility construction costs had been falling dramatically.\textsuperscript{149} Requiring that state-imposed rates provide a fair return on original investments drastically inhibited the regulatory movement from significantly reducing prevailing rates.

Politically unsatisfied with prudent investment analysis,

\textsuperscript{144} San Diego Water Co. v. City of San Diego, 118 Cal. 556, 570, 50 P. 633, 637 (1897).
\textsuperscript{145} Id. at 569-71, 50 P. at 636-37. For a later, complete expression of this argument, see Kirshman, The Principle of Competitive Cost in Public Utility Regulation, 35 Yale L.J. 805, 818-24 (1926). The general basis for equating the constitutional guaranty with a competitive return is discussed infra note 311.
\textsuperscript{147} See infra note 157; infra text accompanying notes 231-34.
\textsuperscript{148} Smyth v. Ames, 169 U.S. 466, 507-09 (1898) (argument of James C. Carter as counsel for appellees); id. at 543-44 (response of Court).
\textsuperscript{149} See J. Bauer & N. Gold, Public Utility Valuation for Purposes of Rate Control 53-55, 110-11 (1934); Goddard, Fair Value of Public Utilities (pt. 1), 22 Mich. L. Rev. 652, 654-56 (1924); infra text accompanying note 156.
proregulatory jurists turned to Brewer's original notion and developed it in a different direction. They recognized that Brewer was correct in establishing that value diminution could amount to a "taking." The prudent investment advocates were also correct in objecting to the differing treatment of bond and stock holders; in pointing out that determining rates of return was a nondiscretionary, factual inquiry; and in limiting the investor's entitlement to competitive market, not actually obtainable, returns. The liberals argued, however, that all this contained another lesson.

Under precedents established by Brewer himself, the compensation awarded upon condemnation of a railroad or utility was the present value of the enterprise. Its present value was not, of course, its unregulated value. That would defeat the purpose of regulation by including its ability to achieve extortionate returns. Nor was its present value its regulated value. That would defeat protection of investors by, in a circular fashion, basing the permissible rates on the rates already set. Rather, the morally appropriate present value was the value set by the competitive market. Therefore, railroad and utility rate regulation was confiscatory only when it reduced the overall return below that obtainable from investing the enterprise's present value in a competitive enterprise carrying similar risks.

Under this analysis, the judicial task was to determine what the value of railroads or utilities would be if they operated in a competitive environment. The usual technique in value determination inquiries—recent sales of similar property between willing buyers and sellers—was obviously unavailable. But economic theory demonstrated that recent sales, i.e., present value, were equivalent

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162 San Diego Water Co. v. City of San Diego, 118 Cal. 556, 570, 50 P. 633, 637 (1897). See also White, Government Control of Transportation Charges (pt. 4), 47 Am. L. Reg. 355, 367 (1899); Note, Government Control of Transportation Charges; The Nebraska Freight Tax Case, 46 Am. L. Reg. 260 (1898).
163 San Diego Water Co. v. City of San Diego, 118 Cal. 556, 570, 50 P. 633, 637 (1897); id. at 587, 50 P. at 643-44 (Harrison, J., concurring); Steenerson v. Great N. Ry., 69 Minn. 353, 382-97, 72 N.W. 713, 718-24 (1897); id. at 410-12, 72 N.W. at 729-30 (Mitchell, J., concurring).
to the funds the buyer would have to expend to construct anew the desired enterprise, because all buyers had the option of building rather than buying.\textsuperscript{154}

Thus, the "reproduction cost" rule, like Brewer's original analysis and its prudent investment development, also grafted the competitive market onto the Constitution's conception of property; and it did so even more completely. Under the reproduction cost approach, railroad and utility investors who bought carefully—for example, at a foreclosure sale when prices were depressed—reaped the benefit of their acumen because the actual present reproduction cost of the facilities they purchased was higher than the price that they had paid. Similarly, those who constructed or bought when prices were high suffered the loss. As in fully private enterprises, the capitalist reaped the full measure of his abilities; the public neither shared the gain attending good choices nor subsidized the loss resulting from bad choices.\textsuperscript{155}

While making a stronger appeal to the norm of the free market, the reproduction cost rule's appeal to the norm of the nondiscretionary judicial role was at least as strong as the alternative approaches to the distinction between regulation and confiscation. To be sure, determination of present reproduction cost, especially in the railroad and utility context, was a complex task. Nonetheless, it was ultimately a factual inquiry and the judgments called for in deciding whether capital costs of one or more decades ago were "prudent" were at least as problematic as estimations of construction based on current prices, and perhaps more so.

Despite the theory's compatibility with traditional norms of the judicial role and its fuller treatment of railroads and utilities as private enterprises, reproduction cost analysis was originally a liberal's and not a conservative's theory. Due to three decades of declining capital costs, prudent investment analysis, which focused on original costs, and reproduction cost analysis, which focused on present costs, had dramatically different effects in application. The reproduction cost theory promised substantial rate reductions in

\textsuperscript{154} See Steenerson v. Great N. Ry., 69 Minn. 353, 383-84, 72 N.W. 713, 719 (1897).

\textsuperscript{155} Id. at 373, 72 N.W. at 715. See also infra note 176. For later expressions of this view, see H. Brown, Transportation Rates and Their Regulation 87-93 (1916); Dorety, The Function of Reproduction Cost in Public Utility Valuation and Rate Making, 37 Harv. L. Rev. 173, 179, 181 (1923).
comparison with the prudent investment theory, which by sheltering the higher historic investment created a rate base in excess of what railroads and utilities were actually using. Consequently, in the economic circumstances of the late nineteenth century, jurists who adopted reproduction cost analysis praised its treatment of railroads and utilities as private enterprises, subject to the risk of capital cost reductions. Accordingly, conservative antiregulatory jurists shunned the reproduction cost theory while more liberal proregulatory jurists embraced it.

In sum, in the mid-1890's the prudent investment and the reproduction cost theories, along with Brewer's original analysis, competed for acceptance as the framework to distinguish rate regulation from confiscation. Despite the judiciary's allegiance to nondiscretionary adjudication, the debate clearly involved more than the inherent logical appeal of these alternatives. The economic circumstances of the late nineteenth century—the declining price levels in capital construction—gave the competing theories widely different substantive impact. Thus, the judiciary's choice between them was highly, albeit subtly and confusingly, political.

16 In adopting reproduction cost theory, one court observed:

No guaranty was ever given by the state . . . that the price of materials and the cost of construction would not decline, or that capital invested in railroads should not be subject to like vicissitudes as capital invested in other enterprises. Modern improvements and other causes have continued to reduce the cost of construction of all kinds of new plants, or render them wholly worthless, and the state did not guaranty that those causes should not in like manner affect the capital invested in railroads [and utilities].

Steenerson v. Great N. Ry., 69 Minn. 353, 374, 72 N.W. 713, 715 (1897).

167 They were not, however, the only theories. One additional theory blended Brewer's analysis with a rejection of the distinction between bond and share holders to create an argument that rate regulation need only cover the railroad's or utility's operating expenses. Smyth v. Ames, 169 U.S. 466, 487-89 (1898) (argument of counsel). Another theory, based on Arthur Hadley's economic studies, concluded that because railroads were effectively limited by competition, they, like all other private enterprises, were immune to rate regulation more intrusive than the prohibition of extortionate charges. A. Hadley, supra note 8, at 101-08. See also Brief for Plaintiff-Appellee at 45-52, Smyth v. Ames, 169 U.S. 466 (1898) (available in New York City Bar Association Law Library); White, supra note 152, at 360. Hadley supported regulation in the form of prevention of discrimination. A. Hadley, supra note 8, at 108-24; Hadley, supra note 30, at 67.

These theories, however, were clearly identified with the radical left and right. Their variance from contemporary mainstream beliefs was too great to garner much following in the courts.
B. "The Rule in Smyth v. Ames"

In 1898, in a decision immediately recognized as a landmark in constitutional law, a unanimous Supreme Court enunciated the test that for the next forty years distinguished rate regulations from confiscations. The case, Smyth v. Ames, involved challenges to Nebraska's 1893 railroad rate legislation. The economic downturn of the early 1890's, which hurt both farmers and railroads, had led to a "state of war" between the Nebraska legislature and its eastern-owned railroads. Ignoring claims of the railroads and the state's own board of experts that Nebraska's railroads were as economically depressed and competitive as other enterprises, the legislature imposed rate cuts averaging 29.5% on intrastate shipments. Shareholders of three of the seven affected railroad companies brought suit in federal court under diversity jurisdiction to enjoin the legislature's rate schedule as confiscatory. The circuit court, on which Justice Brewer sat, found the statute confiscatory, and the state appealed.

The Court, in an opinion written by Justice Harlan, found the rate regulations unconstitutional. The Court focused solely on the impact of Nebraska's regulations on intrastate business and accepted the shareholders' view of the potential impact of the imposed rates on the railroads' profits. Although the state claimed that under the statute the railroads would still show handsome profits on local traffic, the Court, by extrapolating from data from the three immediately previous years, determined that five of the seven railroads would not receive sufficient revenues from local

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158 Matthews & Thompson, Public Service Company Rates and the Fourteenth Amendment, 15 Harv. L. Rev. 249, 264-65 (1901); Robinson, State Regulation of Railways, 166 N. Am. Rev. 398, 398-99 (1898); White, supra note 152, at 365.
159 169 U.S. 466 (1898).
160 The situation in Nebraska at that time is reviewed in Dixon, Railroad Control in Nebraska, 13 Pol. Sci. Q. 617 (1898).
161 Smyth, 169 U.S. at 528-29.
163 Smyth, 169 U.S. at 545-47.
164 Id. at 537.
traffic to cover allocated operating expenses.\textsuperscript{165} The other two companies' revenues, although covering operating expenses, would be insufficient to provide the companies "just compensation for the services rendered."\textsuperscript{166}

The result of Smyth \textit{v. Ames}, overturning Nebraska's rate legislation, did not necessitate an election among the various approaches distinguishing confiscations from regulations that were competing for the Court's imprimatur. Under the Court's factual determinations, all seven railroads' regulated revenues were insufficient to be upheld under any of the theories. The statutory rates neither covered any of the railroad's prudentially assumed necessary charges as required by Justice Brewer's analysis nor allowed sufficient return on their original investment or present reproduction cost to satisfy those approaches.\textsuperscript{167} Yet Smyth \textit{v. Ames} became a landmark case because the Court's rationale indicated the approach it favored.\textsuperscript{168} As Justice Harlan wrote in an often quoted

\textsuperscript{165} The Court allocated expenses by determining that in the three previous years local traffic had generated 7.5% of total revenues generated within Nebraska. Id. at 534. Local traffic, therefore, was expected to cover 7.7% of operating expenses because local traffic was, according to expert testimony, at least 10% more expensive to handle than through traffic. Id. at 528-39; Ames \textit{v. Union Pac. Ry.}, 64 F. 165, 186 (C.C.D. Neb. 1894).

\textsuperscript{166} 169 U.S. at 546-47. Justice Brewer, still using the analysis from his circuit court opinion, concluded that the two railroads' revenues, although sufficient to meet operating expenses, were insufficient to cover prudentially incurred bond interest and other necessary charges. Id. at 543-47.

\textsuperscript{167} For example, the Court calculated that had Nebraska's legislation been in force, the Union Pacific would have shown $16,000 and $8,000 surpluses over operating expenses in 1892 and 1893 respectively. The Union Pacific had 467 miles of track in the state that were bonded at $70,000 per mile (of which $32,000 per mile was under congressional authorization, and which the circuit court took as the minimum prudent investment). Nebraska's own experts admitted that the track and related facilities would cost $30,000 per mile to reconstruct at present prices. See 169 U.S. at 537, 548; Ames \textit{v. Union Pac. Ry.}, 64 F. 165, 186-87 (C.C.D. Neb. 1894). Under these assumptions, using 6% as an appropriate return (as the circuit court did, id.) and allocating 7.5% of total revenue requirement to local traffic, see supra note 165, the surplus over expenses from local traffic should have been $147,105 to cover its share of bonded interest, $67,248 to cover its share of the minimum prudent investment, and $63,045 to cover its share of a competitive return on present value. (The circuit court calculated that for the surplus to have been 6% on present value it should have been $42,030; but the court was using a reproduction cost value of $20,000 per mile which represented cost of track without related facilities. 64 F. at 187.)

\textsuperscript{168} Over two decades later, when Smyth \textit{v. Ames} became the center of political and legal controversy, see infra Part IV, commentators who disliked the Court's holding rigorously analyzed it for the narrowest possible holding. By disregarding the Court's language and concentrating on the subsequent cases' results in light of the issues presented, they argued that neither Smyth nor any other case during the next quarter century necessarily stood for
the basis of all calculations as to the reasonableness of rates . . . must be the fair value of the property being used [by a railroad] for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. 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.  

Removed from its historic context, this passage does not seem to elect among the competing theories. The central concepts, a "fair return" on the "fair value" of the railroads' property, are intrinsically ambiguous. "Fair return" may or may not extend beyond operating expenses and necessary charges and encompass a competitive stock dividend. "Fair value" may refer to original as well as replacement cost. Nor are these locutions, when removed from their context, clarified by the potpourri of factors that Justice Harlan indicated a court might consider in making its determination. This passage, therefore, seems guilty of the criticisms made of it a quarter century later (when Smyth v. Ames began its fall from favor170) that substantively "[i]t has the virtue of considering about everything that had been suggested by the attorneys on both sides"171 and methodologically "there is no rigid principle at all, but that under the guise of some such soothing phrase, as reasona-

the proposition that the Court had chosen reproduction cost over the prudent investment rule. No one denied that Brewer's analysis had been rejected. See, e.g., J. Bauer & N. Gold, supra note 149, at 73-74. But if one reads the opinions for their language, their assumptions, and their animating force rather than for their most narrowly circumscribed "holding," they support the conclusions developed in this article.

169 169 U.S. at 546-47.
170 See infra Part IV.
171 Goddard, supra note 149, at 656.
ble value, all difficulties of theory shall be veiled, and embarrassing commitments avoided.”¹¹²

Nonetheless, no such equivocation marked the Court’s intention,¹⁷³ the case’s subsequent development,¹⁷⁴ or its understanding by contemporary commentators.¹⁷⁵ Smyth v. Ames adopted the liberals’ reproduction cost approach to rate regulation,¹⁷⁶ as evidenced in part by the fact that all subsequent decisions assumed that the “fair” return to which the regulated company was entitled was a competitive dividend. All later litigation on this point involved the extent of that return, not the right to it.¹⁷⁷ Thus, there was no doubt that the Court had rejected Justice Brewer’s initial analysis, which allowed no dividend on stock.¹⁷⁸

Similarly, all subsequent decisions made clear or assumed that “fair” value was the present value of the company’s assets as required by the reproduction cost approach and not their original

¹⁷³ See infra text accompanying notes 177-81.
¹⁷⁴ See infra text accompanying notes 184-87.
¹⁷⁵ See infra text accompanying notes 182-83.
¹⁷⁶ The state had argued for this approach, thinking that the evidence supported a finding of sufficient profits. 169 U.S. at 489-93 (argument of counsel); id. at 537. See Goddard, supra note 149, at 655-56.
¹⁷⁷ See generally J. Bauer & N. Gold, supra note 149, at 341-43; Matthews & Thompson, supra note 158, at 268-69.
¹⁷⁸ See supra text accompanying notes 134-35.
cost as required by the prudent investment theory. In writing the opinion in the Court's next rate regulation case, decided the year after Smyth v. Ames, Justice Harlan clarified his support of the reproduction cost valuation method, calling for a "fair return upon the reasonable value of the property at the time it is being used for the public." The Court subsequently emphasized this new language in the immediately succeeding rate regulation cases, all decided unanimously in opinions written by justices as diverse in their political and jurisprudential outlook as Holmes and Peckham.

Reflecting on the Court's decisions, almost all contemporary commentators concluded that the Court had adopted the reproduction cost theory. Even those commentators who continued to argue against reproduction cost as the appropriate approach to rate regulation generally acknowledged that they argued against the Court's adopted rule.

In cases after Smyth, the Court attempted to define its approach by clarifying the components of reproduction cost. Some later commentators, however, misread these decisions to cast doubt on whether Smyth had actually adopted the reproduction cost approach, misconceiving that approach to be a simple-minded search for the present cost of rebuilding existing facilities at current prices. Rather, the Court's decisions followed true reproduction cost theory, which attempted to secure railroad and utility inves-

179 See supra text accompanying notes 143-45, 154.
180 San Diego Land & Town Co. v. City of National City, 174 U.S. 739, 757 (1899).
181 Stanislaus County v. San Joaquin & King's River Canal & Irr. Co., 192 U.S. 201, 215 (1904) (Peckham, J.); San Diego Land & Town Co. v. Jasper, 189 U.S. 439, 442 (1903) (Holmes, J.). See Willcox v. Consolidated Gas Co., 212 U.S. 19, 52 (1909); City of Knoxville v. Knoxville Water Co., 212 U.S. 1, 9, 13 (1909). See also Cotting v. Kansas City Stockyards Co., 183 U.S. 79, 91 (1901) (Brewer, J.) ("[The Court] has declared that the present value of the property is the basis by which the test of reasonableness is to be determined, although the actual cost is to be considered.").
182 Bailly, The Legal Basis of Rate Regulation, 11 Colum. L. Rev. 532, 533-38 (1911); Matthews & Thompson, supra note 158, at 266-67.
183 See W. Ripley, Railroads: Finance and Organization 346 (1915); Whitten, Fair Value for Rate Purposes, 27 Harv. L. Rev. 419, 433-34 (1914). After the hyperinflation brought on by World War I made adherence to the test in Smyth v. Ames so much more controversial, commentators began to imply that present value was not the adopted focus. See J. Bauer & N. Gold, supra note 149, at 73-74; H. Hartman, Fair Value 112-13 (1920); Goddard, The Evolution of Cost of Reproduction as the Rate Base, 41 Harv. L. Rev. 564, 565-69 (1928); supra text accompanying notes 170-72.
tors the profits of a normal competitive enterprise, expose them to the same risk of loss, and bar them from profits attributable to their privileged position. Thus, the Court held that any determination of present reproduction value must include the depreciation of the existing plant.\textsuperscript{184} The Court also rejected a utility's request to include customer "good will," an important business asset, in reproduction cost valuation.\textsuperscript{185} Inclusion of good will was improper in this setting, the Court held, because the customers were bound to the utility due to the latter's governmental privilege.\textsuperscript{186} Similarly, the Court refused to appraise railroad land at its uniquely higher "railroad-use" value because to do so would constitutionally guaranty railroads profits resulting from their state-granted privileges.\textsuperscript{187}

\textsuperscript{184} City of Knoxville v. Knoxville Water Co., 212 U.S. 1 (1909). Justice Moody stated:

\begin{quote}
The cost of reproduction is one way of ascertaining the present value of a plant . . . but that test would lead to obviously incorrect results, if the cost of reproduction is not diminished by the depreciation which has come from age and use . . .

The cost of reproduction is not always a fair measure of the present value of a plant which has been in use for many years. The items composing the plant depreciate in value from year to year in a varying degree.
\end{quote}

Id. at 9-10.

These remarks must be understood as using the reproduction cost in a narrower sense than connoted in reproduction cost theory. They are a reaffirmation of that theory rather than a rejection of it. The distinction drawn here between reproduction cost in a simplistic and narrow sense and the scope of the theory was observed by early writers. Bailly, supra note 182, at 549; Matthews & Thompson, supra note 158, at 267. Later commentators apparently missed the distinction. E.g., H. Hartman, supra note 183, at 121 (using case as evidence that Court had not adopted the reproduction cost approach).

\textsuperscript{185} Willcox v. Consolidated Gas Co., 212 U.S. 19, 52 (1909).

\textsuperscript{186} Id. See also Des Moines Gas Co. v. City of Des Moines, 238 U.S. 153, 163-65 (1915). On "good will" in rate regulation, see 2 J. Bonbright, The Valuation of Property 1146 (1937). Many economists disagreed with the Court's handling of the "good will" issue, and the Court eventually retrenched. See infra note 229. But see J. Bauer & N. Gold, supra note 149, at 302-03.

\textsuperscript{187} The Minnesota Rate Cases, 230 U.S. 352, 453-54 (1913). All sides in the controversy, as well as the master in equity, assumed that real estate owned by the companies and used for terminals and rights of way should be valued at present, not original, cost. The state, however, objected to the master's appraising the land's value at 25% above contiguous, similarly situated parcels due to its "railway value." Id. at 453. Terming such an increment "speculative," the Court held that it was inappropriate to appraise land "beyond the value of similar property owned by others, solely by reason of the fact that it is used in the public service." Id. at 454. On railroad and utility land valuation, see J. Bauer & N. Gold, supra note 149, at 239-60; 2 J. Bonbright, supra note 186, at 1141-42.

After the Court's correction of its "good will" precedents, see supra text accompanying notes 185-86 and infra note 229, there was only one case that theoretically departed from the reproduction cost approach. In that case, Des Moines Gas Co. v. City of Des Moines, 238
The doubt that later arose concerning whether the Court adopted the reproduction cost approach was also due, in part, to later commentators’ misconceptions of Justice Harlan’s test as involving a discretionary re-weighing of the “fairness” of the governmentally imposed rates. Harlan did establish a lengthy list of “matters for consideration” that were “to be given such weight as may be just and right in each case.” But the weighing, in Harlan’s view, went toward the consideration of a “factual” matter: the present value of an enterprise. As a result, Justice Harlan’s list of “matters for consideration” in the determination of “fair value” were to provide guidance for trial courts by describing various types of evidence one might consider in deter-

U.S. 153 (1915), the company had laid its gas mains before the city streets were paved. After the streets were paved, the Court upheld the city's refusal to value existing mains at the increased cost of placing mains in paved streets.

Thus, all but one case support the contention that the Court was pursuing reproduction cost theory. Nonetheless, there were grave departures from reproduction cost theory in the practical application of the precedents. This was used by the Court's opponents to claim that it was not pursuing that approach. See infra text accompanying notes 212-14.

188 See supra text accompanying notes 171-72; supra note 168.

189 169 U.S. at 547. For those considerations, see supra text accompanying note 169.

190 Henderson, Railway Valuation and the Courts, 33 Harv. L. Rev. 902, 910-11 (1920).

191 Jurists had always appreciated that factual determinations involved judgmental weighing of various evidentiary considerations. Historically, Liberal jurists devised a number of strategies to limit the inescapable discretionary power judges exercise through manipulation of factual determinations. The most important device was the use of the jury for determination of matters of fact. See, e.g., C. Montesquieu, supra note 24, at 202-03; The Federalist No. 83, supra note 23, at 500-01 (A. Hamilton). As a consequence, when a suit at law involved the constitutionality of rates, the Court, in an opinion written by Justice Brewer, held that judges could not direct verdicts where conflicting evidence existed. Chicago & G.T. Ry. v. Wellman, 143 U.S. 339, 343-44 (1892) (judge's refusal to direct jury to find challenged rates unconstitutional was proper in a "friendly suit" between a railroad and one of its passengers). See also Notes of Recent Decisions, 24 Am. L. Rev. 516, 527 (1890) ("What is a reasonable charge for a given service by a corporation engaged in public employment, when the question comes before a judicial court for determination, is a question of fact for a jury."). Nonetheless, the Court also held, upon such grounds as avoidance of a multiplicity of suits and lack of an adequate remedy at law, that suits contesting governmental rate schedules fell within traditional equity jurisdiction. See, e.g., Smyth, 169 U.S. at 517-18; Chicago & N.W. Ry. v. Dey, 35 F. 866, 882 (C.C.S.D. Iowa 1888) (Brewer, J.). As this avoided juries, it became the favored means for railroads and utilities to contest rate regulations and imposed upon judges the required arduous factual determinations.

192 See supra text accompanying note 169.

193 Henderson, supra note 190, at 910-11.
mining the fact of present value. The considerations were not ultimate facts for courts to determine but rather possible factors to aid them in accurate valuation.\textsuperscript{194}

In sum, in \textit{Smyth v. Ames} the Court established present value, as called for by the liberal's reproduction cost approach, and not historic cost, as required by the conservatives' prudent investment analysis, as the basis for all calculations of rates. Jurists understood reproduction cost theory, however, not to involve a simple reconstruction of the actual property nor to require a return on all of the enterprise's assets. The existing plant might be obsolete, inefficiently designed, or too large for its service area.\textsuperscript{195} Some assets that would be highly valued in a private sale were governmentally granted privileges.\textsuperscript{196} Because under normal competitive conditions the public would pay no more for a product or service than a competitive return on a freely entering competitor's capital costs, that was the amount the Constitution guarantied railroad and utility enterprises.\textsuperscript{197} Railroads and utilities were entitled to an equivalent of competitive market returns—morally and politically justified profits—not returns attributable to their monopolistic and legally privileged positions. "Reasonable" rates that would "‘be just both to [regulated enterprises] and to the public’" were the rates necessary to generate free market profits.\textsuperscript{198} Therefore, the judiciary

\textsuperscript{194} Original investment, for example, was on that list not as the ultimate fact sought to be determined, but as a permissible consideration in determining the ultimate fact of present value. In cases where the existing plant or parts of it were constructed recently, actual investment would be excellent evidence of present value. Coal & Coke Ry. v. Conley, 67 W. Va. 129, 189-91, 67 S.E. 613, 639-40 (1910); Bailly, supra note 182, at 541 & n.31.

In general, one must remember that the Court decided \textit{Smyth v. Ames} before physical evaluation of railroad and utility properties was widespread, see Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n, 262 U.S. 276, 309-10 (1923) (Brandeis, J., dissenting), and in 1898 Justice Harlan was seeking to provide alternative techniques to determine present value. The ability to undertake physical evaluation began with the general establishment of administrative commissions charged with this function after 1907. J. Bauer & N. Gold, supra note 149, at 74. The ICC was ordered to determine the "fair value" of the nation's railroads by the Valuation Act, Pub. L. No. 400, § 19a, 37 Stat. 701, 701 (1913). See Tunell, Valuation for Rate Making and Recapture of Excess Income, 35 J. Pol. Econ. 725, 728 (1927).

\textsuperscript{195} See Bailly, supra note 182, at 547-48; Matthews & Thompson, supra note 158, at 266-67; supra text accompanying notes 154-56, 184.

\textsuperscript{196} See supra note 187 and accompanying text.

\textsuperscript{197} See 2 J. Bonbright, supra note 186, at 1086-89; Dorety, supra note 155, at 183.

\textsuperscript{198} \textit{Smyth}, 169 U.S. at 546 (quoting Covington & Lexington Turnpike Rd. Co. v. Sanford, 164 U.S. 578, 598 (1896)).
should limit legislative power over railroad and utility rates not through discretionary re-weighing of the elements of "fairness" but through factual determination of the competitive return on the present competitive market value of the enterprise.¹⁹⁸

IV. THE TRANSFORMATION OF CONSTITUTIONAL LAW

A. The Initial Attack on the Substance of Smyth v. Ames

In Smyth v. Ames, liberal views prevailed. Nevertheless, conservatives accepted the decision. The conservatives' acquiescence related in part to their own mixed reception of the prudent investment theory, which had the fault of depicting railroads and util-

¹⁹⁸ As criticism of Smyth v. Ames mounted, liberals emphasized the extreme complexity of the required factual judgments required by that case to undermine the Court's claim that the "rule in Smyth v. Ames" was within the traditional norms that distinguished adjudication from legislation. See infra text accompanying notes 212-13. Until Smyth was discredited, the "rule" was conceived as methodologically traditional yet embracing the liberals' distinction between rate regulation and confiscation.

This conception is unsurprising given that Justice Harlan, the opinion's author, was himself both substantively liberal and methodologically traditional. His liberalism on that conservative Court has been well noted. See A. Paul, supra note 2, at 180-81, 211-12; Bartosic, The Constitution, Civil Liberties, and John Marshall Harlan, 46 Ky. L.J. 407, 415-44 (1958).

That he reached liberal results through traditional methodology is not usually emphasized. Yet, for example, his dissent in Plessy v. Ferguson, 163 U.S. 537, 552-64 (1896) (Harlan, J., dissenting), the case in which the Court upheld the "separate but equal" doctrine, was in part based upon the impossibility of judicial differentiation between legislatively enforced racial segregation in railroad cars and legislatively enforced racial segregation in all other places of public gathering, such as the streets. He also pointed out the impossibility of judicial differentiation between racial and religious segregation. Noting that the only answer given in argument to the issue of the distinction between these situations was "that regulations of the [latter] kind . . . would be unreasonable," Justice Harlan observed:

Is it meant that the determination of questions of a legislative power depends upon the inquiry whether the statute whose validity is questioned is, in the judgment of the courts, a reasonable one, taking all the circumstances into consideration? . . . I do not understand that the courts have anything to do with the policy or expediency of legislation. . . . If the power exists to enact a statute, that ends the matter so far as the courts are concerned.

Id. at 558-59. See also Standard Oil Co. v. United States 221 U.S. 1, 82, 97 (1911) (Harlan, J., concurring and dissenting) (opposing "rule of reason" construction of Sherman Antitrust Act); Hurtado v. California, 110 U.S. 516, 538 (1884) (Harlan, J., dissenting) (opposing a discretionary conception of procedural guaranties of due process); Kennedy, Classical Legal Thought, Toward an Historical Understanding of Legal Consciousness: The Case of Classical Legal Thought in America, 1850-1940, 3 Research L. & Soc. 3, 9-14 (1980) (comparing methodologies of Justices Peckham and Harlan in their respective majority and dissenting opinions in Lochner).
ties more as "agents of the state" than as private enterprises. In addition, conservatives viewed the reproduction cost theory as sufficiently restrictive of governmental power to allay their fears regarding the immediate imposition of large rate reductions. In a state-by-state analysis of the expected impact of *Smyth v. Ames*, Harry Robinson, the editor of Railway Age magazine, compared railroad revenues and profits with present construction costs and concluded that the *Smyth v. Ames* holding potentially allowed large rate reductions only in the eastern seaboard states, where rate regulation was not a real threat. In the midwestern and southern states, where the public clamor for rate reductions was most intense, the reproduction cost theory placed, in Robinson's words, an "absolute veto" on state-compelled reductions. Even though the rejected prudent investment approach would have been even more protective of railroad and utility interests, Robinson still found *Smyth v. Ames* "to be of the greatest value to the railways of the country, especially in the Western and Southern States."

Economic circumstances, however, undid the liberal triumph. Over the first decade and a half after *Smyth v. Ames* the price level slowly rose. During these years judges and legal commentators devoted themselves to elaborating and refining reproduction cost analysis, discussing its proper application to varied fact patterns. The general absence of critical commentary reflected both the case's general acceptance and that moderate inflation had established a rough equivalence in outcome whether reproduction cost or prudent investment theory was used as a test of constitutional limitation.

But during the first World War, the price level rose almost

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200 See supra text accompanying notes 147-48.
201 Robinson, supra note 158, at 407.
202 Id. at 405.
203 Id. at 398.
204 See, e.g., Bailly, supra note 182; Matthews & Thompson, supra note 158; supra text accompanying notes 180-81, 184-87.
205 J. Bauer & N. Gold, supra note 149, at 73; Goddard, supra note 183, at 566. Economists began criticizing the rule much sooner than lawyers. See infra text accompanying note 209. The only critical commentaries to appear in legal publications before the wartime inflation were Eshleman, Control of Public Utilities in California, 2 Calif. L. Rev. 104, 113-15 (1914), and Whitten, supra note 183 (Whitten was an economist).
150% in seven years. The relative equivalence of historic and present costs was broken; decidedly different results once again followed from whether reproduction cost or prudent investment analysis set the limits on government rate regulation. This time, however, the situation of the 1890's was exactly reversed: now present costs were markedly higher than historic costs.

In these economic circumstances, Smyth v. Ames became a fetter on governmental power. Indeed, under the holding of that case the constitutionally mandated limitations on regulated rates were so high that few railroads and utilities insisted on their maximum allowable charges. With wartime inflation, Smyth v. Ames came to mean that railroads and utilities could charge what the market would bear and government was constitutionally unable to moderate their charges. By 1920, the Smyth v. Ames rule had become extremely controversial. This time, however, liberals and conservatives found that they had exchanged positions in the reproduction cost-prudent investment controversy.

In mounting their attack on Smyth v. Ames, liberal jurists turned to an extensive economic critique developed in the pre-war years. Perhaps reflecting the economists' greater sensitivity to the implications of price level shifts or their greater involvement with theoretical purity, Smyth v. Ames had become a subject of controversy within the economics profession before wartime inflation made the case a subject of intense political controversy. Since the 1905 meeting of the American Economic Association, economists regularly had debated the relative strengths and weaknesses of the reproduction cost and prudent investment theories.

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206 Between 1913 and 1920 the price level rose 150% and during the 1920's settled at around 75% higher than the pre-war level. Not until the economic collapse of 1929 did the price level moderate, and during the Depression it even fell below the pre-war level. See, e.g., J. Bauer & N. Gold, supra note 149, at 77, 105; United States Dep't of Com., supra note 138, at 199, 200.

207 For the outcomes of the differing tests in the 1890's, see supra text accompanying notes 149, 156. For impact of price movement on legal opinion, see J. Bauer & N. Gold, supra note 149, at 103-04.

208 J. Bauer & N. Gold, supra note 149, at 104; Richberg, Value—by Judicial Fiat, 40 Harv. L. Rev. 567, 581-82 (1927).

209 See, e.g., W. Ripley, supra note 183, at 346-70; R. Whitten, Valuation of Public Service Corporations 66-67, 82-87 (1914); Bauer, Bases of Valuation in the Control of Return on Public Utility Investments, 6 Am. Econ. Rev. 568 (1916) [hereinafter cited as Bauer, Bases of Valuation]; Lincoln, The Control of Return on Public Utility Investment, 6 Am. Econ. Rev. 869 (1916); National Association of Railway Commissioners, Proc. 25th Ann. Conven-
The economists' critiques, whether in support of or opposition to the *Smyth v. Ames* rule, were based on a functional analysis of prices and price control. In economic theory, prices served a crucial function in the efficient allocation of resources. If rates were too high, excessive profits would attract too much capital into railroad and utility investment. The result would be an oversupply of railroad and utility facilities and other problems of a misallocation of resources. If rates were too low, inadequate profits would attract insufficient capital into railroad and utility investment. The result would be an undersupply of railroad and utility facilities, with its associated misallocated resource problems. Rate regulation, as a form of price control, should therefore aim at generating sufficient profits to attract capital for necessary future investment. Accordingly, the economists' debate over *Smyth v. Ames* centered on its ability to accomplish this economic task. From 1905 on, with increasing frequency as the price level rose, economists debated whether or not the approach legitimized in *Smyth v. Ames* was irremediably incapable of fulfilling its economic function.

The economists who objected to the reproduction cost approach...
believed that part of the problem with *Smyth v. Ames* was its practical application. Valuation through establishment of present reproduction costs of extensive and complex properties normally was based upon largely conjectural estimations and appraisals. Although employing "experts," interested parties always made these estimations and presented them in a highly politicized atmosphere. They were inevitably suspect and usually wide of the mark.\footnote{2 J. Bonbright, supra note 186, at 1088-89; Bauer, supra note 211, 262-67; Whitten, supra note 183, at 427.}

Even if the estimates of present reproduction cost were accurate, they frequently had an incorrect focus. Reproduction cost theory called for estimating the present cost of reproducing adequate service, not the actual existing plant. In a technologically innovative industry, imaginative creation of a "modern" plant was such a hypothetical, complex, and intangible undertaking that it was not attempted. As administered, the reproduction cost approach estimated the cost of reproducing existing facilities and thus focused on a theoretically inappropriate cost.\footnote{2 J. Bonbright, supra note 186, at 1087-89; Whitten, supra note 183, at 427-29.}

Even to the extent that *Smyth v. Ames* focused on appropriate costs and resulted in accurate valuations, it involved vast commitments of time, labor, and expense by commissions already overwhelmed with responsibilities. The ability of the regulated enterprises to challenge the conjectural valuations through layers of judicial process aggravated the commitment of time and expense further. Moreover, the end result of this time-consuming process was ephemeral. By focusing on present value, rates that were valid one moment were arguably invalid the next. Rather than providing the definite, clear, and simple rule called for by a functional analysis, the *Smyth v. Ames* rule was an administrative nightmare and an inaccurate one at that.\footnote{2 J. Bonbright, supra note 186, at 1092-97; Bauer, Bases of Valuation, supra note 209, at 568-69.}

Beyond its administrative difficulties, the economists who objected to reproduction cost analysis also claimed that *Smyth v. Ames* was theoretically flawed. Reproduction cost theory derived from the economic theory that present reproduction cost was the equivalent of the value the properties would have in a competitive market. The economists who attacked reproduction cost theory de-
nied this correspondence. They argued that the market value and present reproduction costs were equivalent only for small-scale enterprises which required small, fluid capital investments. Only under conditions of relatively easy new entry would present capital costs determine the charges of established enterprises. The economies of large-scale enterprises, involving huge sunk and fixed capital costs, were different. As these firms had already committed capital and could not easily remove it, competitive pricing reflected the marginal cost of providing new services. Any return over this marginal cost was acceptable because it would go to cover fixed overhead costs. Therefore, the competitive rate large capital-intensive enterprises charged was not determined solely by their capital investment as were rates charged by small, less capital-intensive enterprises. Consequently, the reproduction cost of the large enterprise was not an accurate reflection of its market value.215

To these economists, the prudent investment approach stood in marked contrast. It was the essence of administrative simplicity. Regulatory commissions empowered to oversee investment could establish prudent investment with relative ease.216 Commissions could set the rate of return to attract new capital by simply using


Professor Hadley, no friend of the prudent investment approach, see supra note 101, made the same points. See Hadley, The Meaning of Valuation, 18 Am. Econ. Rev. Supp. No. 1, at 173, 177-78 (1928). Indeed, he had observed the implications of the change from small- to large-scale capital requirements as early as 1892 when he wrote:

We have reached a point where added investment of capital does not ensure fair prices. As long as the fixed capital is relatively small and the circulating capital relatively large, competition will never permit rates to be much above cost of service and will cease when rates fall below that standard. But if the capital charges are large, as in a modern factory or still more clearly in a consolidated railroad system, the standard which will bring in new capital is very much higher than that which will cause existing capital to contract its operations. The automatic character of price regulation, as it was produced by competition a hundred years ago, is now apparently gone, and in some measure, though not so far as is generally supposed, it is gone in reality. Hadley, supra note 30, at 60. See also A. Hadley, supra note 8, at 67-78; Hadley, supra note 30, at 66.

216 Some complexity was introduced by the desire to avoid retrospective application to investments made prior to the switch to the prudent investment approach. See, e.g., Whitten, supra note 183, at 432-36.
whatever rate was in fact required to attract the capital they thought needed to be invested in the enterprise. The prudent investment approach was in theory and practice functionally superior to reproduction cost analysis.\textsuperscript{217}

Thus, when the price level's rise was large enough to renew controversy within the legal profession over the merits of the two approaches to rate regulation, liberal jurists were able to turn to the economists' critical commentary and more or less incorporate it as their own.\textsuperscript{218} Through these arguments, liberal jurists questioned the legal propriety of the Smyth v. Ames rule and put in issue one of the most important areas of constitutional law.\textsuperscript{219}

Nevertheless, conservative jurists confronting the liberals' attack remained unmoved. Despite the trenchant critiques, reproduction cost theory still had support and the prudent investment approach still had doubters among professional economists.\textsuperscript{220} Some economists argued that the prudent investment approach had its own administrative problems. To attract sufficient new investment capital, they pointed out, that theory required setting railroad and

\textsuperscript{217} 2 J. Bonbright, supra note 186, at 1084-86; Bauer, The Control of Return on Public Utility Investments, 31 Pol. Sci. Q. 260, 262-68, 276-84 (1916); Bauer, supra note 211, at 267-76; Bonbright, supra note 209, at 595-614; Whitten, supra note 183, at 425-26, 432 (using "normal actual capital cost" as label for prudent investment approach).

\textsuperscript{218} A few of the leading legal commentators and publications are Goddard, Fair Value of Public Utilities (pt. 2), 22 Mich. L. Rev. 777, 777-85 (1924); Hale, Valuation and Rate Making, 80 Stud. Hist. Econ. & Pub. L. (No. 185, 1918); Henderson, supra note 190; Richberg, A Permanent Basis for Rate Regulation, 31 Yale L.J. 263 (1922).

Lawyers added very little to the points economists made. Legal commentators did, however, analyze Smyth v. Ames and subsequent cases to show that no case, when read narrowly, had held that the reproduction cost rule was the constitutionally compelled rule. See, e.g., Goddard, supra, at 785-92; Richberg, The Supreme Court Discusses Value, 37 Harv. L. Rev. 289, 291 (1924) [hereinafter cited as Richberg, Supreme Court].

\textsuperscript{219} The liberal jurists' use of the economists' commentary was significant for another reason. It involved the jurists in drawing from nonlegal sources, employing functional analyses, considering practical administration, using contemporary social scientific theory, and investigating what courts and administrative agencies did, as well as said. It was, in short, one of the earliest extensive "legal realist" critiques. For discussion of the contemporaneous appearance of legal realist critiques in other areas of legal controversy, see E. Purcell, supra note 7, at 74-94; G. White, Tort Law in America 63-113 (1979); Schlegel, American Legal Realism and Empirical Social Science, 28 Buffalo L. Rev. 459 (1979).

\textsuperscript{220} This literature is cited and reviewed in 2 J. Bonbright, supra note 186, at 1086-89.

Hadley insisted on a third analysis. He thought that railroads and utilities, in the long run, were sufficiently subject to market pressures that rates set for commercial reasons would operate fairly and efficiently. See, e.g., A. Hadley, supra note 8, at 100-08; Hadley, supra note 101, at 426-28. Professor Cabot of Harvard pursued the same line of analysis. See Cabot, Public Utility Rate Regulation, 7 Harv. Bus. Rev. 257 (1929).
utility rates of return higher than generally prevailing rates to compensate investors for such unique limitations on their investments' potential as the inability to realize unearned increments on land values, the inability to profit from unusually efficient management, and the inability to protect the purchasing power of their dividend stream from inflation. But it was unrealistic to expect politicians seeking to ingratiate themselves with a public searching for cheaper rates to set rates sufficiently above normal rates of return. Nor was it credible that politicians would long stand by the bargains they had struck if a drop in the price level were to make cheaper rates available through new construction.

Some economists also argued that the prudent investment approach had its own theoretical flaws. By focusing on historic costs, the prudent investment approach chronically mispriced railroad and utility services, thereby misallocating resources. On the one hand, the higher rate of return necessary to attract investors to these industries resulted in customer rates that were proportionately higher than charges in other industries. This comparative differential in price would continuously distort user preferences. On the other hand, because of the succession of business cycles, railroad and utility prices would be continually out of phase with the current economic climate. During economic downturns railroad and utility services would be priced too high, reflecting investments made during prosperous times; during economic upturns, they would be priced too low, reflecting investments made during depressed times.

Therefore, some economists still concluded that despite its administrative complexity, the reproduction cost approach was decidedly preferable. Given this continued, if less than universal, sup-

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221 The argument was not that investors deserved to profit from "unearned increments" but that most investors had the opportunity to realize such gains. Under the prudent investment approach, railroad and utility investments would be uniquely disadvantaged and therefore would require a higher return to equalize the disparity. See H. Brown, supra note 155, at 88-89.

222 H. Brown, supra note 155, at 87-93; Brown, Railroad Valuation and Rate Regulation, 33 J. Pol. Econ. 505, 506-20 (1925); Hadley, supra note 215, at 177-78; Hadley, supra note 101, at 423-24, 432; Lincoln, supra note 209, at 870-71; Valuation of Public Utilities—Discussion, supra note 210, at 213-14 (remarks of Professor Brown).

223 In responding to the most fundamental criticism, that reproduction cost theory did not reflect the realities of large-scale enterprise, Professor Harry Gunnison Brown concluded:
port for the reproduction cost approach among economists, conserva-
tive jurists held their ground in the face of the liberal jur-
ists' attack on Smyth v. Ames. Thus, when the renewed contro-
versy between advocates of the replacement cost and prudent in-
vestment approaches surfaced in 1923 in Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission, a divided Supreme Court reaffirmed its adherence to Smyth v. Ames and the reproduction cost analysis. Indeed, in subsequent opinions, under the leadership of Justice Butler, the Court more

If it be argued that a plant once built should be used even if rates must be as low as operating costs, it can be argued with no less cogency that the plant should not be built—or have been built—unless the rates it can charge are likely to make the building worth while. As a long-run public policy, therefore, it seems to me that a return ought to be allowed, if it can be secured. . . . [U]ndesirable turning of industry from one locality to another, or other economic wastes, are likely to be caused by a policy which does not allow—if the customers can be made to pay it—a fair return on current cost of construction.

Valuation of Public Utilities—Discussion, supra note 210, at 213 (remarks of Professor Brown). See also 2 J. Bonbright, supra note 186, at 1086 & nn.11-13 (citing authorities); Lincoln, supra note 209, at 872-73.

A decided majority of published economic papers and books favored the prudent investment approach.

No less a jurisprudential figure, for example, than Learned Hand remained unpersuaded that reproduction cost theory should be abandoned. Reflecting on the liberals' critique, he stated in a case decided shortly after the outbreak of the legal controversy that despite certain valuation problems, the "component elements" of a railroad or utility were capable of valuation with "fair accuracy." Consolidated Gas Co. of New York v. Newton, 267 F. 231, 238-39 (S.D.N.Y. 1920). Hand later became more critical. See supra note 172 and accompanying text. For another legal commentator who considered and thoughtfully rejected the liberal critique, see Dorety, supra note 155, at 191 (Dorety was General Counsel of the Great Northern Railway).

Justice Butler authored numerous rate regulation opinions, particularly two crucial cases, Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n, 262 U.S. 679 (1923), and McCardle v. Indianapolis Water Co., 272 U.S. 400 (1926), which are discussed infra note 229.

Justice Butler was a leading railroad attorney whose appointment to the Court in 1922 was believed to be related directly to the renewed rate regulation controversy. See D. Danelski, A Supreme Court Justice Is Appointed 132, 137-38, 186-87 (1964). The Senate was sufficiently concerned to extract a commitment from him not to participate in railroad rate decisions. But Butler circumvented this restriction by participating in and authoring decisions concerning utility rates. See D. Pearson & R. Allen, The Nine Old Men 119 (1936); F. Ro-
and more aggressively asserted the place of reproduction cost analysis.\textsuperscript{229} In short, faced with the liberal onslaught, the Court’s conservative majority\textsuperscript{230} became more insistent on the propriety of its
dell, Nine Men 220 (1955). Professor Rodell describes Butler as “the least intellectually gifted of the [members of the Court], . . . the farm boy become millionaire by his monolithic legal services to the Great Northern, Northern Pacific, and Chicago, Burlington & Quincy Railroads.” Id. at 220. One work’s chapter on Butler is entitled “The Bruiser.” D. Pearson & R. Allen, supra, at 116.

\textsuperscript{229} In Bluefield Water Works & Improvement Co. v. Public Serv. Comm’n, 262 U.S. 679 (1923), and McCardle v. Indianapolis Water Co., 272 U.S. 400 (1926), both written by Justice Butler, the Court came the closest it had theretofore come to insisting that present reproduction cost of the actual plant was in all cases the only or decisive factor to be consulted in determining a railroad’s or utility’s present value. For the shocked liberal reaction, see, e.g., J. Bauer & N. Gold, supra note 149, at 156-57; Cook, supra note 172, at 320-21; Goddard, supra note 183, at 571-77; Richberg, supra note 208.

Another aspect of the Court’s more insistent stance is its treatment of good will. Earlier precedent had declared simply that a legal monopoly could not have any good will. See supra text accompanying notes 185-86. In the 1920’s the Court pointed out that this was too simplistic an analysis. Although the value arising from the possession of a franchise was not to be included in valuation proceedings because the franchise was a privilege, a monopoly, like any other business, still could be efficiently managed and have a reputation for good service that would in a competitive market increase its value. Accordingly, the Court began commanding that good will was distinguishable from franchise value and should be included in valuation proceedings. \textit{McCardle} was the key case in this development. See Goddard, supra note 183, at 575-76. See also 2 J. Bonbright, supra note 186, at 1146-51 (reviewing inclusion of amounts for “going concern” value). Only through these developments, largely delayed until the 1920’s, did reproduction cost analysis clearly move beyond valuation of the tangible assets and include the even more speculatively based intangible elements of value.

The Court’s more insistent stance is also illustrated by the line of cases, following from Ohio Valley Water Co. v. Ben Avon Borough, 253 U.S. 287 (1920), in which the Court declared and enforced the notion that because constitutional values were at stake, appellate courts were not bound by a commission’s factual determinations but must make an independent determination based on the record. Justice Brandeis filed a dissent in which Justices Holmes and Clarke joined, id. at 292-99 (Brandeis, J., dissenting), and the case received much unfavorable comment in legal journals. See, e.g., Buchanan, The Ohio Valley Water Company Case and the Valuation of Railroads, 40 Harv. L. Rev. 1033 (1927); Hardman, Judicial Review as a Requirement of Due Process in Rate Regulation, 30 Yale L.J. 681 (1921).

The more insistent conservative analysis illustrated by the railroad and utility rate regulation cases was just one part of the Court’s more thoroughly conservative stance in the 1920’s. The Court was more thoroughly conservative in deciding cases involving industrial regulation in general. Professor Brown calculated that the Court struck down social and industrial legislation 6% of the time from 1868 to 1912, 7% of the time from 1913 to 1920, and 28% of the time from 1921 to 1927. Brown, Due Process of Law, Police Power, and the Supreme Court, 40 Harv. L. Rev. 943, 945 n.11 (1927).

\textsuperscript{230} The Court’s majority included such arch-conservatives as Van Devanter, Sutherland, Butler, and McReynolds. For portraits of these justices, emphasizing their political commitments, see F. Rodell, supra note 228, at 217-21. The remaining justices, Taft, Sanford, and McKenna, may be described as moderate conservatives. See id. at 187 (McKenna), 188-89
adopted reproduction cost approach.

Despite the economic learning and analysis marshaled by jurists for their respective sides, in the end the economic debate was inconclusive and did not carry determinative weight. Commitments to values other than the economic merits motivated proponents of each approach. Both liberals and conservatives knew that under *Munn v. Illinois* rate regulation had the potential of spreading generally across the economic landscape,\(^{231}\) and by the 1920's both sides understood that the choice between the two competing valuation theories involved a choice between competing conceptions of private property.\(^{232}\) Robert Hale—a liberal proponent of the prudent investment approach—wrote in 1922:

> The truth . . . is, that in regulating the rates of utilities the law is trying the experiment in one limited field of turning its back on the principles which it follows elsewhere. The experiment may perhaps be extended to other fields if successful. We are experimenting with a legal curb on the power of property owners. In applying that curb, we have to work out principles or working rules—in short a new body of law. Those principles will necessarily differ from the ones upon which the law acts in other fields . . . \(^{233}\)

In other words, as significant as the struggle over regulation of railroad and utility rates was for its own sake, liberals and conservatives realized that the debate implicated the much broader issue of general governmental control of the economy. Unlike the 1890's, when the two theories' short-term and long-term consequences

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\(^{231}\) See supra note 123 and accompanying text. Rate regulation was generally justifiable because of the spread of large-scale, concentrated industrial combinations and the consequent inability of competition to control prices. See supra note 215.

\(^{232}\) Proponents of prudent investment who made this observation included 1 & 2 J. Bonbright, supra note 186, at 98-109, 1166-74, 1195-98; H. Hartman, supra note 183, at xi; Bauer, supra note 211, at 275-76; Goddard, supra note 218, at 792-96. Representative of prudent investment opponents were Hadley, supra note 215, at 178-80; Lincoln, supra note 209, at 873 ("[C]arried to its logical conclusion, this method of control of the return on public utility investments can lead in only one direction—to the socialistic state. Whether or not that would be a desirable outcome is another question.") (emphasis in original).

\(^{233}\) Hale, Rate Making and the Revision of the Property Concept, 22 Colum. L. Rev. 209, 213 (1922).
were inconsistent,\textsuperscript{234} in a period of escalating costs reproduction
cost was unambiguously conservative and prudent investment un-
questionably liberal in terms of both immediate impact\textsuperscript{235} and ab-
stract connotation.

Accordingly, sustained by an economic analysis that commanded
support from some professional economists, untroubled by the
thought that meaningful regulation of railroad and utility charges
would be stymied, and unsympathetic to the idea that the tradi-
tional concept and role of property needed revision, conservative
jurists aggressively adhered to the reproduction cost theory. The
liberal jurists were subject to the opposite motivations and con-
cerns. The renewed conflict over railroad and utility rate regula-
tion was intense. But conservative judges were in the majority\textsuperscript{236}
and they successfully repelled the attack on \textit{Smyth v. Ames}.

\textbf{B. The Second Attack on the Substance of Smyth v. Ames}

Confronted with this successful opposition, the liberals de-
veloped a deeper critique. This more fundamental critique was an
elaboration of the jurisprudential implications of the late nine-
teenth century's transformation of economic theory, known as the
marginal revolution, that gave rise to the neoclassical school of eco-
nomic thought.\textsuperscript{237} Although rooted in the classical theories that
had dominated English and American economic thought since
Adam Smith, neoclassical economics involved a variety of different
fundamental assumptions, methods, and conclusions.\textsuperscript{238} Neoclassi-

\begin{itemize}
\item \textsuperscript{234} See supra text accompanying note 156.
\item \textsuperscript{235} In the economic climate of the 1920's, the immediate impact of continued adherence
to reproduction cost theory effectively meant the end of meaningful rate regulation. See
supra text accompanying note 208.
\item \textsuperscript{236} See supra note 230. President Harding, despite his short tenure, made four Supreme
Court appointments. They were two arch-conservatives, Sutherland and Butler, and two
conservatives, Taft and Sanford.
\item \textsuperscript{237} On this transformation see generally P. Deane, The Evolution of Economic Ideas 93-
114 (1978); E. Paul, Moral Revolution and Economic Science 219-79 (1979); J. Schumpeter,
\item \textsuperscript{238} For example, neoclassicists believed that the factors of production—land, labor, and
capital—were not independent but interdependently related through the principle of substi-
tution. They made greater use of mathematics, especially calculus. They rejected the wages
fund doctrine and the notion that the market necessarily served ethical ends. Neoclassicists
also created a new theory of value, described infra text accompanying notes 241-52. See P.
Deane, supra note 237, at 98-101, 107-09; E. Paul, supra note 237, at 229-30, 248-58; J.
Schumpeter, supra note 237, at 909-20.
\end{itemize}
cal theory originated in the 1870's and was ascendant in the 1890's. By the early twentieth century all mainstream English and American economists had adopted its fundamental points. Thus, the unique strength of the liberal jurists' second attack on Smyth v. Ames was its reliance upon assumptions shared by economists regardless of whether they supported the reproduction cost or prudent investment theory as a matter of sound economic policy.

The liberals based their second critique upon the fundamental difference between the classical and the neoclassical theories of value. Classical economists asserted that ultimately value was intrinsic and morally justified. This meant that prices, which are an inseparable indicator of value, were in turn intrinsically and morally determined. Classical economists were aware, of course, that values and prices in fact fluctuated too much and too rapidly to be determined wholly by some intrinsic quality. They nevertheless conceived variations in value and price as merely transient fluctuations around a "natural" quantity. The "natural" value and price was intrinsic to the object as it was largely and permanently established by the quantity of labor required in the productive process. Values and prices were thus generally, or on the average, or in the long run determined by labor, which in moral theory entitled the owner to both the object and its value.

In other words, in order to establish a morally acceptable economic order, classical economists managed to disregard or minimize the import of all factors extrinsic to the quantity of labor required in the productive process. For example, they explained

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Temporally, both this and the attack already described arose simultaneously. This attack is described as the "second" because the other was more readily understood and generally used earlier.

The value of an object is intrinsic when it is determined by a more or less permanent quality of the object itself that is part of the nature of things.

Indeed, classical economists were less centrally concerned with the analysis of intrinsic values and just prices than their medieval predecessors. Their focus on, and their analysis of, the influence of extrinsic factors on values and prices was one of their primary advances over prior economic thought. P. Deane, supra note 237, at 19-21; E. Paul, supra note 237, at 23.


away the influence of ownership of capital by conceiving of capital as frozen labor or as the product of the labor of abstinence.\textsuperscript{245} Further, they explained away the influence of demand through the analysis of present reproduction cost as a limit of what one could charge for the product.\textsuperscript{246}

Thus, only with the marginal revolution in economic thought was the labor theory of value entirely overthrown, allowing other factors to join labor as equally important codeterminants of value and price.\textsuperscript{247} With the marginal revolution, value became conceived entirely as a product of joint causation—the resolution of the relative strength of many conflicting influences. No single influence was determinative in the short- or long-run, for not only did they all jointly influence the value and price of a product, but they were themselves mutually determined and had correlative, not determinative, relationships among themselves. As neoclassical economists’ conception of causation was mutual, interdependent codetermination, the value and price of labor were as much an effect as a cause of value and price.\textsuperscript{248}

As a consequence of this shift in theory, the economist’s concept of value ceased to be bifurcated into exchange value (current market value), set by supply and demand and other factors, and “nat-


\textsuperscript{246} P. Deane, supra note 237, at 25; E. Paul, supra note 237, at 97.

\textsuperscript{247} P. Deane, supra note 237, at 115-16; E. Paul, supra note 237, at 229-33, 235. For a more general study of the transformation of causal concepts in late nineteenth-century social science, which attributes the change to the shift in economic scale, see T. Haskell, The Emergence of Professional Social Science 24-47 (1977).

Economic historians have described but not fully accounted for the fall of the labor theory of value, other than to show that the neoclassic substitute was a scientific advance or to suggest that the Marxist use of the labor theory made it politically undesirable. Speculatively, the overthrow of the labor theory of value was intimately connected with the shift from an economy characterized by small-scale production to one based on large-scale industry.

The labor theory of value is fundamentally a cost theory in which unskilled labor is the chief or sole cost. In small-scale economies this is generally the case. But in large-scale economies, value and price are not solely determined by costs. See supra text accompanying note 215; infra note 251. Thus, value and price theory could no longer be validly related to any cost theory, including labor cost theory.

\textsuperscript{248} P. Deane, supra note 237, at 108-09, 116-19; M. Dobb, Theories of Value and Distribution Since Adam Smith 168-72 (1973); E. Paul, supra note 237, at 236-37; J. Schumpeter, supra note 237, at 914.
ural" value, set by labor, toward which exchange value gravitated in the long run. The economist discarded "natural" value as an outdated concept, and exchange value became the only recognized and intelligible concept. The economist’s concept of value and price lost its moral dimension. The distinction of wealth into property and privilege collapsed as economists began to argue that the value of all property depended as much on the owner’s legal ability to withhold it from those who needed it as it did on the cost of production. Value and price continued to have a central functional role in the economic system’s allocation of scarce resources; however, they became facts that one could empirically establish and predict but not morally justify.

Because they subscribed to the neoclassical theory of value, the economists who debated the Smyth v. Ames rule, including those who advocated the reproduction cost approach, all agreed that one could not in any way use a railroad’s or utility’s value as a measure of the validity of regulated rates. Value was the equivalent of exchange value; exchange value was the equivalent of capitalized earnings; capitalized earnings were dependent upon rates. Without the notion of intrinsic value, the circular relationship between value and rates was inescapable; value could not be the basis of rates because rates were the basis of value. The choice between reproduction cost and prudent investment analysis was, therefore,

249 See, e.g., 2 J. Bonbright, supra note 186, at 1082-83; Hadley, supra note 215. As Professor Deane explains:

The marginalists then shifted the whole emphasis of their enquiries from value to exchange, from ‘natural’ price which had been the focus of interest for classical economists to ‘market’ price. Significantly, for example, Jevons did not attempt a theory of value. He set out instead to expound a theory of exchange.

250 See, e.g., 2 J. Bonbright, supra note 186, at 1082-83; Tunell, supra note 194, at 769.

251 See, e.g., J. Commons, supra note 114, at 51-64 (arguing that all significant wealth had monopoly attributes, the source of which was the inability of competition to control price fully in an economy characterized by large-scale production). See supra note 215.

252 This meant not that the capitalist economic system was morally unjustifiable but only that the focus of moral justification shifted away from value and price theory. This shift actually involved a movement of professional interest away from questions that raised moral issues and an assertion of the value freedom of the science. See P. Deane, supra note 237, at 121; M. Furner, Advocacy & Objectivity 103-04, 112-13 (1975) (viewing the shift of economics from a moral to an objective science as part of a general movement within the social sciences).

Adherence to the neoclassical theory of value also meant that the choice turned entirely upon functional considerations such as resource allocation and administrative feasibility. Liberal jurists knew, however, that although economists might advocate a particular analysis based purely on beliefs concerning its functional superiority, traditional jurisprudential norms constrained a court from doing so. Functional superiority, even if undebatable, was a matter of policy, committed to the unreviewable discretion of the legislature. In the 1890's, when the Court adopted reproduction cost as the constitutionally compelled conception of value, jurists viewed that approach as based on more than a putative functional analysis. The jurists who adopted it held a world view that defined competitive market value as the equivalent of "natural" value, an intellectually legitimate and morally superior alternative to pure exchange value. By the 1920's, however, the neoclassical transformation of value theory had left reproduction cost analysis indefensible as a matter of definition or morality. Although unimportant in economic thought, this was quite significant in jurisprudence. Accordingly, liberal jurists began a campaign to apply neoclassical value theory to railroad and utility valuations in order to establish its implications for the struggle over the constitutional limits of rate regulation. In doing so they deployed two related arguments against the *Smyth v. Ames* rule that had the advantage of being premised entirely upon the same arguments to which economists still favoring reproduction cost analysis subscribed.

First, using neoclassical value theory, liberal jurists criticized *Smyth v. Ames* by claiming that value meant only exchange value, which was entirely dependent upon rates. The "fair value" of a

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254 Hadley, supra note 215, at 176-77. As Professor Bonbright said, So the courts refer to the determination of a rate base as one of "finding out" what the "present value" or "fair value" of the property really is, whereas the economists refer to the same problem as one of choosing a proper rate base—of deciding how much the property should be permitted to be worth rather than of discovering how much it actually is worth. 2 J. Bonbright, supra note 186, at 1081 (emphasis in original).

255 2 J. Bonbright, supra note 186, at 1081-82.

256 Goddard, supra note 218, at 793, 796-97; Henderson, supra note 190, at 910, 1050-51, 1055; Richberg, supra note 208, at 581-82.
regulated enterprise existed only as a policy to be debated and chosen from among competing policies and not as an existential fact to be discovered.257 Thus, one could no longer conceive the Smyth v. Ames rule as a complex inquiry directed toward establishing a fact—the regulated enterprise’s value. Harlan’s list of factors for consideration in valuation proceedings could no longer be, as Harlan described them, types of evidence to be weighed and given “just recognition” in ascertaining the value of the enterprise.258 They were, instead, a “cloak which conceals a process of arbitrary decision based on considerations of policy.”259

Second, liberal jurists criticized Smyth v. Ames by claiming that “value is a word of many meanings.”260 This argument superficially contradicted their previous argument but was in fact the obverse of it. Strictly used, “value” and “valuation” had only one meaning—exchange value. The liberals would have preferred that jurists cease using those locutions when the focus was on anything other than exchange value,261 but use of the terms outside of strictly appropriate confines was too deeply ingrained to be abandoned sum-

257 Henderson, supra note 190, at 910, 1051.

258 Munn, 169 U.S. at 546-47.


261 Professor Hadley seriously suggested dropping the word “valuation” in favor of the word “assessment.” He stated:

I believe that the word valuation ought not to be applied to such a process of assessment; that its use . . . is wrong in principle, misleading in practice, and likely to hinder the work of clarification . . .

. . . . Valuation, in the traditional meaning of the term, is an estimate of what people will pay for a given piece of property.

. . . . Assessment is the fixing of a price by government authority. It differs radically from value in the fact that it depends on public authority—not on public demand. It is essentially a political term—not a scientific one. We fix an assessment; we ascertain a value. We ascertain the value of a piece of property by the same process of observation and calculation that we use in ascertaining the weight of a mass of metal or the size of a piece of land. . . . A cost assessment neither produces value nor measures it. Hadley, supra note 215, at 173, 179-80. See also Tunell, supra note 253, at 268 (quoting Mr. Eshleman, President of Railroad Ass’n of California).
The liberals argued that no harm would come from continuing this linguistic practice so long as the meaning of the locutions varied with the purposes for which they were employed. Every valuation not focused on establishing exchange value required a special definition of value, determined by the purpose, goal, and function for which the valuation was being made. James Bonbright advised that, except when exchange value was meant,

one must abandon the attempt to solve valuation problems by finding out what value "really means," and must address . . . the question, What meaning should here be assigned to the term in view of the intent of the legislature that used it, and in light of the probable social consequences flowing from the adoption of one definition rather than another?262

Thus, phrases such as "value for tax purposes," "value for realized income purposes," and "value for rate-making purposes" crept into the legal literature in recognition of the fact that frequently property assessments were made that were not for the purpose of discovering exchange value.263 Rate regulation, of course, was the paradigmatic example of an instance where "value" inescapably had a special definition—necessarily dependent upon its special function—because exchange value could not possibly be the appropriate meaning.

These arguments were devastating to the constitutional pretensions of Smyth v. Ames. In response, some conservative jurists continued to assert the functional superiority of the reproduction cost approach.264 This claim, though, was irrelevant, because it did not entitle reproduction cost to judicial imposition. Others continued to insist, in Justice Butler's words, that "the value of a thing, whether it be a vacant lot or a railroad property, is the determination of a fact, and that the same property cannot be of two or more different values at one time."265 But this notion was thoroughly

262 2 J. Bonbright, supra note 186, at 1167.
263 Id. at 1167-68. See also 20 Proc. Nat'l Tax Ass'n 263-95 (1928) (problems of valuation).
264 See, e.g., Dorety, supra note 155, at 173.
265 Butler, "Valuation of Railway Property for Purposes of Rate Regulation," 23 J. Pol. Econ. 17, 17 (1915). Butler said of his title:
   The title of this paper is included within quotation marks because this or like form of words has been used recently to indicate the thought that value for the purpose of rate regulation is not value in its broadest sense. It is not to be understood that because of the use of that title the writer approves any such doctrine.
discredited. Even railroad tax counsel, albeit concerned about tax-
ation of their employers at their high reproduction cost values, be-
gan to voice the observation that “value is a word of many mean-
ings” and that value for tax purposes was different from value for rate-making purposes. No justice appointed to the Supreme Court after 1925 seriously advocated adherence to the *Smyth v. Ames* rule.

**C. The Attack on the Method of Smyth v. Ames**

Nevertheless, reproduction cost analysis continued to be the Court’s imposed rule for another two decades. Indeed, it achieved its most notable successes after and in the face of the liberals’ crit-
tiques. The Court, dominated by a conservative majority, did not predicate continued adherence to the *Smyth v. Ames* rule sim-
ply from concern with immediate impact, as is shown by the gen-
eral commitment to it after the Great Depression’s reversal of the

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Id. For examples of other lawyers’ reiteration of this position, see Tunell, supra note 194, at 733-70.

Butler wrote these words when still a railroad counsel but adhered to them vociferously after his appointment to the Court. See, e.g., Denver Union Stock Yard Co. v. United States, 304 U.S. 470 (1938); McCardle v. Indianapolis Water Co., 272 U.S. 400 (1926). Due to his prominence, his words immediately became a focal point for ridicule which only increased in intensity with each assertion of them. Judge Prouty, one of Butler’s contemporaries and director of the Texas Bureau of Valuations, was quoted as saying:

> Mr. Butler . . . contends that value is a thing immutable, which when once discov-
ered by some occult process which he himself cannot clearly define, applies at all times and for all purposes. He apparently adopts as his definition of value the ex-
change value of the economist, but clearly the selling value is not the value for rate-
making purposes.

Tunnell, supra note 194, at 751. See Hale, *Does the Ghost of Smyth v. Ames Still Walk?*, 55 Harv. L. Rev. 1116, 1127 (1942) (“circular reasoning is crystal clear”); Richberg, supra note 208, at 576-77, 581-82 (“Mr. Butler’s attempt to ascertain an ‘absolute value’ . . . was for-
doomed to failure. The result of this futile attempt is that he has neither found what the present value of the property is, nor stated what the fair value of the property should be.” Id. at 582.).

206 See, e.g., 2 J. Bonbright, supra note 186, at 1106-08.

207 This included four appointees of Presidents Coolidge and Hoover, two of whom, Stone and Cardozo, became leaders of the opposition to that approach.

208 See, e.g., *St. Louis & O’Fallon Ry. v. United States*, 279 U.S. 461 (1929); McCardle v. Indianapolis Water Co., 272 U.S. 400 (1926). Brandeis and Stone dissented in both cases, and they were joined by Holmes in the latter. For a discussion of the significance of these well-noted decisions, see, e.g., *J. Bauer & N. Gold*, supra note 149, at 98-104, 128-29; 2 J. Bonbright, supra note 186, at 1104-07, 1146-47; *Cook*, supra note 172, at 320-21; Richberg, supra note 208.
price level brought prices down below their 1913 levels.\textsuperscript{269} Rather, Smyth v. Ames continued to garner support in part because of the struggle's implications for the overall place of property in American law.\textsuperscript{270} But support also followed from further implications of the liberals' attack.

As presented thus far, the liberal-conservative argument was over the correct constitutional rule. The liberals' second attack, however, brought into issue not only the substance of the constitutional rule but the judicial method which supported it. Their substantive analysis necessitated repudiation of traditional notions of the judiciary's role in constitutional controversy. Turning necessity into a virtue, the liberals articulated a new theory of judicial review that, like their substantive analysis, supported the conclusion that Smyth v. Ames should be overturned.

The liberal jurists' second critique of Smyth v. Ames proved too much: it showed that the prudent investment approach was itself inappropriate for judicial imposition.\textsuperscript{271} The arguments from neo-

\textsuperscript{269} J. Bauer & N. Gold, supra note 149, at 105-11; infra notes 304-05 and accompanying text.

\textsuperscript{270} See supra text accompanying notes 231-34.

\textsuperscript{271} Some liberals never perceived this implication of their argument. Justice Brandeis, for example, thought that the prudent investment approach met all the criteria of a judicially imposable doctrine. He wrote of the prudent investment approach as the correct interpretation of the understanding between railroad and utility investors and the state, which was judicially reviewable through inquiries into existent facts. Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n, 262 U.S. 276, 306-09 (1923) (Brandeis, J., dissenting). The "rule in Smyth v. Ames," in contrast, was neither the correct understanding of investor expectations nor judicially reviewable through factual inquiry because it required so many subsidiary discretionary choices among hypothetical situations that it was not a rule at all. Id. at 296-98. See Henderson, supra note 190, at 1046-48.

Brandeis demonstrated his willingness to act on these contentions by voting to overturn rate discriminations that did not meet the requirements of prudent investment theory. See, e.g., Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n, 262 U.S. 679, 695 (1923) (Brandeis, J., concurring); Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n, 262 U.S. 276, 289 (1923) (Brandeis, J., dissenting).

Consider also Brandeis' dissent in Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922). Justice Holmes, writing for the majority, overturned a police power regulation that undoubtedly was a public safety measure on the grounds that the financial loss it imposed was too extreme. Id. at 413. Brandeis' dissent illustrates his rejection of judicial balancing in favor of traditional methodology in which judicial review ends once a measure is determined to be within a governmental power. Id. at 416 (Brandeis, J., dissenting).

Thus an analysis of the legal thought in the Lochner era should distinguish between old and new liberals. Old liberals, like Brandeis and Harlan, used the old methodology to reach liberal results, while new liberals, like Holmes, premised their conclusions on new methodology. The difference among liberals is paralleled by a split in conservative thought. Although
classical value theory that so effectively undermined the constitutional pretentions of the reproduction cost approach applied with equal force to prudent investment analysis. Prudent investment analysis was itself neither definitionally nor morally superior to any other functional substitute for exchange value. Its imposition was a policy choice, and therefore a legislative and not a judicial question.

This last point turned upon the view that there was no conception of the relationship between railroad and utility investors and the government which could be said to be the correct conception. Railroad and utility undertakings were subject to an infinite variety of risks, Gerard Henderson observed in a 1920 seminal article, some of them unique to their public utility status. The appropriate rate of return depended upon the allocation of these risks between the regulated enterprise investor and the public; and the appropriate risk allocation between the parties depended, in turn, upon the allowed rate of return. There was, therefore, "a substantial variety of possible adjustments" of the investor-govern-

most conservatives, like Brewer and Butler, used the old methodology to achieve conservative results, some put the new methodology to conservative ends. For an example, see Wickersham, supra note 122. I am indebted to Professor Horwitz for the distinction between old and new conservatives.

272 Henderson, supra note 190.
273 The varying risks faced by regulated enterprises included: their locales may be developed or undeveloped and subject to differing expectations of further development; general economic cycles may be favorable or unfavorable, and expansion may be correctly or incorrectly timed to their fluctuation; labor relations and managerial quality may be good or bad; and facilities may depreciate faster or slower depending on technological advances. Some of the unique risks regulated enterprises faced were caused by uncertainty over whether public donations of property were forthcoming and by variations in savings attributable to the use of eminent domain. See Id. at 913-14, 925-27.
274 Id. at 923. Consider, for example, whether a railroad could profit from increases in the value of governmentally donated land by including the land's present value in its rate base. Depending on whether the answer is yes or no, a lower or higher rate of return would be appropriate.

Or consider the same problem in a slightly more complex context. A railroad, seeking to expand into an underdeveloped locale, receives donated land as encouragement. Whether the railroad keeps the profit from the increases in the land values affects the appropriate rate of return which in turn is affected by the risk that the underdeveloped area will never develop and that risk's allocation to the investors or the public.

Similarly, a water company may maintain overall profitability throughout the business cycle either by maintaining a rate thought to average out, or by lowering prices in bad times (to stimulate demand or ease suffering) and raising them in flush times (when the demand is there anyway). The degree of raising or lowering is intimately connected with its impact on demand, which is also a risk variable.
ment relation. Actual expectations resulted from "practical adjustment and compromise" and were undeterminable and unascertainable by logical speculation. No particular resolution was to be preferred or expected; no particular resolution was necessarily the appropriate one.

This conception of the regulated enterprise investor-government relation, Henderson maintained, necessitated a departure from traditional norms of judicial review in rate regulation cases. The tradition of nondiscretionary review constrained courts to find their rules of decision in the parties' own agreement or course of dealing, established principles or precedents, or customary or currently accepted rules of conduct. When the facts at bar were familiar or consisted of simple relationships and problems, application of even such inherently vague standards as "fair" and "reasonable" could have the force of a logically compelled outcome. But the regulated enterprise investor-government relation had no socially settled detailed standards. It was too unique and complex, both in the abstract and for each specific railroad and utility, for the application of vague standards to lead to determinate results. In adjudicating disputes involving that relation, courts had no alternative to imposing their views. They necessarily exercised a "political discretion" by engaging in "a process of arbitrary decision based on considerations of policy."

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275 Id. at 928.
276 Id. at 1031. See also id. at 923-24, 927-28, 1051.
277 Id. at 928.
278 Id. at 1055-56. Henderson also included eminent domain cases. Id. Professor Fuller has generalized the occurrence of the problem and thus the pervasiveness of its implications. Fuller, The Forms and Limits of Adjudication, 92 Harv. L. Rev. 353, 394-404 (1978).
279 Henderson, supra note 190, at 910, 924, 1050-51. This view of the source of legal standards was a staple of traditional legal thought and was shared by conservatives and liberals alike. See O.W. Holmes, The Common Law 122-29, 149-52 (1881); Carter, supra note 28.
280 Henderson, supra note 190, at 924.
281 Id. at 924-28. Interestingly, Justice Butler was aware that the ability of courts to supervise regulated enterprise rates before the modern era was based upon the existence of "customary charges." He knew, too, that the absence of a concept of customary charges for modern railroads and utilities undercut the court's supervisory abilities. But he drew different conclusions from the lack of custom. His conclusion was to leave rate regulation to the self-interest of the entrepreneur because his interests coincided with the public's. Butler, supra note 265, at 19-20.
282 Henderson, supra note 190, at 1050, 1055. Henderson knew that the jurists of the 1890's who debated and decided Smyth v. Ames were aware of his analysis. Those jurists' discussions were full of examples of and arguments from the uniqueness and complexity of
In light of this analysis, courts could not review railroad and utility rate legislation according to traditionally accepted canons. There were three alternatives: the judiciary could cease to review rate regulations, arbitrarily impose some standard, or consciously engage in a discretionary mode of review. The first two were not to be seriously considered; thus, the third necessarily was appropriate. But because courts, to review rate determinations at all, must of necessity re-weigh the same interests previously balanced by popularly elected legislatures and perhaps impose their views of the public interest over those of the legislatures, they should do so hesitantly. Legislative decisions should stand, Henderson said, unless "so outrageous as to shock the common sense of justice."

These words, which became a popular characterization of modern judicial review when they were paraphrased three decades later
by Justice Frankfurter, transformed the liberal jurists’ critique of *Smyth v. Ames*. Certainly the liberals’ ready acceptance of Henderson’s standard of review was attributable to the fact that the standard did not originate entirely with him. In framing his concluding remarks, Henderson drew from a liberal critique of judicial method that had its initial expression decades earlier in the writings of James Thayer and Oliver Wendell Holmes. But due to limitations in these jurists’ work, the linkage between their methodological critiques and the substantive controversy over rate regulation had remained unrealized.

Professor Thayer, responding critically to the first spate of substantive due process cases, had maintained that despite conventional conceptions of the boundaries of the judicial function, the institution of judicial review necessarily involved courts in “political” decisionmaking. But judicial participation in such decisions, he argued, had always been and should remain strictly limited. Though empowered to review and annul legislative decisions, Thayer asserted that in such cases “[t]he judicial function is merely that of fixing the outside border of reasonable legislative action.” The judiciary must not impose its view of the correct meaning of the Constitution, but rather it should act only when “a competent and duly instructed person who has carefully applied his faculties to the question” would conclude there is no “reasonable doubt” concerning the legislation’s unconstitutionality.

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286 Rochin v. California, 342 U.S. 165, 172 (1952). See also id. at 175 (Black, J., concurring).

287 Thayer, The Origin and Scope of the American Doctrine of Constitutional Law, 7 Harv. L. Rev. 129, 152 (1893). Substantive due process review began in the states in the mid-1880’s. See, e.g., In re Jacobs, 98 N.Y. 98 (1885); Godcharles & Co. v. Wigeman, 113 Pa. 431, 6 A. 354 (1886); B. Twiss, supra note 2, at 99-109, 127-30. When Thayer wrote, the United States Supreme Court had not yet generally engaged in such review. See, e.g., Mugler v. Kansas, 123 U.S. 623 (1887). The one exception was Chicago, M. & St. P. Ry. v. Minnesota, 134 U.S. 418 (1890), discussed supra text accompanying notes 119-20. Thayer approved of that exception because it stood for the principle of judicial oversight and did not necessarily indicate that that oversight would be more than deferential. See Thayer, supra, at 148 (calling that case “highly important” and having “vindicated” his theory of judicial review).

288 Thayer, supra note 287, at 148. The importance of this power was to prevent legislatures from accomplishing forbidden ends. Id.

289 Id. at 149. Thayer drew an analogy to the judicial overturning of jury verdicts: “To ask ‘Should we have found the same verdict,’ is surely not the same thing as to ask whether there is room for a reasonable difference of opinion.” Id. at 148. See also id. at 150.
But Thayer's argument for confined judicial review was itself of limited scope. Although commenting that confining judicial review would promote a sense of responsibility among legislators, Thayer primarily based the propriety of his approach on a formal political principle: that the court was revising the decisions of a coordinate department of government. It did not apply, he admitted, when federal courts reviewed state legislation under the federal Constitution. Consequently, it did not apply to the controversy over rate regulation. Henderson's analysis, therefore, expanded the scope of Thayer's conclusions to rate regulations by grounding limited review in the "nature" of the case.

Unlike Thayer's analysis, Holmes' thinking on the function of courts in constitutional controversy had always been of general application. For almost half a century, Holmes had been expressing the view that the increased complexity and interdependence of modern society was fundamentally challenging the application of traditional legal categories. The "nature" of most cases in both public and private law, he maintained, was such that judicial distinctions turned upon differences in degree and not upon differ-

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290 Id. at 155-56.
291 Id. at 150.
292 Id. at 154-55.
293 To conservatives, Thayer's analysis did not apply to rate regulations or to many other controversies even when before a state court for another reason. Consider the editorial written in response to Thayer's article, which stated that judicial deference depends as a matter of statesmanship on the subject with which [the legislature] deals. However unwise, however foolish, if it is a question of the exercise of a power of government, those powers should be construed in no narrow spirit; but if, on the other hand, it is a question of the rights of individuals as it was intended they should be preserved by the constitution which have been violated, no pains, it seems to us, should be spared to protect the individual as against the legislature.

. . . . [T]he introduction of the idea for which [Thayer] contends would result in sustaining so many laws which trampled on individual liberty, that our condition would soon become intolerable.

Editorial Comment, 42 Am. L. Reg. 73, 75 (1894).

Property was, of course, the preeminent civil right and guarantor of liberty. See also Wickersham, supra note 122, at 313, 315-16 (discussing extent to which police power can encroach on individual rights).

294 Henderson, supra note 190, at 1055-56.
295 The earliest expression is in an unsigned comment Holmes wrote on Munn v. Illinois. See Book Notice, 12 Am. L. Rev. 354 (1878). M. Howe, supra note 125, at 59, attributes authorship to Holmes.
ences of kind. But although Holmes offhandedly indicated he approached rate regulation decisions from this standpoint, it was Henderson, and not Holmes, who concretely linked this universal perspective to the particular issue.

By joining the liberal substantive analysis of rate regulation with this methodological view of judicial function, Henderson’s analysis resolved the liberal jurists’ inability to argue for the prudent investment approach per se. Knowing that with a freer rein legislatures and commissions would generally adopt that approach, he enabled liberal jurists to argue that the Court should uphold any approach and result that was “reasonable.” He laid the foundation for a later and more radical development of the argument, which maintained that the Court should not substantively review rate regulations at all: if the legislature’s or commission’s procedures were thorough and fair, the Court should uphold the rate regulation decision.

Yet the transformed liberal jurists’ critique, with its logic perfected and followed through to its inevitable conclusion, only made it more difficult for others to depart from the Smyth v. Ames rule.

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298 With the exception of the cases cited supra note 297, Holmes simply joined in other justices’ opinions.

299 Goddard, supra note 149, at 669; Kirshman, supra note 145, at 814.

300 Beutel, Valuation as a Requirement of Due Process of Law in Rate Cases, 43 Harv. L. Rev. 1249, 1272-73, 1281 (1930); Goddard, supra note 218, at 793-94. This argument also turned upon a conception of the police power that depended upon the new methodology. For an indication of the police power under the old and new methodologies, see Siegel, supra note 93, at 621-27.

Some economists, probably reflecting their lack of legal training, had for decades advocated that rates be reviewed under a reasonableness standard. See, e.g., Adams, Reasonable Rates, 12 J. Pol. Econ. 79 (1904); Smalley, supra note 209, at 420.

In the first quarter of the twentieth century there were instances of conservatives who on other issues supported a “reasonableness” standard of judicial review because they saw it promoting conservative ends. See, e.g., Wickersham, supra note 122.

301 See, e.g., Driscoll v. Edison Light & Power Co., 307 U.S. 104, 122 (1939) (Frankfurter, J., concurring); infra note 308. Henderson may have been pointing to nonsubstantive review. See Henderson, supra note 190, at 1055.
The stakes of the controversy over railroad and utility rate regulation had increased dramatically. Not only did the critique more thoroughly undermine constitutional protection of property, but it also denied deeply held notions of judicial method. The new liberal jurists’ critique was abhorrent to someone who, like Justice Butler, thought the only “calamity so great as that which is certain to follow a valuation based upon the theory that the federal Constitution does not protect the full present value of railroad property in rate regulation” was a jurisprudence in which “individual conceptions of right and wrong may be substituted for fundamental principles of organic law.”

Thus, the reproduction cost approach flourished in the 1920’s and survived in the 1930’s. Through that latter decade, however, the Court wavered. Sometimes it seemed to embrace “reasonableness” review of regulated rates, only to revert to the rule in Smyth v. Ames. The disjunction between intellectual legitimacy and traditional notions of property and judicial method was not easily resolved. James Bonbright concluded in 1937 that “the Court sometimes recognizes, sometimes denies [its dilemma, but the overt recognition is a reluctant one and is apparently accompanied with emotional pain on the part of the [Court’s] more conservative members.”

Nonetheless, the Great Depression’s impact on electoral preferences and the flurry of Roosevelt appointments towards the end of

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Note: The numbers in superscript indicate footnotes from the original document that provide further details or sources for the statements made in the main text. The footnotes are not included in the natural text representation here.
the decade\textsuperscript{306} eventually took their toll. In the early 1940's the Court finally overruled Smyth \textit{v.} Ames.\textsuperscript{307} It was overturned, however, not in favor of its traditional adversary, the prudent investment approach. The new liberal majority on the Court, though feuding over whether judicial review of rate regulations was to involve substance as well as procedure, made clear that they were not imposing any particular substantive theory.\textsuperscript{308} Many factors had transformed the substance of the constitutional law of railroad and utility rate regulation, but a revolution in the conception of judicial method fundamentally shaped the outcome.\textsuperscript{309}

\section*{V. \textbf{Conclusion}}

In Liberal thought, the good society is one in which individuals are free to define and pursue their own ends. Liberal thought also maintains, however, that some form of collective life is necessary as a support for individual prosperity and liberty. Thus, the central goal of Liberal political theory is to fashion a polity in which collective activity promotes individual prosperity and liberty and does not become a means of interpersonal domination. Collective life should control, and not be a part of, the Hobbesian "war of all against all."\textsuperscript{310} Collective life should enable individuals to define and pursue their self-interest without endangering the same pursuit by others.

In nineteenth-century Liberal thought, the two most important mechanisms for establishing and maintaining the proper relation between individual and collective life were limited government and

\begin{footnotesize}
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\item \textsuperscript{306} Roosevelt appointed five justices between 1937 and 1939 and three more before 1942.
\item \textsuperscript{307} Federal Power Comm'n \textit{v.} Hope Natural Gas Co., 320 U.S. 591 (1944); Federal Power Comm'n \textit{v.} Natural Gas Pipeline Co., 315 U.S. 575 (1942).
\item \textsuperscript{308} Compare the various opinions, concurrences, and dissents in the cases cited supra notes 301, 307. Justice Jackson, for example, specifically advocated the use of noncost standards in Federal Power Comm'n \textit{v.} Hope Natural Gas Co., 320 U.S. 591, 628-60 (1944) (Jackson, J. dissenting), discussed in Hale, supra note 304, at 520-30. The differences are discussed in Hale, supra note 265, at 1130-40; Hale, supra note 304, at 497-98.
\item \textsuperscript{309} The subsequent history of utility rate regulation is discussed in Rose, The Hope Case and Public Utility Valuation in the States, 54 Colum. L. Rev. 188 (1954).
\item \textsuperscript{310} T. Hobbes, Leviathan 66 (E. Rhys ed. 1914) (1st ed. London 1642) ("warre of every man against every man").
\end{itemize}
\end{footnotesize}
the free market. Government established the conditions and enforced the rules that allowed a market to exist and flourish. The market allowed individuals to seek their own ends without dominating others. As individuals could not impose their will on the market or government, they could not use collective life to impose their will on each other. As all domination was on behalf of or by market forces, it was impersonal and promoted the common good.

Near the end of the century, however, economic forces began to generate large-scale, market-dominating enterprises. This posed a fundamental dilemma for Liberals. On the one hand, these enterprises were inadequately controlled by market forces and could impose their will on others. They dominated their customers and their employees. Government, it seemed, was the only counterpoise to them. On the other hand, though, to allow government to dominate these large-scale enterprises could lead to government domination of the market, and through the market all society. American jurists, whether liberal or conservative, were sensitive to this dilemma and moved to redefine the substance of constitutional law to meet these developments. Although varied in detail and application, the jurists' responses were remarkably similar in that most sought some doctrine to constitutionalize the free market.311

The Lochner era began, then, when American jurists decided that the constitutional notion of property included its free market value. This idea, first settled in the railroad context, was soon generalized.312 All citizens, like the railroads, were entitled to the free market value of their property. "Liberty of contract," that central doctrine of the Lochner period, was a corollary of the protection of property's free market value.313 These related decisions had deep

311 Constitutionalizing the free market was premised upon the distinction between property and privilege. Free market profits, understood as the return on labor and savings, were economically, politically, and morally justified. They were part of the common-law conception of property and included in the constitutional guaranty. In contrast, greater than free market profits flowed from privileged, monopolistic holdings. Economics, politics, morals, and the common law proscribed rather than allowed these returns. Eliminating these superfluous profits was not only permissible, but also the state's moral duty. In short, free market profits delimited the returns attributable to property as opposed to privilege.

312 See supra notes 9, 130; infra note 313.

313 The "liberty of contract" doctrine is conventionally seen as a sui generis imposition of the Lochner era judges, particularly the conservative ones. For the first statement of this view, see Pound, Liberty of Contract, 18 Yale L.J. 454 (1909). Nonetheless, "liberty of contract" follows necessarily from the decision, shared by liberals and conservatives, to protect the free market value of property because free market value is exchange value which en-
roots in Liberal thought and masterfully brought traditional learning to bear on newly arisen problems.

The essential problem of the *Lochner* era, however, was that in constitutionalizing the free market the judiciary incorporated the norms of a vanishing society based on an economy characterized by small-scale enterprises. Among those norms was an abhorrence of monopoly power. But large-scale enterprise involved factors, such as sunk costs, that fundamentally altered the working of the free market. Among those changes was the impossibility of perfect competition. Imperfectly competitive, large-scale economies necessarily allow some degree of monopoly power. Therefore, one could not constitutionalize the free market and exclude monopoly power. One had to err on one side or the other or abandon the attempt.

Thus, in the railroad and utility context the problem was not just that the reproduction cost approach inaccurately established the value of large-scale enterprises. Rather, because the free market itself now involved monopoly power, there was no measure of free market value that did not include some or all of the monopoly effects proscribed by nineteenth-century norms. Similarly, in the industrial labor relations context, the problem with the "liberty of contract" approach was not just that it no longer accurately depicted the relationship between business enterprise and the individual members of its work force. More fundamentally, the free market value of business enterprise, of which the "liberty of contract" doctrine was an adjunct, necessarily but impermissibly included some degree of coercive power over employees.

New problems are typically approached from within established frameworks and with means that have worked before. That is what the jurists of the early *Lochner* era did. Their extension of the traditional constitutional protection of private property to in-

314 See supra notes 215, 251. See also E. Chamberlin, *The Theory of Monopolistic Competition* (1933); P. Deane, supra note 237, at 153-57 (discussing J. Robinson, *Economics of Imperfect Competition* (1933)).

clude its free market value reflected nineteenth-century understandings of the purpose of the constitutional guaranty, the problems posed by large-scale enterprise, and the limits of the judicial role.

Eventually, however, escalating prices engendered by the first World War caused a wide disparity between the results liberals thought the response should bring in theory and the results it did bring in experience. Consequently, they began to rethink their position. Conservatives, on the other hand, were more satisfied with the fruits of the original response and were therefore less prone to doubt its validity. Their faith was in no small measure an expression of their abhorrence of the alternatives. Conservatives, indeed even all Liberals, had to be troubled deeply by the results of the Lochner approach before they would devise and embrace the liberals' alternative. It was difficult to accept the notion that private property, theretofore the central institution of the economic, political, moral, and legal order, should be secured by Henderson's proposed minimal and variable protection standard of what "shocks the [judicial] conscience." It was also difficult to accept the notion that nondiscretionary judicial method, theretofore an essential component of the rule of law, must be abandoned. It was not easy to embrace a jurisprudence that, in the words of one of its most influential proponents, is based on the view that law, even constitutional law, is anything that "has a sufficient force of public opinion behind it." Many conservatives clung to the original response of the Lochner era because to them its results were less problematic when compared to the alternatives. Many liberals abandoned that response because for them the opposite was true.

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816 Application of the rate regulation precedents and the "business affected with the public interest" precedents did not take an identifiably conservative turn until the late 1910's. See supra notes 86, 229. The same is generally true in the industrial labor relations context. It was not until the first World War that the Supreme Court precedents took on a decidedly conservative cast. Until then, Lochner-type decisions were more the exception than the norm. Lochner itself was modified in Muller v. Oregon, 208 U.S. 412 (1908), and overruled in Bunting v. Oregon, 243 U.S. 426 (1917). See also Brown, supra note 229 (commenting on difference between the Supreme Court's police power precedents before and after World War I).

817 Tyson & Bro. v. Banton, 273 U.S. 418, 446 (1927) (Holmes, J., dissenting). Holmes exempted "express prohibition in the Constitution" from these remarks. Id. Such prohibitions are few and far between and even then, under contemporary norms of jurisprudence, are subject to interpretation. See, e.g., J. Ely, Democracy and Distrust 13 (1980).
For both conservative and liberal jurists, legal thought, larger systems of social thought, and general social experience interacted in the life of the law.