COMMENT

EASTERN PHILOSOPHY: A CONSTITUTIONAL ARGUMENT FOR FULL STRANDED COST RECOVERY BY DEREGULATED ELECTRIC UTILITIES

I. INTRODUCTION

Stranded costs are those assets, or interests, belonging to a regulated enterprise that will diminish in value as a result of deregulation.[1] The issue of whether deregulated electric utility companies ("utilities") should be able to recover their stranded costs from consumers has become one of the most significant issues in deregulation, prompting much debate and eliciting a variety of proposed solutions.[2] The topic is particularly relevant in states like Texas[3], which have recently passed deregulatory legislation, and in states like New Hampshire,[4] in which resolution of the stranded costs issue impedes electricity deregulation.[5]

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1. *See* Indianapolis Power & Light Co. v. Pennsylvania Pub. Util. Comm'n, 711 A.2d 1071, 1074 (Pa. Commw. Ct. 1998) (defining "stranded costs" as "the costs prudently incurred by the local utilities that will not be recoverable through market-determined prices, and that result from the utilities' reliance on the previous regulatory structure").

2. Refer to Part II *infra* (discussing the background of the stranded-cost issue and outlining some of the proposed solutions).

3. Recently passed Texas Legislation awarded stranded-cost recovery to deregulated utilities. *See* Act of June 18, 1999, 76th Leg., R.S., ch. 405, §39.201, 1999 Tex. Gen. Laws 2543, 2574-2575 (allowing for the securitization and recovery of 75% of a utility's estimated stranded costs).

4. *See* S. Con. Res. 1, 156th Leg., 1st Sess. (N.H. 1999). The bill stated:

> Whereas, implementation of [electric utility] retail competition in much of the state has been blocked due to litigation by the largest utility in the state
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> Resolved by the Senate, the House of Representatives concurring:
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> That the general court of New Hampshire respectfully requests that the New Hampshire supreme court extend the highest possible priority to the issuance of an opinion on the issues before the court . . . relating to the public utility commission's authority to address claims for stranded costs.

See id.

5. *See* Pam Boschee, *States' Lawmakers Grapple with Deregulation Snafus*,

This Comment discusses whether deregulated electric utilities have a right to recover their stranded costs under the Takings[6] or Due Process[7] Clauses of the United States Constitution. This Comment focuses on the United States Supreme Court's recent decision in *Eastern Enterprises v. Apfel*.[8] The Court's holding in *Eastern Enterprises* will likely have significant influence on the lower courts and state legislatures when they address the stranded-costs issue. Moreover, *Eastern Enterprises* provides important insight into how the Supreme Court might treat the stranded-costs issue in the future. To that end, Part II overviews the current debate among industry representatives, economists, legislators, and courts about stranded costs. Part III assesses the state of substantive due process and takings law prior to *Eastern Enterprises*, and Part IV analyzes *Eastern Enterprises*'s subsequent effect. Part V applies the *Eastern Enterprises* standard to electric utility deregulation and concludes that the current Supreme Court would probably find that deregulated utilities can recoup their stranded costs under either a substantive due process theory or a takings theory.

Part VI observes that the federal government and the states will most likely continue to grapple with the stranded costs issue, concludes that the utilities have a constitutional basis to recover their stranded costs, and argues that the courts and legislatures should consider that right when addressing the stranded-costs issue. Because of the large amounts of money involved, it is likely that the electric utility stranded-costs issue will eventually be litigated. This Comment expresses concern that such litigation, if it were to occur, will be unnecessarily difficult because of the United States Supreme Court's failure to address the doctrinal confusion in the due process and takings area.

This Comment suggests that the Court, at its earliest opportunity, should prevent unnecessary litigation by delineating clearer standards in this muddled area of constitutional law. This Comment argues that the Court should adopt the framework proposed by Justice Kennedy in his *Eastern*

ELECTRIC LIGHT & POWER, Aug. 1, 1998, at 1 (reporting that nineteen states have enacted laws or regulations promoting customer choice in electricity, and noting that the stranded-costs issue has sparked an intense debate), *available in* 1998 WL 10332430. Refer to Part II.E *infra* for further detail about various approaches to the stranded-cost dilemma.

6. U.S. CONST. amend. V ("nor shall private property be taken for public use, without just compensation").

7. *Id.* ("nor be deprived of life, liberty, or property, without due process of law"). Refer to Parts III.B, IV.C *infra* (surveying substantive due process case law).

8. 524 U.S. 498 (1998).

Enterprises concurrence as a basis for awarding the utilities recovery of their stranded costs and for protecting them from arbitrary deprivation of their property. Justice Kennedy's due process approach provides significant benefits over the plurality's takings theory. First, providing protection for deregulated utilities under the Due Process Clause would be a strong move toward resolving the inconsistencies in the Court's substantive due process jurisprudence. Moreover, such an approach would free the Court from having to stretch the Takings Clause beyond its traditional realm. It would afford the Court an opportunity to reconsider its "public use" strand of takings analysis in light of the criticisms of Justice Kennedy, the dissenting Justices in *Eastern Enterprises*, and scholars.

II. STRANDED COSTS

A. Background

Regulation of the electrical utility industry began in the late nineteenth century[9] with states granting franchises to electric utilities, thereby authorizing the electric utility to provide exclusive service within all or part of a particular jurisdiction.[10] More recently, state regulation has been accomplished through the use of regulatory commissions,[11] which set the price and terms of electricity sales.[12] Prices are set at a level that allows the utility to recover its costs of production along with a fair rate of return.[13] The utility is entitled to recover all of its costs[14] unless

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9. *See* ALAN E. FINDER, THE COUNCIL OF STATE GOVERNMENTS, THE STATES AND ELECTRIC UTILITY REGULATION 16-17 (1977) (documenting the early history of state regulation of the electric utility industry).

10. *See id.* at 3.

11. *See* Paul R. Joskow & Richard Schmalensee, *Incentive Regulation for Electric Utilities*, 4 YALE J. ON REG. 1, 1-2 (1986) (describing the modern regulatory regime).

12. *See id.* at 1, 4 (noting that a commission controls a "utility's rate structure by setting an allowed rate of return for the utility on its invested capital").

13. This price setting process is called "rate making" and can be determined by first utilizing the formula $R = O+(V-d)r$: R represents the total revenue required by the utility, O represents the utility's operating costs, V represents the tangible and intangible property value, d represents the accrued depreciation of tangible and reproducible property, and r represents the rate of return. *See* CHARLES F. PHILLIPS, JR., THE REGULATION OF PUBLIC UTILITIES 169 (2d. ed. 1988). The rate is then adjusted according to a complex set of factors to arrive at a specific rate structure by which particular customers are charged. *See id.* at 170-71.

14. *See generally* Office of Pub. Counselor v. Indianapolis Power & Light Co., 413 N.E.2d 672, 673-75 (Ind. Ct. App. 1980) (discussing how a utility establishes a rate of return and how changes in costs affect the fair-value rate base and the rate of return).

the regulators determine that certain costs were imprudently incurred.[15]

Federal regulation of the electric power industry began with passage of the Federal Power Act of 1920,[16] which gave the Federal Power Commission authority to license hydroelectric power plants on navigable waters.[17] In the aftermath of the great depression, faced with growing concerns about the market power that various electric utilities were achieving and believing that a tightly regulated power industry would best serve the public good,[18] President Franklin Roosevelt proposed, and Congress enacted, the Public Utility Act of 1935, thereby granting the Federal Power Commission authority to regulate the interstate transmission and sale of electricity.[19] The resulting regulatory structure, a combination of state and federal regulation, remained in place for decades, essentially freezing the economic form of the electric utility industry.[20]

A wave of federal and state electric utility deregulatory legislation[21]—based upon the theory that competition among generators will lower utility costs[22]—is fundamentally changing

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15. *See, e.g.*, 220 ILL. COMP. STAT. ANN. 5/9-213 (Michie 1993) (providing that the cost of new electric utility generating plants or significant additions thereto will be included in the rate base only if reasonable); *In re* Iowa Pub. Serv. Co., 46 Pub. Util. Rep. (PUR) 4th 339, 363 (Iowa State Commerce Comm'n 1982) (denying a utility recovery of imprudently incurred costs).

16. 16 U.S.C. §§ 791a-828c (1994).

17. *See id.* § 797e; WILLIAM F. FOX, JR., FEDERAL REGULATION OF ENERGY 754 (1983).

18. *See* Jeffrey D. Watkiss & Douglas W. Smith, *The Energy Policy Act of 1992—A Watershed for Competition in the Wholesale Power Market*, 10 YALE J. ON REG. 447, 451 (1993) (discussing the early history of federal electric utility regulation).

19. *See id.* at 451-53.

20. *See* Kathryn Kranhold, *Current Event: As Deregulation Moves into the Electricity Market, the Changes Promise to be Dramatic—and Confusing*, WALL ST. J., Sept. 14, 1998, at R4 [hereinafter Kranhold, *Current Event*] (discussing the static nature of regulation prior to the recent deregulatory steps taken by Congress and the states).

21. *See id.* (noting that many states are moving towards deregulated utility markets).

22. *See* John Burritt McArthur, *Cost Responsibility or Regulatory Indulgence for Electricity's Stranded Costs?*, 47 AM. U. L. REV. 775, 803, 915 (1998) (opining that provision of a profit motive will make the industry more efficient and that the emerging deregulated generating companies will not have to absorb the losses of today's big utilities); *AGA Study Forecasts Average 14 Percent Drop in Electricity Prices by 2015 in a Deregulated Generation Market*, FOSTER ELEC. REP., Aug. 19, 1998, at 16 (noting that after deregulation, residential prices of electricity could decrease by ten percent), *available in* 1998 WL 7902355. *But cf.* Edward G. Lance IV, *Electric Utility Reform Fosters Consumer Choice*, 10 LOY. CONSUMER L. REP. 6, 6 (1998) (noting that some consumer advocates believe that deregulation will not lower costs for lower income consumers).

the old regulatory regime. Under the long-standing regulatory scheme, utilities were characterized as natural monopolies[23] and, as such, were awarded exclusive service rights in their respective service areas.[24] In contrast, newly deregulated utilities must compete in the open market for customers.[25] This transition from a regulatory to a competitive paradigm is bringing bring about change in every facet of the utilities industry.[26]

Deregulation is altering the way electricity is generated[27] and marketed[28] and is changing the relationship that exists among the government, utility companies, and customers.[29] States usually begin the deregulation process by unbundling, that is, by breaking up the local utilities' vertical monopolies and separating the ownership of the generation assets (those which create electricity) from ownership of the transmission and distribution assets (those which transfer and channel electricity to individual consumers).[30] Additionally, deregulation plans often

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23. *See* DAVID C. HJELMFELT, ANTITRUST AND REGULATED INDUSTRIES 131-35 (1985) (asserting that electric utilities can be classified as "natural monopolies" and describing the basis for determining the natural monopoly's structure).

24. *See* J. GREGORY SIDAK & DANIEL F. SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT: THE COMPETITIVE TRANSFORMATION OF NETWORK INDUSTRIES IN THE UNITED STATES 20-25 (1997) (discussing the characteristics of a natural monopoly and noting that such a position imposes "obligations to serve").

25. *See* Benjamin A. Holden, *Electric-Deregulation Machine Starts to Pick up Steam: Fearing Federal Action and the Flight of Businesses, States Are Taking Steps*, WALL ST. J., July 14, 1997, at B4 (noting that after deregulation, electricity customers will be able to choose their supplier).

26. *See id.* (noting that 170-plus utilities face sweeping market changes).

27. *See* William M. Carley, *Power Surge: Short-Lived Chaos in Electricity Market Generates a Windfall*, WALL ST. J., Oct. 27, 1998, at A1 (reporting on the recent explosion in sales of gas turbine generators that was in part prompted by market volatility resulting from the deregulation of the wholesale generation market and noting that utilities prefer gas turbine generators over nuclear-powered and coal-fired plants).

28. *See* John R. Emshwiller & Kathryn Kranhold, *What's All the Buzz About Electricity Trading?*, WALL ST. J., July 9, 1998, at A2 (listing an increase in market needs and the ability to turn quick profits as the impetuses of the growing wholesale electricity market); Mark Golden, *Young and Wild: Electricity Trading Is Fast Becoming One of the Biggest Commodity Markets in the Country*, WALL ST. J., Sept. 14, 1998, at R13 (noting that the federal Energy Policy Act "encouraged the creation of independent power trad[ing] companies that don't generate a watt of electricity themselves but buy and sell it for profit").

29. Refer to Part V.A.2 *infra* (discussing the changing nature of regulation).

30. *See* Kranhold, *Current Event*, *supra* note 20, at R4 (noting that vertical separation is the first step in most deregulatory plans); Sarah E. Strasser & Ilene Knable Gotts, *Utility Consolidation in the Face of Deregulation: Much Ado About Nothing, or the Tempest*, *in* TELECOMMUNICATIONS MERGERS & ACQUISITIONS—FINANCING, REGULATORY AND BUSINESS ISSUES 389, 391-92 (PLI Corp. L. & Practice Course Handbook Series No. B0-0079, 1998) (describing generation assets as those that produce a supply of "bulk power").

place limits on the number of generation assets a given company may own in a discrete region,[31] thus limiting any one producer's market power[32] and preventing the emergence of a horizontal monopoly.[33]

Beyond the market check that unbundling will place on prospective profits,[34] deregulation threatens the future of those utilities that have particularly burdensome stranded costs.[35] Many of these costs are the result of soured business decisions.[36] Some of those decisions were based upon erroneous projections, such as assumptions that the price of oil would reach $100 a barrel.[37] Other decisions banked on the success of developing technologies, such as nuclear power, that ultimately did not live up to their early promise.[38] An additional set of costs can be directly traced to utilities' compliance with various regulatory requirements, such as the Public Utility Regulatory Policies Act (PURPA),[39] which requires utilities to purchase electricity from qualifying facilities.[40]

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31. *See, e.g.*, Order Authorizing Process for the Auctioning of Generating Facilities, N.Y. Pub. Serv. Comm'n, No. 94-E-0098, 94-E-0099 (May 6, 1998) (on file with the *Houston Law Review*) [hereinafter New York Divestiture Order] (addressing general market power issues and restricting divesting utilities from bidding in the divestiture auction).

32. "Market power" has been defined as "the ability of a single seller to raise price and restrict output." Fortner Enters., Inc. v. United States Steel Corp., 394 U.S. 495, 503 (1969).

33. *See, e.g.*, New York Divestiture Order, *supra* note 31, at 21-22 (describing the New York Public Service Commission's ongoing concern about preventing the emergence of horizontal monopolies).

34. *See* Bill Paul, *Power Play: Electric Utilities Find Market Forces Taking More Important Role*, WALL ST. J., Feb. 26, 1986, at A1 (explaining that under deregulation, competitive pricing will not guarantee a profit).

35. *See* Michael Totty, *Competition in Electric Industry May Have Huge Costs for Utilities*, WALL ST. J., July 3, 1996, at T1 (claiming that stranded costs could be as high as $23 billion in Texas alone and utilities could not recoup these costs at competitive market rates); *Competition/Regulation: What Others Are Saying About Stranded Cost Recovery, Edison Electric Institute* (Mar. 1998) <http://www.eei.org/issues/comp_reg/stranded.htm> [hereinafter *Stranded Cost Recovery*] (quoting Susan D. Abbot of Moody's Investors Service as being concerned about utility bankruptcies).

36. *See* Alfred E. Kahn, *Competition and Stranded Costs Re-Revisited*, 37 NAT. RESOURCES J. 29, 30 (1997) (discussing causes of stranded costs).

37. *See id.*

38. *See Competition/Regulation: Recovering Transition Costs: Key to Advancing Electricity Competition, Edison Electric Institute* (July 1998) <http://www.eei.org/issues/comp_reg/power6.htm> [hereinafter *Recovering Transition Costs*] (describing how utilities' investments in large coal-powered and nuclear-powered plants are exacerbating the stranded-costs problem).

39. 16 U.S.C. § 824 (1994).

40. *See id.* § 824a-3(a)(1)-(2). Refer to notes 285-89 *infra* and accompanying text for a discussion of utility claims resulting from compliance with PURPA and other regulatory requirements.

Under regulation, these costs, whether caused by the utilities' business decisions or by regulation itself, did not appear to matter because the utilities were able to raise their rates and recover losses from unprofitable assets.[41] This lack of a market check resulted in a wide variance in electricity prices among various regions of the country.[42] For example, the cost of electricity in California in 1993 was roughly fifty percent higher than the national average.[43] In the new open-market environment, however, utilities will no longer be able to base their rates entirely on cost of service and, thereby, earn a return regardless of the ultimate price paid by the consumer.[44] Rather, utilities will have to compete on equal footing with producers that are not carrying the vestiges of former bad investments.[45] Unlike the protected market of regulated utilities, consumers will no longer be forced to purchase electricity from the local utility[46] and may choose among various electricity providers.[47] Utilities unable to match the market price because of their higher stranded costs may be unable to compete and may ultimately become insolvent.[48]

The costs described above, recoverable under regulation but not in a free market, are known as stranded costs.[49] The

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41. *See* Jeff Bailey, *Unicom to Sell Coal-Fired Power Plants to Raise Cash for Its Nuclear Network*, WALL ST. J., July 7, 1998, at A5 (describing how the rates that Unicom charges for electricity are among the highest in the country because the costs of its nuclear power plants are rolled into its regulated rate base).

42. *See* Andrea Stone, *The What, When and How of Legislation*, USA TODAY, May 12, 1997, at 6B (discussing regional price differences in the cost of electricity and noting that states with higher electricity costs could benefit under a competitive scheme).

43. *See In re* Regulatory Structure Governing California's Natural Gas Industry, 185 Pub. Util. Rep. (PUR) 4th 49 (Cal. Pub. Util. Comm'n 1998).

44. *See* SIDAK & SPULBER, *supra* note 24, at 118-19 (describing the demise of pure cost of service regulation and stating that, as a result, electricity rates should fall in a deregulated market).

45. *See* Raymond S. Bolze & Deborah A. Carpentier, *Utility Restructuring: Negotiating, Structuring and Documenting the Deal*, *in* STRUCTURING TRANSACTIONS AGAINST THE BACKDROP OF REGULATION: ANTITRUST ISSUES 25, 30 (PLI Corp. L. & Practice Course Handbook Series No. B0-0030, 1998) (noting that it is difficult for suppliers of energy to compete in a vertically integrated market).

46. *See* Holden, *supra* note 25, at B4.

47. *See id.*; *see also* Dylan McGrath, *California Fabs Get Power to Choose*, ELECTRONIC NEWS, Apr. 13, 1998, at 6 (describing how Silicon Valley computer companies are responding to the ability to choose their electricity providers).

48. *See* ECONOMIC REPORT OF THE PRESIDENT 187 (1996).

49. *See* William J. Baumol & J. Gregory Sidak, *Stranded Costs*, 18 HARV. J.L. & PUB. POL'Y 835, 835 (1995) [hereinafter Baumol & Sidak, *Stranded Costs*] (defining "stranded costs" as "costs that the utilities currently are permitted to recover through their rates but whose recovery may be impeded or prevented by the advent of competition in the industry").

magnitude of these stranded costs is potentially enormous, with estimates ranging up to 400 billion dollars.[50]

B. The Industry's Position

Not surprisingly, the electric utilities believe that they should be allowed to recover all of their stranded costs.[51] The industry supports its position with legal, economic, and moral arguments. The industry argues that utilities and regulators are bound by a regulatory contract that obligates the utilities to provide service and, in turn, obligates the regulators to allow the utilities to recover their cost of service and a fair return on their investment.[52]

The utilities further contend that, as a matter of economics, full stranded-cost recovery will promote healthy competition and ensure that all competitors will enter the new deregulated market on equal footing.[53] They also assert that a failure on the part of the government to grant full stranded-cost recovery will seriously blemish the credibility of the government,[54] which in turn may cause investors to refuse to invest in future projects that the government wishes to encourage.[55] Finally, the utilities raise the specter of bankruptcy should they be denied full recovery of their stranded costs.[56]

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50. *See* AMERICAN BAR ASS'N, ANNUAL REPORT SEC. PUB. UTIL. COMM. & TRANSP. L. 188 (1994) (estimating 300 billion); Boschee, *supra* note 5, at 1. Refer to notes 69-72 *infra* and accompanying text (presenting arguments of those who believe the costs are more limited).

51. *See Recovering Transition Costs*, *supra* note 38 (explaining that other deregulated industries, from airlines to trucking, recovered their transition costs after deregulation).

52. *See* J. Gregory Sidak & Daniel F. Spulber, *Givings, Takings, and the Fallacy of Forward-Looking Costs*, 72 N.Y.U. L. REV. 1068, 1076 (1997) [hereinafter Sidak & Spulber, *Givings, Takings*] (arguing that "a deal is a deal" and that the government should honor its "regulatory contract" with utilities by allowing them to recover their "investment-backed expectations"). Refer to Part V.A.2 *infra* for further discussion of the regulatory contract.

53. *See, e.g.*, Kahn, *supra* note 36, at 32-34, 37 (arguing specifically that utility companies were not given an incentive to invest in low-cost facilities and claiming that if electric service is to persist, companies must be allowed to recover their "true economic costs").

54. *See* ECONOMIC REPORT OF THE PRESIDENT, *supra* note 48, at 187 (asserting that "recovery should be allowed for legitimate stranded costs. The equity reason for doing so is clear, but there is also a strong efficiency reason for honoring regulators' promises. Credible government is key to a successful market economy, because it is so important for encouraging long-term investments").

55. *See id.*

56. *See, e.g.*, Ross Kerber, *Two Big Northeast Utilities Units May Seek Chapter 11 Protection*, WALL ST. J., Jan. 20, 1997, at B4 (reporting on two large utilities who were contemplating bankruptcy, writing off assets valued at $800 million).

From a moral standpoint, the utilities assert that it would be unfair and inequitable to pull the proverbial rug out from under them after they have been adhering to the rules for such a long period of time.[57] They also point out that ninety percent of utility shareholders are nearing retirement age[58] and that these shareholders should not have to suffer a significant economic loss because the government has decided to change the regulatory regime.[59]

C. The Counter Arguments

Many who oppose granting the utilities full stranded-cost recovery contend that the concept of an unwritten "regulatory contract" between the government and regulated utilities has no legal basis and is merely an "intellectual invention" of utilites seeking an unwarranted windfall.[60] The opposition further asserts that granting recovery would be economically inefficient and would limit the benefits of deregulation.[61] Some have also argued that because utilities have effectively lobbied governmental bodies to allow full stranded-cost recovery, utilities, and not consumers, have "captured" the benefits of deregulation.[62] These commentators assert that utilities should be subject to market forces like all other businesses.[63] Those that made wise capital investments should profit,[64] and those that invested foolishly should suffer the consequences of their decisions and be forced to write off their bad investments.[65]

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57. *See Recovering Transition Costs*, *supra* note 38 (contending that utilities have provided important economic benefits to the communities that they serve and arguing that placing the utilities at a competitive disadvantage would harm those communities that have relied upon the utilities' generation of tax revenues).

58. *See id.*

59. *See id.*

60. *See, e.g.*, Robert J. Michaels, *Stranded Investments Surcharges: Inequitable and Inefficient*, PUB. UTIL. FORT., May 15, 1995, at 21 (asserting that "[t]he fictitious regulatory compact that justifies stranding compensation makes for poor history and misleading fable").

61. *Cf.* Alan L. Madian, *Meaningful Restructuring: Resolving the Stranded Cost Dilemma*, ELECTRICITY J., Jan.-Feb. 1997, at 62, 62-63 (positing that the full benefits of deregulation will only accrue when the electricity market is fully open and unencumbered by stranded-cost recovery mechanisms).

62. *See* McArthur, *supra* note 22, at 923-24 (analyzing the stranded-cost issue under the economic "capture theory," whereby concentrated and focused interests have a greater ability to lobby their agencies than the general consumer).

63. *See id.* at 821-22 (drawing a comparison between deregulated utility markets and unregulated natural gas markets and concluding that there will be great welfare loss if full recovery of stranded costs is allowed).

64. *See id.* at 893.

65. *See id.* at 803; *Beaulieu Wants to Force PSNH into Bankruptcy*, ASSOCIATED PRESS POLITICAL SERV., Aug. 13, 1998, at 1 (reporting that a state

Critics of stranded-cost recovery have proffered another argument: deregulation is premised on the notion that the utilities' investments were not prudent,[66] and thus the utilities should not be entitled to recover those imprudently incurred costs.[67] This argument is not likely to succeed; inasmuch as the utilities previously received regulatory approval for their investments, the legitimacy of an additional review at this point would be questionable.[68]

Critics of stranded-cost recovery also allege that the losses are vastly overestimated. In support, they cite the recent sales of power plants for prices far above book value.[69] However, it is still too early to draw conclusions from the few sales of generating assets that have occurred; in many cases, the utilities have auctioned off their most valuable assets,[70] retaining the less attractive assets for later disposition.[71] Moreover, the early sales may not be true indicators of the market value of all utility assets for the reason that energy companies may see the first sales as a crucial opportunity to gain a toehold in the emerging deregulated market, thus inflating the assets' value.[72]

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gubernatorial candidate advocates bankrupting a large utility on the belief that it would lower the costs of electricity).

66. *See* McArthur, *supra* note 22, at 781, 856 (positing that the motivating force behind deregulation is the realization that regulated utilities are acting imprudently).

67. *See id.* at 856-57 (characterizing the utilities' investments as imprudent, bad business decisions and arguing that the expenses should not be recoverable).

68. *See* SIDAK & SPULBER, *supra* note 24, at 487, 490 (pointing out that at the time the investments were made they were adjudged prudent by regulatory agencies in prudency reviews and arguing against a second round of prudency reviews on various grounds, including res judicata).

69. *See* Herbert Hovenkamp, *The Takings Clause and Improvident Regulatory Bargains*, 108 YALE L.J. 801, 804 & n.15 (1999) (reviewing J. GREGORY SIDAK & DANIEL F. SPULBER, *supra* note 24, and observing that "recent power plant sales . . . suggest that the problem of stranded costs in the electricity industry is not nearly as great as was once thought").

70. *See, e.g*, New York Divestiture Order, *supra* note 31 (describing generation assets to be auctioned by Niagara Mohawk Power Corporation and noting that its nuclear assets will not be included in the sale).

71. *See, e.g.*, Bailey, *supra* note 41, at A5 (reporting the sale of coal-fired plants to support a utility's nuclear network).

72. *Cf.* Liz Enochs & Chris Martin, *California Power Deregulation Not Working Few See Savings; Utilities Shy Away, Citing Lack of Profit*, ARIZ. REPUBLIC, Apr. 4, 1999, at D9 (reporting that many large utilities received more than four times the book value for the sale of older power plants); *Electricity Restructuring Bill Delayed/Distracted Administration Says It Will Be Introduced After Break*, HOUS. CHRON., Mar. 24, 1999, at 2C (quoting the Federal Energy Regulatory Commission Chairman, James Hoecker, as saying that "(Generation plants) are selling at twice the book value, mitigating the problem of stranded costs" (alteration in original)).

D. The Federal Government

Deregulation of the wholesale generation market began with the passage of the Comprehensive National Energy Policy Act of 1992.[73] The Act empowered the Federal Energy and Regulatory Commission (FERC) to require utilities to allow other utilities to transmit electricity on their proprietary grids.[74] In utility parlance, transmission of electricity is referred to as "wheeling,"[75] and transfer in bulk is referred to as "wholesale wheeling."[76] In implementing this deregulatory step, FERC provided for stranded-costs recovery in certain situations.[77] FERC's decision to allow for full recovery of wholesale stranded costs has in turn catalyzed the current debate on retail stranded costs.[78]

Congress is considering how to deal with the retail stranded-cost issue as well.[79] During the 105th Congress, a variety of resolutions were introduced, ranging from bills favoring full stranded-cost recovery[80] to bills precluding such recovery[81] to those that propose leaving the retail stranded-cost decision to the states.[82] Currently pending in the Senate is a resolution that would mandate full stranded-cost recovery for electricity purchase and sales contracts entered into by utilities under Section 210 of PURPA.[83]

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73. 16 U.S.C. §§ 824-824m (1994 & Supp. 1996).

74. *See id.* §§ 824j-k.

75. *See* Otter Tail Power Co. v. United States, 410 U.S. 366, 368 (1973) (defining "wheeling" as the "transfer by direct transmission or displacement [of] electric power from one utility to another over the facilities of an intermediate utility").

76. *See* 16 U.S.C. § 824k(a).

77. *See* Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 62 Fed. Reg. 64,688, 64,688-89 (1997) (permitting recovery of "legitimate, prudent, and verifiable wholesale stranded costs" in the deregulation of the wholesale electricity market).

78. *See* McArthur, *supra* note 22, at 792, 848-50 (contending that many states will consider the FERC precedent and arguing that FERC erred in providing for full stranded-cost recovery when it mandated wholesale wheeling); Keith R. McCrea & Gregory K. Lawrence, *East and West Coast Restructuring Efforts*, 12 NAT. RESOURCES & ENV'T 243, 243 (1998) (indicating that FERC's restructuring efforts "have produced a flurry of activity at the state level").

79. *See* Bryan Lee, *The Federal Solution: Congress Hopes to Avoid a Patchwork Quilt of State Regulations by Coming up with More-Uniform Rules. It Won't Be Easy*, WALL ST. J., Sept. 14, 1998, at R6 (noting that the House and Senate are considering at least 20 proposals).

80. *See* S. 1401, 105th Cong. § 105(a)-(c) (1997).

81. *See* H.R. 1230, 105th Cong. § 3(b)(1) (1997).

82. *See* S. 1276, 105th Cong. § 2(a)(2) (1997).

83. *See* S. 282, 106th Cong. § 5(a) (1999); *see also New Legislative Initiatives Offer Electric Power Restructuring Options for the 106th Congress as Well as Other*

E. The States

To date, both the federal government and the states have been actively involved in deregulating the electric utility industry. Although the future of the industry is unclear, there are several possibilities.[84] Congress may leave deregulation to the States.[85] On the other hand, Congress may pass federal legislation and preempt all existing state laws.[86] It is also possible that Congress will grandfather state regulatory laws into its own legislation.[87]

Notwithstanding this uncertainty, however, the states have been actively involved in deregulating their local electric utility industries. As part of their deregulatory legislation, many states have addressed the issue of stranded-cost recovery.[88] California, the first state to deal with the retail stranded-cost issue,[89] followed the FERC precedent[90] and mandated full recovery.[91]

Proposals, FOSTER ELECTRIC REP., Oct. 21, 1998, at 4 (discussing electric utility deregulatory proposals that are being floated by congressional members for introduction during the 106th Congress).

84. *See* Peter Navarro, *Electric Utilities: The Argument for Radical Deregulation*, HARV. BUS. REV., Jan.-Feb. 1996, at 112, 112 (asserting that it is unclear whether deregulation will continue to evolve state by state in piecemeal fashion or whether Congress will pass national deregulation legislation).

85. *See Stranded Cost Recovery*, *supra* note 35 (listing the comments of various members of government regarding whether the stranded-costs issue should be left to the states).

86. *See* Kyle Chadwick, *Crossed Wires: Federal Preemption of States' Authority over Retail Wheeling of Electricity*, 48 ADMIN. L. REV. 191, 191-94 (1996) (discussing possible federal preemption of state legislation and analyzing the arguments being put forth by many state regulators as to why the states' deregulation schemes will not be preempted by federal legislation).

87. *See* National Conference of State Legislatures, *Comparison of Federal Electric Utility Restructuring Proposals* (Apr. 16, 1998) <http://www.ncsl.org/statefed/ecpart2.htm> (quoting Washington Senator Slade Gorton's position that federal legislation should grandfather all existing state legislation prior to 2002).

88. *See, e.g.*, H.B. 2360, 44th Leg., 1st Sess. (Ariz. 1999) (listing a number of factors that determine a public power entity's ability to recover stranded costs); S. 115, 113th Sess. (S.C. 1999) (creating a task force to study all aspects of deregulation); *see also State by State: Where Deregulation Currently Stands Across the Country*, WALL ST. J., Sept. 14, 1998, at R6 [hereinafter *State by State*] (conducting a state by state survey of utility deregulation); Richard M. Zomnir, *Retail Competition Part I: A State-by-State Update*, ENERGY USER NEWS, Feb. 1, 1998, at 16 (same), *available in* 1998 WL 10836845.

89. *See* Allyson LaBorde, *Learning the Hard Way: California Is Ahead of the Pack in Deregulating Electricity and Way Ahead in Stirring Opposition, as Well*, WALL. ST. J., Sept. 14, 1998, at R8 (detailing the effect California Assembly Bill 1890, a "legislative landmark," will have on the price of electricity in California).

90. Refer to Part II.D *supra* (discussing the federal government's efforts to grant stranded cost recovery)

91. *See* Order Instituting Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation, 1995 WL 792086, at *3 (Cal. Pub. Util. Comm'n 1996) (directing that in

Massachusetts, New York, and Pennsylvania soon followed suit.[92] New Hampshire, on the other hand, has proposed limiting utilities' stranded-cost recovery.[93] Other states, including South Carolina,[94] have not yet decided how they will resolve the stranded-cost dilemma.[95]

State adjudicative and administrative bodies have addressed the issue as well.[96] A Michigan court of appeals,[97] a New York trial court,[98] and the Texas Public Utility Commission [99] have all ruled that full stranded-cost recovery is not mandated by law. In rejecting the utilities' claims for protection under the Fifth Amendment, the New York trial court[100] and the Texas Public Utility Commission[101] both relied upon *Market Street Railway Co. v. Railroad Commission of California*,[102] a 1945 case in which the United States Supreme Court held that a railroad was not entitled to compensation when it was forced to lower its rates by the regulatory authority.[103]

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order to "assure the continued financial integrity of California's investor owned utilities, and give them an opportunity to be vital participants in the restructured market following the transition, [the Commission] will allow them to recover 100 percent of [their stranded costs]").

92. *See* McCrea & Lawrence, *supra* note 78, at 247, 304-05.

93. *See In re* Retail Competition Pilot, 164 Pub. Util. Rep. (PUR) 4th 193 (N.H. Pub. Utils. Comm'n 1995) (proposing that shareholders of New Hampshire utilities bear 50% of the retail wheeling stranded-cost losses); Boschee, *supra* note 5, at 5 (noting that deregulation in New Hampshire has been delayed indefinitely because of litigation over stranded costs); Robert O'Brien, *Conrail, CSX Lead Stocks Higher; Dow Industrials Gain 41.18 Points*, WALL ST. J., Mar. 4, 1997, at C2 (reporting that New Hampshire's deregulation plan, which could force part of the utility into bankruptcy, prompted a sell off of Northeast Utility stock).

94. *See, e.g.*, Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1015 (1992) (ruling that a regulation is a taking when it deprives an owner of all economically beneficial use of the property).

95. *See* Boschee, *supra* note 5, at 5-8 (reporting on the different positions which have been taken by various states); *State by State*, *supra* note 88, at R6 (same).

96. Refer to notes 131-44 *infra* and accompanying text. *See also* Boschee, *supra* note 5, at 5-8.

97. *See In re* Retail Wheeling Tariffs, 575 N.W.2d 808, 816 (Mich. Ct. App. 1998) (summarily rejecting a Takings Clause challenge).

98. *See In re* Energy Ass'n v. Public Serv. Comm'n, 653 N.Y.S.2d 502, 514-15 (N.Y. Sup. Ct. 1996) (holding that the United States Constitution does not mandate full stranded-cost recovery for deregulated utilities).

99. *See In re* Central Power & Light Co., 176 Pub. Util. Rep. (PUR) 4th 397, 444 (Tex. Pub. Util. Comm'n 1997) (stating that the Takings Clause "does not guarantee a utility a return in the face of a more successful competitor").

100. *See In re Energy Ass'n*, 653 N.Y.S.2d at 514.

101. *See Central Power*, 176 Pub. Util. Rep. (PUR) 4th at 444 & n.1.

102. 324 U.S. 548 (1945).

103. *See id.* at 552-53, 567-68 (holding that when a regulated streetcar operator suffered economic losses, there was no obligation on regulators to allow for recovery of those losses).

Responding to this interpretation of *Market Street Railway*, Professors Sidak and Spulber have persuasively argued that *Market Street Railway* stands for the proposition that a utility cannot recover exogenously created costs[104] and is therefore not relevant to the electric utility stranded-costs debate, which addresses costs created endogenously by regulation.[105] However, they also argue that the Supreme Court's opinion in *Northern Pacific Railway Co. v. North Dakota*[106] supports full stranded-cost recovery for endogenous costs.[107] *Northern Pacific Railway* holds that the government cannot require a utility to change the purpose to which its dedicated property is used.[108] It remains unclear, then, whether the state adjudicative and administrative bodies will continue to deny utilities' constitutional claims for stranded-cost recovery or whether they will be persuaded by the arguments being put forth by Professors Sidak and Spulber and others.[109]

III. THE CONSTITUTIONAL FRAMEWORK

A. The Context

A finding by the United States Supreme Court that utilities have a constitutional right to full stranded-cost recovery would

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104. *See* Sidak & Spulber, *Givings, Takings*, *supra* note 52, at 1087-93 (observing that the "Court repeatedly emphasized that the streetcar industry was growing obsolete for reasons beyond the control of either the company or regulators"). Exogenous costs are those created by changes in the marketplace outside of the regulators' control, whereas endogenous costs are created by changes in the regulatory environment. *See generally id.* (providing "economic and technological forces" as examples of exogenous cost creators and "acts or omissions by regulators" as endogenous cost creators).

105. *See id.* (distinguishing *Market Street Railway* from present cases by pointing out that the Railway's costs were stranded because of external forces, not because of changes imposed by law or regulation). *But see* James Boyd, *The "Regulatory Compact" and Implicit Contracts: Should Stranded Costs Be Recoverable?*, 19 ENERGY J. 69, 79 n.24 (propounding that "exogenous technical change can . . . be thought of as a necessary, if not sufficient, condition for deregulation"). To Boyd, electric utility deregulation is an exogenous event because it is the result of technological change. *See id.*

106. 236 U.S. 585 (1915) (holding that once a regulated utility has dedicated private property to a public use, the government cannot freely appropriate that property for another purpose).

107. *See* Sidak & Spulber, *Givings, Takings*, *supra* note 52, at 1982 (explaining the Court's position in *Northern Pacific Railway* that a state may not "redefine the public use to which the [company]'s property is dedicated" without compensating the company for any losses resulting from such a redefinition).

108. *See id.*

109. Refer to Part II.B *supra* (presenting arguments of those who support stranded-cost recovery).

overturn legislation limiting that recovery.[110] On the other hand, a finding that the Constitution forbids full stranded-cost recovery[111] would wreak havoc on the many proposed and existing state initiatives that provide for full stranded-cost recovery.[112]

Although stranded-cost recovery implicates a wide range of constitutional issues,[113] this Comment focuses on the issues raised under the Takings and Due Process Clauses.[114] Unlike the Commerce Clause, which defines Congress's power to enact federal legislation,[115] the Takings and Due Process Clauses apply to both federal and state government action.[116] Moreover, the Supreme Court has recently reinvigorated the Takings and Due Process Clauses in the 1998 case of *Eastern Enterprises v. Apfel*,[117] rendering a discussion of the impact of the clauses on the stranded-cost debate timely.

*B. Substantive Due Process Jurisprudence—Pre-*Eastern

The Supreme Court's views concerning whether the Due Process Clause protects substantive economic rights have changed over the years.[118] In *Lochner v. New York*,[119] the Court

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110. Refer to Parts II.D-E *supra* (describing legislative proposals that limit stranded-cost recovery).

111. *See, e.g.*, Indianapolis Power & Light Co. v. Pennsylvania Pub. Util. Comm'n, 711 A.2d 1071, 1073 (Pa. Commw. Ct. 1998) (evaluating a Commerce Clause challenge to a stranded-costs recovery statute).

112. Refer to Parts II.D-E *supra* (providing examples of legislation that provide for full stranded-cost recovery).

113. *See, e.g., Indianapolis Power & Light Co.*, 711 A.2d at 1073-75 (rejecting a dormant Commerce Clause challenge to stranded-cost recovery legislation); *In re Retail Wheeling Tariffs*, 575 N.W.2d at 815-16 (rejecting Takings and Contracts Clause challenges to a Michigan law that mandated retail wheeling without providing for stranded-cost recovery), *rev'd on other grounds sub nom.* Consumers Power Co. v. Michigan Pub. Serv. Comm'n, 596 N.W.2d 126 (Mich. 1999).

114. U.S. CONST. amend. V.

115. *See* U.S. CONST. art. 1, § 8, cl. 3 (stating that "[t]he Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States").

116. *See* Chicago, Burlington & Quincy R.R. Co. v. Chicago, 166 U.S. 226, 241 (1897) (holding that the Takings Clause is incorporated in the Fourteenth Amendment's Due Process Clause and thus restricts state-government actions). The Fourteenth Amendment protects both natural and corporate persons and would therefore protect corporate electric utilities. *See* First Nat'l Bank v. Bellotti, 435 U.S. 765, 781 n.15 (1978) (stating that "corporations are persons within the meaning of the Fourteenth Amendment").

117. Refer to Part IV *infra* (analyzing the Justices' views in *Eastern Enterprises* on the Takings and Due Process Clauses).

118. The modern theory of substantive due process considers whether the Supreme Court is authorized "to pour into the due process clause fundamental values not traceable to constitutional text or history or structure." GERALD GUNTHER & KATHLEEN M. SULLIVAN, CONSTITUTIONAL LAW 516 (13th ed. 1997). The Court

expanded the contours of the doctrine, holding that the Fifth and Fourteenth Amendments protect the "right of contract."[120] The *Lochner* Court deemed the right of contract as fundamental to ordered liberty,[121] thus triggering heightened scrutiny.[122] Beginning in the 1930s, the Court rolled back its substantive due process jurisprudence, deciding that economic legislation would not run afoul of substantive due process if it was enacted to achieve a legitimate governmental objective by means rationally related to that objective—essentially adopting a "hands off" standard of review.[123]

Both before and after its retreat from substantive due process protection for economic rights, the Court found substantive due process protection for a variety of individual rights.[124] With respect to those newly protected individual rights, the Court generally applied a strict scrutiny standard. The resulting discrepancy between the Court's careful application of the Due Process Clause in the personal rights area[125] and its

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has long struggled to define which values are sufficiently fundamental to trigger constitutional protection. *See id.* at 516-18 (describing the origins and development of substantive due process theory in American jurisprudence).

119. 198 U.S. 45 (1905).

120. *See id.* at 53.

121. *See id.* (holding that "[t]he general right to make a contract . . . is part of the liberty of the individual protected by the Fourteenth Amendment of the Federal Constitution").

122. *See* GUNTHER & SULLIVAN, *supra* note 118, at 469 (suggesting that the *Lochner* Court made "an implicit assumption that liberty of contract *was* a fundamental value warranting special judicial protection").

123. *See id.* at 482-83; *see also* Ferguson v. Skrupa, 372 U.S. 726, 729-33 (1963) (stating that "it is up to legislatures, not courts, to decide on the wisdom and utility of legislation"); West Coast Hotel Co. v. Parrish, 300 U.S. 379, 386, 396 (1937) (reinforcing prior holdings that presumed the constitutionality of state legislation falling within a state's "police powers" absent a factual record to the contrary). As a result of the liberal application of this rational basis test, substantive due process protection for economic rights was declared dead by many commentators. *See* GUNTHER & SULLIVAN, *supra* note 118, at 482-83 (pointing out that the Court had not invalidated any economic law on substantive due process grounds since 1937).

124. *See, e.g.*, Meyer v. Nebraska, 262 U.S. 390, 399-403 (1923) (stating that the Fourteenth Amendment protections include the right "to engage in any of the common occupations of life, to acquire useful knowledge, to marry, establish a home and bring up children"); Pierce v. Society of Sisters, 268 U.S. 510, 534-35 (1925) (upholding "the liberty of parents and guardians to direct the upbringing and education of children under their control" as constitutionally guaranteed rights); Griswold v. Connecticut, 381 U.S. 479, 485 (1965) (finding that a married couple's right to use contraception fell within a "zone of privacy created by several fundamental constitutional guarantees").

125. *See, e.g*, Roe v. Wade, 410 U.S. 113, 152-53 (1973) (noting that the "right of personal privacy" is "broad enough to encompass a woman's decision whether or not to terminate her pregnancy"); *Griswold*, 381 U.S. at 485 (protecting a married couple's right of privacy).

deferential approach in the economic arena has created a tension in the Court's jurisprudence.[126]

C. *Takings Jurisprudence—Pre-*Eastern

Unlike the Due Process Clause, which prohibits procedural and substantive infringements on property rights,[127] the Takings Clause, on its face, does not bar governmental action.[128] Rather, it obligates the government to give fair compensation when it takes private property for public use.[129] Thus, although both the takings and substantive due process guarantees are included in the Fifth and Fourteenth Amendments,[130] and although both guarantees

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126. *Compare Ferguson*, 372 U.S. at 730-33 (stating that the Court would not invalidate economic legislation under the Due Process Clause), *with Roe*, 410 U.S. at 152-53, 155-164 (holding that the government had not demonstrated a "compelling state interest . . . and . . . legislative enactments [that were] narrowly drawn to express only the legitimate state interests at stake" so as to warrant the denial of a woman's right to an abortion). *See also* Lynch v. Household Finance Corp., 405 U.S. 538, 552 (1972). In *Lynch*, the Court stated:

> [T]he dichotomy between personal liberties and property rights is a false one. Property does not have rights. People have rights. The right to enjoy property without unlawful deprivation, no less than the right to speak or the right to travel, is in truth a "personal" right, whether the "property" in question be a welfare check, a home, or a savings account. In fact, a fundamental interdependence exists between the personal right to liberty and the personal right in property. Neither could have meaning without the other. That rights in property are basic civil rights has long been recognized.

See id.; *see also* United States v. Carolene Prods. Co., 304 U.S. 144, 152 & n.4 (1938) (suggesting that the Due Process Clause should be applied more carefully to fundamental rights than to economic rights).

127. *See* Cleveland Bd. of Educ. v. Loudermill, 470 U.S. 532, 541 (1985) (emphasizing that "[t]he point is straightforward: the Due Process Clause provides that certain substantive rights—life, liberty, and property—cannot be deprived except pursuant to constitutionally adequate procedures. The categories of substance and procedure are distinct").

128. *See* Eastern Enters. v. Apfel, 524 U.S. 498, 545 (1998) (Kennedy, J., concurring in the judgment and dissenting in part) (stating that "the Takings clause . . . has not been understood to be a substantive or absolute limit on the government's power to act. The Clause operates as a conditional limitation, permitting the government to do what it wants so long as it pays").

129. *See* First English Evangelical Lutheran Church v. County of Los Angeles, 482 U.S. 304, 314-15 (1987) (clarifying that the Takings Clause "does not prohibit the taking of private property, . . . but [rather] secure[s] *compensation* in the event of otherwise proper interference amounting to a taking"); Lawrence Berger, *Public Use, Substantive Due Process and Takings—An Integration*, 74 NEB. L. REV. 843, 853 (1995) (recognizing the early understanding of the Clause's effect as being limited to guaranteeing compensation for implicit takeovers of property by the government).

130. *See* Chicago, Burlington & Quincy R.R. Co. v. Chicago, 166 U.S. 226, 241 (1897) (declaring that a state's taking of private property for public use without compensating the owner "is, upon principle and authority, wanting in the due process of law required by the Fourteenth Amendment").

are triggered when a property interest is threatened,[131] their respective inquiries have traditionally been understood to be addressing fundamentally seperate questions.[132] The due process inquiry logically comes first because it determines whether the government action in question was a legitimate exercise of the government's police power, whereas the takings inquiry only becomes relevant once it has been determined that the government action was permissible.[133] The latter inquiry determines whether the government must compensate individuals for its admittedly legitimate action.[134] Thus, under the traditional interpretation of the Takings Clause, if a governmental action does not pass the due process hurdle, the takings question should not be relevant.

In recent years, however, the Court has devoted much attention to, and expanded the parameters of, the Takings Clause.[135] One possible explanation for this trend is that the Takings Clause, unlike many of the Court-discovered fundamental rights protected by substantive due process,[136] is an explicit provision in the Constitution.[137]

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131. *See Eastern Enters.*, 524 U.S. at 540 (Kennedy, J., concurring in the judgment and dissenting in part) (explaining that a takings claim must attach itself to an identifiable property interest, such as an estate in land, intellectual property, or a bank interest); Phillips v. Washington Legal Found., 524 U.S. 156, 163-64 (1998) (addressing the crucial question of what is considered private property for Takings Clause purposes); Board of Regents v. Roth, 408 U.S. 564, 578 (1972) (ruling that a fired professor did not have a property interest in his position and was therefore not entitled to procedural due process); Morrissey v. Brewer, 408 U.S. 471, 481 (1972) ("The question [of whether due process applies] is . . . whether the nature of the interest is one within the contemplation of the 'liberty or property' language of the Fourteenth Amendment.").

132. *See Eastern Enters.*, 524 U.S. at 545-49 (Kennedy, J., concurring in the judgment and dissenting in part) (arguing that the Takings Clause "permit[s] the Government to do what it wants so long as it pays" and that it is the Due Process Clause that asks whether the legislation at issue is a legitimate exercise of the government's police power).

133. *See id.* at 546 (Kennedy, J., concurring in the judgment and dissenting in part) (reflecting Justice Kennedy's interpretation of previous Supreme Court cases).

134. *See First English Evangelical Lutheran Church*, 482 U.S. at 314-15.

135. *See* Dolan v. City of Tigard, 512 U.S. 374, 392 (1994) (stating that the Court "see[s] no reason why the Takings Clause of the Fifth Amendment, as much a part of the Bill of Rights as the First Amendment or Fourth Amendment, should be relegated to the status of a poor relation").

136. *See, e.g.*, Roe v. Wade, 410 U.S. 113, 152 (1973) (holding that the Constitution protects a fundamental right of privacy even though such a right is not explicitly mentioned in the Constitution's text).

137. *See* J. Gregory Sidak & Thomas A. Smith, *Four Faces of the Item Veto: A Reply to Tribe and Kurland*, 84 NW. U. L. REV. 437, 465 (1990) (noting that the Takings Clause is explicit but other protections such as the "right to privacy" do not have "textual anchor[s]"). *But cf.* John D. Echeverria & Sharon Dennis, *The Takings Issue and the Due Process Clause: A Way Out of a Doctrinal Confusion*, 17 VT. L.

The Court has found Takings Clause violations in three different contexts. The first and most evident form of a taking occurs when there is an actual appropriation of property by the government.[138] The second form, commonly referred to as a regulatory taking, involves cases in which governmental regulations deny property owners economically viable use of their property.[139]

In its purest form, a regulatory taking occurs when the government, using its police power, destroys the value of an asset.[140] Often, however, the government regulates the use of a property interest in a manner that whittles away, but does not completely destroy, the asset's value.[141] Although many such restrictions have been upheld by the courts,[142] some of these restrictive regulations have been adjudged as unconstitutional takings.[143] The Court has struggled to define the point at which a regulation that diminishes the value of a property interest becomes a taking.[144]

When the Supreme Court analyzes these first two forms of takings—the appropriation of tangible assets or destruction of

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REV. 695, 695 (1993) (opining that the reasons for commentators' and litigants' embrace of the Takings Clause are "rooted largely in history").

138. *See, e.g.*, Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 421 (1982) (holding that a physical occupation of property can be a taking).

139. *See* Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1015 (1992) (ruling that a regulation is a taking when it deprives an owner of all economically beneficial use of the property).

140. *See id.*

141. *See* Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 130 (1978) (declining to overturn New York's historic preservation law although the law deprived Penn Central of a potentially developable property interest).

142. *See, e.g.*, Agins v. City of Tiburon, 447 U.S. 255, 260-61 (1980) (deciding that, as long as an owner is not denied "economically viable use of his land," a regulation is not a taking so long as it "substantially advance[s] legitimate governmental goals"); *Penn Cent. Transp. Co.*, 438 U.S. at 130.

143. *See* Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 415 (1922) (concluding that "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking").

144. *Compare* Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 485 (1987) (upholding a regulation banning sub-surface mining because the regulation did not make profitable business impossible or unduly interfere with investment-backed expectations), *with Pennsylvania Coal Co.*, 260 U.S. at 402 (holding that a regulation banning sub-surface coal mining was an unconstitutional taking because it had the practical effect of destroying the coal that Pennsylvania Coal Co. had a right to mine). In *Keystone*, the Court distinguished *Pennsylvania Coal Co.* by finding that the regulation in *Keystone* was enacted "to protect the public interest in health, the environment, and the fiscal integrity of the area," whereas the regulation in *Pennsylvania Coal* served "only to ensure against damage to some private landowners' homes." *Keystone*, 480 U.S. at 487-88; *see also* GUNTHER & SULLIVAN, *supra* note 118, at 491 (elaborating on the differences between *Keystone* and *Pennsylvania Coal*). Notwithstanding the Court's simplistic distinction, consideration of the two cases in tandem illustrates the difficulty of determining when a regulation becomes a taking.

economic viability—the Court has focused on whether a "taking" has occurred and viewed the modifying phrase "for public use" as a presupposition.[145] Thus, the phrase "for public use" does not address whether an action is a taking; it is included in the Takings Clause because, pursuant to the Due Process Clause, all government action must be based upon a police power to qualify as a legitimate exercise of power—regardless of compensation.

Consequently, the traditional takings inquiry attempts only to discern when diminution of ownership constitutes a taking.[146] This analysis is free standing and is not linked to a due process-like "ends and means" inquiry.[147] Whereas due process analysis determines whether the government *may* deprive,[148] the takings inquiry determines whether the government *has* deprived.[149] Takings analysis is a value-neutral inquiry that does not address the legitimacy of governmental action but instead assesses whether compensation must be paid as a result of such an action.[150]

Over the years, the Supreme Court has developed a third strand of takings analysis, which essentially creates a hybrid constitutional inquiry by incorporating a due process-like, value-based inquiry into traditional takings analysis.[151]

Consequently, the modern Court has adopted the view that the Takings Clause's "public use" phrase supports the inclusion of an ends-based factor in the takings inquiry[152] so that the

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145. *See* Echeverria & Dennis, *supra* note 137, at 697.

146. *See id.* at 696-98 (citing early Supreme Court cases that clearly distinguished between the takings and due process inquiries).

147. *See id.* at 698 (emphasizing that "review of the legislative means had no place in the [Court's takings] analysis").

148. *See, e.g.*, Goldblatt v. Town of Hempstead, 369 U.S. 590, 591, 594 (1962) (addressing a substantive due process challenge by assessing whether the governmental action was legitimate).

149. *See* First English Evangelical Lutheran Church v. County of Los Angeles, 482 U.S. 304, 314 (1987) (stating that the Takings Clause "does not prohibit the taking of private property, but instead places a condition on the exercise of that power").

150. *See id.* at 315.

151. *See* Agins v. City of Tiburon, 447 U.S. 255, 261 (1980) (holding that a regulation may "effect[ ] a taking if [it] does not substantially advance legitimate state interests"); Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 124 (1978) (incorporating an assessment of the merit of the governmental action in the takings analysis); *see also* Katherine E. Stone & Philip A. Seymour, *Regulating the Timing of Development: Takings Clause and Substantive Due Process Challenges to Growth Control Regulations*, 24 LOY. L.A. L. REV. 1205, 1229 (1991) (noting that "[t]he relationship between takings analysis and substantive due process analysis is less than clear in the existing case law"); Glen E. Summers, Comment, *Private Property Without* Lochner*: Toward a Takings Jurisprudence Uncorrupted by Substantive Due Process*, 142 U. PA. L. REV. 837, 842-46 (1993) (contrasting the Court's takings and substantive due process precedents).

152. *See* Jan G. Laitos, *The Public Use Paradox and the Takings Clause*, 13 J.

takings inquiry asks: (1) whether the government has taken the property interest,[153] (2) whether the alleged taking was for a public use,[154] and (3) whether just compensation was provided.[155] This reading of the Clause clearly makes the public-use question a part of the takings inquiry.

Public-use takings analysis is an ends-focused inquiry that questions the merits of the challenged legislation and, as such, resembles a substantive due process inquiry.[156] Under this form of analysis, the Court finds a taking if the government action in question "does not substantially advance legitimate state interests."[157] In other words, governmental regulation that merely diminishes an asset's value will constitute a taking only if the public use element is weak.

The Supreme Court's blurring of the boundary between substantive due process and takings jurisprudence has made it difficult to predict how the Court will analyze any given scenario.[158] Expansion of the takings doctrine to incorporate a due process inquiry implicates another possible consequence: a

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ENERGY NAT. RESOURCES & ENVT'L. L. 9, 13-14 (1993) (discussing various possible interpretations of the "public use" phrase); Thomas J. Coyne, Note, Hawaii Housing Authority v. Midkiff: *A Final Requiem for the Public Use Limitation on Eminent Domain?*, 60 NOTRE DAME L. REV. 388, 396 (1985) (contending that "[b]y requiring . . . defer[ence] to legislative determinations of what constitutes public use, the Supreme Court has seemingly characterized all takings as [legitimate] economic regulat[ion]" (footnote omitted)).

153. *See* Nollan v. California Coastal Comm'n, 483 U.S. 825, 831 (1987) (finding a public easement over private property to be a taking); Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 434-39 (1982) (discussing prior takings jurisprudence and finding a law requiring landlords to permit cable installation on their premises to be a taking).

154. *See Agins*, 447 U.S. at 260 (proclaiming that an ordinance affecting a property interest is a taking if it "does not substantially advance legitimate state interests"); *Penn Cent. Transp. Co.*, 438 U.S. at 127 (explaining that "a use restriction on real property may constitute a 'taking' if not reasonably necessary to the effectuation of a substantial public purpose").

155. *See* Duquesne Light Co. v. Barasch, 488 U.S. 299, 310 (1989) (indicating that the "reasonableness" of a utility rate and, consequently, what is just compensation for an excessive rate, depends partly upon defining "a fair rate of return given the risks under a particular ratesetting system"); Hodel v. Virginia Surface Mining & Reclamation Ass'n, 452 U.S. 264, 297 n.40 (1981) (stating that the constitutional proscription against takings is triggered only if just compensation has not been provided).

156. *See* Eastern Enters. v. Apfel, 524 U.S. 498, 537 (1998) (acknowledging the correlation between the two inquiries).

157. *Agins*, 447 U.S. at 260.

158. Refer to Part IV *infra* (analyzing the divergent opinions in the Court's most recent application of the Takings and Due Process Clauses). *See also* Karena C. Anderson, *Strategic Litigating in Land Use Cases:* Del Monte Dunes v. City of Monterey, 25 ECOLOGY. L.Q. 465, 467-68 (1998) (discussing how this "doctrinal inconsistency" can be used by plaintiffs to increase their likelihood of success).

claimant's failure to establish a takings violation may preclude a substantive due process claim,[159] thereby limiting the remedies available to an injured party.[160] Notwithstanding these doctrinal inconsistencies, the Court has absorbed the ends-based inquiry into its takings analysis.[161]

IV. *EASTERN ENTERPRISES V. APFEL*

In *Eastern Enterprises v. Apfel*, the Supreme Court further invigorated the Takings Clause and may have opened the door for future expansion of economic substantive due process jurisprudence as well. The four-Justice plurality in *Eastern Enterprises* incorporated an ends-focused, value-based inquiry into its takings analysis.[162] The plurality also expanded the parameters of the Takings Clause, holding that legislation assessing a general penalty against a company effected a taking, even if the sanction did not deprive the company of any specific asset.[163] This expansive analysis may significantly increase utilities' ability to recover on Takings Clause claims. Many such claims are based upon a breach of a regulatory contract theory,[164] which does not necessarily deprive a company of a particular asset.[165] Moreover, the relatively favorable treatment accorded to Eastern's substantive due process claim by many of the Justices[166] bodes well for deregulated utilities and others who adopt a substantive due process theory in retroactive deprivation claims.

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159. *See* Toni M. Massaro, *Reviving Hugo Black? The Court's "Jot for Jot" Account of Substantive Due Process*, 73 N.Y.U. L. REV. 1086, 1099-110 (1998) (noting the "general proscription against invoking substantive due process whenever a specific textual provision . . . may apply").

160. *See id.* at 1102 (suggesting that a "court could simply dismiss the substantive due process claim as unavailable . . . and analyze only the takings claim").

161. Refer to notes 152-55 *supra* and accompanying text (comparing the Court's takings analysis in several cases).

162. Refer Part IV.B *infra* (discussing the plurality's approach in *Eastern Enterprises*).

163. *See* Eastern Enters. v. Apfel, 524 U.S. 498, 529 (1998) (declaring that "[t]he fact that the Federal Government ha[d] not specified the assets that Eastern [had to] use to satisfy its obligation [did] not negate [the] impact [of the financial burden upon Eastern]").

164. Refer to Part V.A.2 *infra* (providing a detailed discussion of regulatory contracts).

165. Refer to Parts V.A.2 *infra* (explaining the significance of regulatory contracts in takings analysis when a company is not being deprived of a tangible asset).

166. Refer to Parts IV.B-D *infra* (describing the plurality, concurring, and dissenting opinions, respectively).

Although the Justices forming the plurality in *Eastern Enterprises* could not agree on a basis for their holding,[167] a majority of the Court decided that certain provisions of the 1992 Coal Industry Retiree Health Benefit Act[168] ("Coal Act") were unconstitutional.[169] Justice O'Connor, joined by Chief Justice Rehnquist and Justices Scalia and Thomas, held that the provisions violated the Takings Clause.[170] Justice Kennedy concurred in the judgment,[171] but instead would have invalidated the legislation on substantive due process grounds rather than the takings issue.[172] The dissenters, Justices Stevens, Souter, Ginsburg, and Breyer, would have upheld the constitutionality of the Coal Act.[173] All four dissenters joined two opinions, written by Justices Stevens and Breyer.[174] Justice Breyer adopted Justice Kennedy's substantive due process framework[175] but concluded that the Coal Act did not violate the Due Process Clause.[176] Justice Stevens took a deferential position toward Congress's legislative judgment and determined that, regardless of whether the statute was analyzed under the Takings Clause or under the Due Process Clause, Eastern had not "overcom[e] the presumption of constitutionality accorded to an Act of Congress."[177]

A. The Facts

A precise understanding of the various holdings in *Eastern Enterprises* requires a close look at the particular facts of the case. Eastern, the petitioner, was directly involved in the coal mining industry from its formation in 1929[178] until it divested its

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167. *See Eastern Enters.*, 524 U.S. at 529 (acknowledging the Justices' different approaches).

168. 26 U.S.C. §§ 9701-9722 (1994).

169. *See Eastern Enters.*, 524 U.S. at 515, 537; *id.* at 539 (Kennedy, J., concurring in the judgment and dissenting in part).

170. *See id.* at 502, 537.

171. *See id.* at 539 (Kennedy, J., concurring in the judgment and dissenting in part).

172. *See id.* (Kennedy, J., concurring in the judgment and dissenting in part).

173. *See id.* at 553 (Stevens, J., dissenting); *id.* at 568 (Breyer, J., dissenting).

174. *See id.* at 550 (Stevens, J., dissenting); *id.* at 553 (Breyer, J., dissenting). All four dissenters joining in both dissenting opinions makes it difficult to discern exactly where Justices Souter and Ginsburg lie on the continuum of the opinion.

175. *See id.* at 554 (Breyer, J., dissenting) (agreeing with Justice Kennedy that "the plurality view[ed] this case through the wrong legal lens").

176. *See id.* at 553, 556 (Breyer, J., dissenting) (opining that it was "not fundamentally unfair" to hold Eastern liable).

177. *Id.* at 553 (Stevens, J., dissenting).

178. *See id.* at 504.

coal-related activities to a subsidiary in 1963.[179] During that period, Eastern signed a series of National Bituminous Coal Wage Agreements (NBCWA),[180] which provided health care benefits for working miners.[181] The benefits were offered on a "pay as you go"[182] basis, and the level of benefits was subject to revision at any time by the plan's trustees.[183] Before 1974, miners and their dependents were not promised specific benefits.[184] In 1974, after Congress passed the Employee Retirement Income Security Act (ERISA),[185] the structure of the NBCWA began to change.[186] These changes, however, occurred long after Eastern was out of the coal business.[187]

The 102nd Congress, concluding that miners were "led to believe by their own union leaders, and [by] the companies for which they worked that they were guaranteed lifetime [health] benefits,"[188] passed the Coal Act in response.[189] The Coal Act created a health benefit provision system for retired miners and their dependents.[190] This health plan assigned eligible coal industry retirees to current and former coal mining companies ("operators"), which then became responsible for the retiree's health care.[191] Although efforts were made to assign retired coal workers to employers for whom they had recently worked,[192] any employer who was a signatory to the 1950, 1974, 1978, or any subsequent NBCWA benefit plan remained potentially liable for

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179. *See id.* at 516. *See generally* Grant Crandall et al., *Hiding Behind the Corporate Veil: Employer Abuse of the Corporate Form to Avoid or Deny Workers' Collectively Bargained and Statutory Rights*, 100 W. VA. L. REV. 537, 587-88 (1998) (referring to Eastern's use of a wholly owned subsidiary as a corporate shield to liability).

180. *See Eastern Enters.*, 524 U.S. at 505 (providing historical background on the NBCWA).

181. *See id.* at 505-06.

182. *See id.* at 506.

183. *See id.* at 507.

184. *See id.* at 506.

185. 29 U.S.C. § 1001 (1994) (introducing specific funding requirements for pension plans in general).

186. *See Eastern Enters.*, 524 U.S. at 509 (noting the establishment of four new trusts to manage the plan and expansion of the plan's scope).

187. *See id.* at 530 (explaining that Eastern ceased its coal mining operations in 1965).

188. *See Coal Commission Report on Health Benefits of Retired Coal Miners: Hearing Before the Subcommittee on Medicine and Long Term Care of the Senate Committee on Finance*, 102nd Cong. 59 (1991) (prepared statement of Sen. Orrin G. Hatch).

189. 26 U.S.C. §§ 9701-9722 (1994).

190. *See id.* §§ 9702-9706.

191. *See id.* § 9706(a)(1),(2),(3).

192. *See id.* § 9706(a)(1).

funding the health benefits of their assignees.[193] If an eligible beneficiary had worked only for companies that were not signatories to either the 1978 or subsequent wage agreements, the Act assigned the worker to the operator that had "employed the coal industry retiree . . . for [the] longe[st] period of time . . . prior to the effective date of the 1978 . . . agreement."[194]

After the Coal Act was enacted, Eastern was assigned more than 1,000 retired miners who had worked for the company before 1966.[195] The assignment was based upon Eastern's status as the pre-1978 signatory operator for whom the miners had worked the longest time.[196] Eastern sued, asserting various causes of action, including violations of the substantive due process and takings gaurantees of the Fifth Amendment.[197] The district court denied Eastern's subsequent motion for summary judgment.[198]

The Court of Appeals for the First Circuit affirmed the district court's denial of summary judgment,[199] stating that Commerce Clause legislation is "entitled to the most deferential level of judicial scrutiny" and that "[w]here, as here, a piece of legislation is purely economic and does not abridge fundamental rights, a challenger must show that the legislature acted 'in an arbitrary and irrational way.'"[200] The Supreme Court granted certiorari[201] and reversed.[202]

B. The Plurality—Takings

Although the First Circuit considered the merits of Eastern's substantive due process claim,[203] the plurality decided that it was unnecessary to address that issue because, in its view, the Coal Act violated the Takings Clause.[204] Although declining to address Eastern's substantive due process claim,[205] Justice O'Connor

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193. *See id.*
194. *See id.* § 9706(a)(3).
195. Eastern Enters. v. Apfel, 524 U.S. 498, 517 (1998).
196. *See id.*
197. *See* Eastern Enters. v. Shalala, 942 F. Supp. 684, 685-86 (D. Mass. 1996).
198. *See id.*
199. *See* Eastern Enters. v. Chater, 110 F.3d 150, 162 (1st Cir. 1997).
200. *See id.* at 155-56 (quoting Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 15 (1976)).
201. *See* Eastern Enters. v. Apfel, 522 U.S. 931, 931 (1997).
202. *See* Eastern Enters. v. Apfel, 524 U.S. 498, 538 (1998).
203. *See Chater*, 110 F.3d at 159 (holding that the Coal Act did not offend substantive due process).
204. *See Eastern Enters.*, 524 U.S. at 538.
205. *See id.*

recognized that the Court's "analysis of legislation under the Takings and Due Process Clauses is correlated to some extent"[206] and, indeed, acknowledged that "there is a question whether the Coal Act violates due process."[207] The plurality was reluctant to pursue Eastern's substantive due process claim,[208] however, because of traditional "concerns about using the Due Process Clause to invalidate economic legislation."[209] Despite it's reluctance, the plurality did not dismiss the substantive due process claim out of hand; rather, it chose to proceed carefully, ever wary of *Lochner*, but at the same time, it left the door ajar for reconsideration of economic substantive due process claims.[210]

The plurality's use of a takings analysis is somewhat problematic. Logically, the substantive due process inquiry should come first[211] because it addresses whether the government has the power to act at all.[212] The takings inquiry, addressing whether the government should compensate economically injured parties for legitimate governmental action, should be embarked upon only if the government satisfactorily prevails on the due process challenge.[213]

The *Eastern Enterprises* plurality, not wishing to base its decision upon a substantive due process theory, invalidated the

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206. *Id.* at 537.

207. *Id.*

208. *See id.* (explaining the plurality's hesitance concerning the use of the Due Process Clause).

209. *Id.*

210. *See* Harold J. Krent, *Supreme Court Slams Retroactive Lawmaking*, CHI. DAILY L. BULL., July 6, 1998, at 6 (declaring that "[i]f the court is willing to protect coal and other companies from economic regulation . . . then a resurgence of the 1920s and 1930s *Lochner*-style judicial activism may not be far away"); *see also* Sally Burgin, *Local Governments Taking Charge of Water Quality—Is It a Good Idea?*, 5 NAT. RESOURCES & ENV'T 19, 21 (1991) (interpreting Nollan v. California Coastal Comm'n, 438 U.S. 825 (1987) as an indication that "a resurgence of substantive due process review may be on the horizon"); Nathaniel S. Lawrence, *Means, Motives, and Takings: The Nexus Test of* Nollan v. California Coastal Commission, 12 HARV. ENVTL. L. REV. 231, 246 (1988) (observing the possible rebirth of substantive due process suggested by *Nollan*); David G. Andersen, Comment, *Urban Blight Meets Municipal Manifest Destiny: Zoning at the Ballot Box, the Regional Welfare and Transferable Development Rights*, 85 NW. U. L. REV. 519, 534-35 (1991) (discerning a recurrence of "*Lochner*-Era" substantive due process jurisprudence in the Supreme Court's land use cases and extending the "*Lochnerian*" logic to "regulatory takings cases involving only economic rights in private property" (footnote omitted)).

211. *See Eastern Enters.*, 524 U.S. at 546 (Kennedy, J., concurring in the judgment and dissenting in part).

212. *See id.* (Kennedy, J., concurring in the judgment and dissenting in part).

213. Refer to 133-34 *supra* (discussing the pre-*Eastern Enterprises* understanding of the Takings Clause). *See also* Anderson, *supra* note 158, at 467 (contrasting substantive due process and takings Claims).

legislation on takings grounds instead.[214] Justice O'Connor began the Takings Clause analysis by reiterating that the purpose of the Takings Clause "is to prevent the government 'from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.'"[215] She then provided a framework for determining whether the government has taken property within the meaning of the Fifth Amendment.[216]

Justice O'Connor first reaffirmed the traditional paradigm of a taking, whereby the government directly appropriates private property for its own use.[217] If, however, the government restricts property rights through implementation of a "public program [that adjusts] the benefits and burdens of economic life to promote the common good,"[218] then assessment of the regulation's constitutionality requires an "ad hoc and fact intensive" inquiry as to the "justice and fairness" of the governmental action.[219] The most significant triggering factors in this ad hoc inquiry are "'[t]he economic impact of the regulation, its interference with reasonable investment backed expectations, and the character of the governmental action.'"[220]

Measuring the Coal Act against the three regulatory takings factors—economic impact, interference with reasonable investment backed expectations, and the character of the governmental action—the plurality found the Coal Act to effect an unconstitutional taking.[221] Although the plurality analyzed the Coal Act under the framework for a regulatory taking,[222] it remains unclear whether this analysis mirrors the due process inquiry proposed by Justice Kennedy's concurring opinion[223] and the dissent[224] or whether there is a substantive difference

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214. *See Eastern Enters.*, 524 U.S. at 538.

215. *Id.* at 522 (quoting Armstrong v. United States, 364 U.S. 40, 49 (1960)).

216. *See id.* at 522-29.

217. *See id.* at 522.

218. *Id.* (quoting Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 124 (1978)).

219. *See id.* at 523.

220. *See id.* at 523-24 (quoting Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979)).

221. *See id.* at 522-29.

222. *See id.*

223. *See id.* at 548 (Kennedy, J., concurring in the judgment and dissenting in part) (stating that "'[t]he retrospective aspects of [economic] legislation, as well as the prospective aspects, must meet the test of due process'" (alteration in original) (quoting Usury v. Turner Elkhorn Mining Co., 428 U.S. 1, 15 (1976))).

224. *See id.* at 556 (Breyer, J., dissenting) (stating that the question of whether the Coal Act is fundamentally unfair "finds a natural home in the Due Process Clause"); *see also* Leading Cases, 112 HARV. L. REV. 122, 218-21 (1998) (concluding

between the tests employed in the various opinions.[225] The plurality recognized this doctrinal confusion,[226] but did little to clarify the matter.[227]

Additional difficulties are raised by the plurality's application of its takings analysis. Prior to *Eastern Enterprises*, the Takings Clause was applied only in cases involving a specific property right or interest.[228] The plurality's application of the Takings Clause to Eastern's general right not to incur liability blurs the distinction between a substantive due process claim and a takings claim[229] and affords little guidance with respect to the appropriate point of demarcation between the two types of claims.[230]

Beneath this doctrinal confusion, it appears that the Court is struggling with the fundamental inconsistencies between its application of substantive due process to economic rights and its interpretation of the doctrine with respect to personal rights.[231] The plurality appears to be importing substantive due process theory into takings analysis in an attempt to remedy this imbalance.[232]

C. Justice Kennedy's Concurrence—Substantive Due Process

Justice Kennedy, in an unjoined concurrence, concluded that the Takings Clause was not implicated because Eastern was not

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that there is no substantive difference between the legal principles embraced in the various opinions).

225. *See* Leading Cases, *supra* note 224, at 218-21. Possible substantive distinctions between the different approaches may include Justice Kennedy's focus on whether Eastern was being held liable for a problem it did not create, Justice Breyer's focus on "reasonable reliance and settled expectations," and the plurality's focus on investment-backed expectations. *See id.* However, these distinctions seem to reflect differences in semantics rather than substance.

226. *See Eastern Enters.*, 524 U.S. at 537 (recognizing that "analysis of legislation under the Takings and Due Process Clauses is correlated to some extent").

227. *See id.* at 537-38.

228. *See id.* at 541 (Kennedy, J., concurring in the judgment and dissenting in part); William Funk, *Supreme Court News*, ADMIN. & REG. L. NEWS, Fall 1998, at 12, 13 (contending that *Eastern Enterprises* expands the Takings Clause beyond the real property context).

229. *See* Anderson, *supra* note 158, at 507-08 (describing the doctrinal uncertainty caused by the plurality's importation of substantive due process analysis into its takings jurisprudence).

230. *See Eastern Enters.*, 524 U.S. at 540 (Kennedy, J., concurring in the judgment and dissenting in part).

231. Refer to Part III.B *supra* (describing the tension in the Court's substantive due process jurisprudence).

232. Refer to notes 156-61 *supra* and accompanying text (discussing the elusive distinction between the Court's takings analysis and the due process analysis).

deprived of a specific property right.[233] He argued that the Act should have been struck down on substantive due process grounds.[234]

Justice Kennedy asserted that his position was consistent with both "accepted principles" of constitutional law[235] and Court precedent.[236] His opinion, however, appears to venture beyond those precedents, moving toward greater acceptance of substantive due process rights in the economic arena.

Justice Kennedy cited nine Supreme Court cases in support of his contention that his analysis comports with Court precedent.[237] In each one of those cases, however, the Court upheld the statute at issue and declined to invalidate on due process grounds or any other constitutional basis.[238]

Moreover, Justice Kennedy argued that the "retroactive effect" and "unprecedented scope" of the liability imposed by the Coal Act lay "far outside the bounds of retroactivity permissible under our law."[239] Notwithstanding this emphatic declaration,

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233. *See Eastern Enters.*, 524 U.S. at 540 (Kennedy, J., concurring in the judgment and dissenting in part) (pointing out that the statute "does not operate upon or alter an identified property interest . . . . The statute is indifferent as to how the regulated entity elects to comply or the property it uses to do so. To the extent it affects property interests, it does so in a manner similar to many laws . . .").

234. *See id.* at 539 (Kennedy, J., concurring in the judgment and dissenting in part).

235. *See id.* at 547 (Kennedy, J., concurring in the judgment and dissenting in part) ("Accepted principles forbidding retroactive legislation of this type are sufficient to dispose of the case.").

236. *See id.* at 547-48 (Kennedy, J., concurring in the judgment and dissenting in part).

237. *See id.* at 547-49 (Kennedy, J., concurring in the judgment and dissenting in part).

238. *See* United States v. Carlton, 512 U.S. 26, 31-32 (1994) (ruling that retroactive tax liability does not violate the Due Process Clause); Landgraf v. USI Film Prods., 511 U.S. 244, 266-68 (1994) (deciding that judicial deference to Congress trumped the due process protection from retroactive civil litigation even if the legislation at issue appears unfair); Concrete Pipe & Prods. of Cal., Inc. v. Construction Laborers Pension Trust, 508 U.S. 602, 636-41 (1993) (deciding that a partially retroactive pension plan withdrawal penalty did not violate due process); General Motors Corp. v. Romein, 503 U.S. 181, 183, 191-92 (1992) (upholding a Michigan law that retroactively denied employers previously recoverable benefits); United States v. Sperry Corp., 493 U.S. 52, 64-65 (1989) (finding retroactive and selective application of a governmental charge constitutional); United States v. Hemme, 476 U.S. 558, 569-70 (1986) (holding that retroactive assessment of a tax does not violate due process); Pension Benefit Guar. Corp. v. R.A. Gray & Co., 467 U.S. 717, 719-20 (1984) (deciding that retroactive application of pension plan liability was constitional); United States v. Darusmont, 449 U.S. 292, 296-97 (1981) (per curiam) (rejecting a due process challenge to retroactive application of tax statute amendments); Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 18-20 (1976) (upholding the constitutionality of a health benefit scheme similar to the one challenged in *Eastern Enterprises*).

239. *Eastern Enters.*, 524 U.S. at 549-50 (Kennedy, J., concurring in the

however, it is difficult to distinguish the Coal Act from other statutes that have withstood due process and takings challenges, even though the challenged statutes imposed liability on employers for past employment relationships.[240] Even if the Coal Act is distinguishable from previously challenged legislation, striking down economic legislation on substantive due process grounds, retroactive or not, amounts to a clear break from the Court's post-*Lochner* precedent.[241]

Justice Kennedy attempted to defuse and de-emphasize the significance of the specter of *Lochner* by pointing to the retroactive nature of the Coal Act.[242] Justice Kennedy stated that "[i]f retroactive laws change the legal consequences of transactions long closed, the change can destroy the reasonable certainty and security which are the very objects of property ownership."[243] The Coal Act had the effect of changing the legal consequences of the NCBWA by imposing liability for health benefits long after Eastern had left the coal business.[244] Under the Coal Act, companies were assigned liability based upon their prior employment of certain individuals, even though at the time of these individuals' employment the obligations were not an accepted part of the transaction.[245]

Despite Justice Kennedy's assertions, distinguishing the Coal Act from other legislation based upon retroactivity seems unwarranted because all economic legislation is retroactive to the extent that it changes the legal import of past actions. For example, passage of the Endangered Species Act or wetlands legislation changed the legal significance of many land

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judgment and dissenting in part).

240. *See, e.g.*, *Concrete Pipe & Prods.*, 508 U.S. at 609, 641 (permitting the retroactive imposition of penalties to employers withdrawing from a multiemployer pension plan); *Usery*, 428 U.S. at 5, 23-24 (rejecting a substantive due process challenge to the Black Lung Benefits Act of 1972, which provided that mining operators were potentially liable for "compensat[ing] certain miners, former miners, and their survivors for death or total disability due to pneumoconiosis arising out of employment in coal mines").

241. *See* Krent, *supra* note 210, at 6 (warning that the Court's willingness "to protect coal and other companies from economic regulation" indicates a possible "resurgence of the 1920s and 1930s *Lochner*-style judicial activism"); *see also* ERNEST GELLHORN & RICHARD J. PIERCE, JR., REGULATED INDUSTRIES IN A NUTSHELL 83 (2d ed. 1987) (pointing out that the Court has not invalidated economic legislation on substantive due process grounds since 1937).

242. *See Eastern Enters.*, 524 U.S. at 549 (Kennedy, J., concurring in the judgment and dissenting in part).

243. *Id.* at 548 (Kennedy, J., concurring in the judgment and dissenting in part).

244. *See id.* at 550 (Kennedy, J., concurring in the judgment and dissenting in part) (noting Eastern's departure from the coal business long before the expectation of benefits had been established).

245. *See id.* at 514-15 (explaining the primary provisions of the Coal Act).

purchases.[246] Upon passage of those laws, land tracts that had previously been developable became unfit for development.[247]

Justice Kennedy conceded that retroactivity is not a per se disqualifier, but noted that "our law has harbored a singular distrust of retroactive statutes."[248] He reasoned that a finding of a retroactive statute as "arbitrary and irrational" and thus unconstitutional would be based upon an assessment of three factors.[249] The first factor Justice Kennedy considered was whether the statute "change[d] the legal consequences of [prior] transactions [so as to] *destroy the reasonable certainty and security* . . . of property ownership."[250] The second factor was whether the legislation had an excessive retroactive effect.[251] The third factor inquired whether the legislation was remedial and, thus, designed to impose an "actual measurable cost" that resulted from the activity at issue.[252]

When one views these factors in their totality, they are arguably all variants of one central question: was the deprivation a foreseeable cost of doing business? Therefore, under Justice Kennedy's criteria, deprivations that do not destroy "reasonable certainty," that do not have an excessive retroactive effect, and that recoup an actual measurable cost of doing business comprise foreseeable risks and not unconstitutional deprivations. Conversely, a statute that destroys certainty, that is excessively retroactive, and that does not seek to recoup a measurable cost of doing business is unforeseeable and, thus, an unconstitutional substantive due process violation. Essentially, the pivotal question is not whether the statute is retroactive per se, but whether the consequences were foreseeable.

Justice Kennedy's willingness to expand the application of substantive due process in the economic arena, albeit a very narrow expansion, is a positive development. The discrepancy between the Court's application of the due process guarantees in the economic and personal rights area has created a disturbing

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246. *See* Jan G. Laitos, *Legislative Retroactivity*, 52 WASH. U. J. URB. & CONTEMP. L. 81, 114 n.116, 115 & n.120 (1997) [hereinafter Laitos, *Legislative Retroactivity*] (discussing cases in which environmental wildlife legislation restricted the use of land, yet withstood takings challenges).

247. *See id.*

248. *Eastern Enters.*, 524 U.S. at 547 (Kennedy, J., concurring in the judgment and dissenting in part).

249. *See id.* (Kennedy, J., concurring in the judgment and dissenting in part).

250. *Id.* at 548 (Kennedy, J., concurring in the judgment and dissenting in part) (emphasis added).

251. *See id.* at 549 (Kennedy, J., concurring in the judgment and dissenting in part).

252. *See id.* (Kennedy, J., concurring in the judgment and dissenting in part).

asymmetry in the Court's constitutional jurisprudence.[253] Additionally, the Court's recent expositions on the Takings Clause have interpreted the clause in a manner inconsistent with its plain and historical meanings.[254] An expanded reading of the Due Process Clause will aid in addressing both concerns.

D. The Dissenters

The remaining four Justices joined in two separate dissenting opinions.[255] Justice Stevens's dissenting opinion demonstrated complete deference to congressional judgment[256] and adhered to the Court's historical "hands off" approach to economic legislation.[257] He argued that Eastern had not overcome the "presumption of constitutionality accorded to an Act of Congress"[258] and that it was therefore unnecessary to decide whether Eastern's claims should be addressed under the Takings or the Due Process Clauses.[259]

The primary dissent, authored by Justice Breyer, argued that an implicit understanding existed between the mining companies and the unions under which the miners would be awarded lifetime health benefits, and therefore the Due Process Clause was not violated.[260] Justice Breyer agreed with Justice Kennedy's argument that the Takings Clause was not applicable,[261] but dissented based upon his belief that Eastern failed to show that it had not expected to pay for the benefits in question.[262] Justice Breyer concluded that upon consideration of Eastern's "reasonable reliance and settled expectations"[263] and the benefits that Eastern derived from the employment of the

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253. Refer to Part III.B *supra* (expounding upon the Court's personal and economic substantive due process jurisprudence).

254. Refer to Part IV.B *supra*.

255. *See Eastern Enters.*, 524 U.S. at 550 (Stevens, J., dissenting); *id.* at 553 (Breyer, J., dissenting).

256. *See id.* at 553 (Stevens, J., dissenting) (stating that "it seems to me that the plurality and Justice Kennedy have substituted their judgment about what is fair for the better informed judgment of the members of the Coal Commission and Congress").

257. Refer to note 123 *supra* and accompanying text (describing the Court's rational basis standard of review for economic legislation).

258. *Eastern Enters.*, 524 U.S. at 553 (Stevens, J., dissenting).

259. *See id.* (Stevens, J., dissenting).

260. *See id.* at 554, 568 (Breyer, J., dissenting).

261. *See id.* at 554 (Breyer, J., dissenting).

262. *See id.* at 567-68 (Breyer, J., dissenting) (asserting that "Eastern has . . . failed to show that the law unfairly upset its legitimately settled expectations").

263. *Id.* at 559 (Breyer, J., dissenting).

now retired miners,[264] it was not fundamentally unfair to require the company to pay for the health care costs of its assigned retired miners.[265]

Justice Breyer's dissent, focusing on whether it was fair to require Eastern to pay,[266] undertook an *ends* analysis[267] that, in a sense, embraced the very "super legislative" posture that the Court had so strongly disavowed in the past.[268] However, by conceding to Justice Kennedy's framework and applying a "fact intensive" analysis of economic fundamental property rights under the Due Process Clause,[269] one could infer that Justice Breyer is prepared to reconsider the Court's economic due process jurisprudence.[270] In sum, it would appear that both Justice Kennedy and Justice Breyer employed a test with more "bite" than the traditional, deferential rational basis standard; both Justices delved into the facts of the particular case and decided for themselves whether the congressional action was "fair."

E. Summary

Accordingly, in *Eastern Enterprises*, the Justices may have reopened a long-closed door. Although the Justices do not expound upon the basis for their doctrinal shift,[271] they may well be disturbed by the disparity between the Court's jurisprudence in the area of fundamental economic rights and its treatment of fundamental personal rights.[272] To be sure, it is not certain that

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264. *See id.* at 560 (Breyer, J., dissenting).

265. *See id.* at 553-54, 559 (Breyer, J., dissenting).

266. *See id.* at 559-66 (Breyer, J., dissenting).

267. *See* Anderson, *supra* note 158, at 501 (noting that a means-ends analysis "traditionally associated with due process" was first considered in a takings context in *Penn Central*).

268. *See, e.g.*, Ferguson v. Skrupa, 372 U.S. 726, 729 (1963) (stating that "it is up to legislatures, not courts, to decide on the wisdom and utility of legislation").

269. *See Eastern Enters.*, 524 U.S. at 558-64 (Breyer, J., dissenting).

270. *See* Thomas W. Merrill, *Compensation and the Interconnectedness of Property*, 25 ECOLOGY L.Q. 327, 349 n.87 (1998) (interpreting the positions of the four dissenters and Justice Kennedy as requiring substantive due process review for regulations that reduce "general wealth").

271. *See Eastern Enters.*, 524 U.S. at 529 (asserting that the plurality's ruling is based upon application of "the three factors that traditionally have informed our regulatory takings analysis"); *id.* at 547 (Kennedy, J., concurring in the judgment and dissenting in part) ("When the constitutionality of the Coal Act is tested under the Due Process Clause, it must be invalidated. Accepted principles forbidding retroactive legislation of this type are sufficient to dispose of the case."); *id.* at 556 (Breyer, J., dissenting) (reasoning that the "question involved . . . finds a natural home in the Due Process Clause"); *see also* Anderson, *supra* note 158, at 507-08 (referring to the Court's current position as a "doctrinal muddle").

272. Refer to notes 124-26 *supra* and accompanying text (discussing the

the opinions in *Eastern Enterprises* foreshadow a shift toward greater support of economic rights. *Eastern Enterprises* may simply turn out to be an anomalous case, distinguished in upcoming opinions of the Court. The Justices' focus on the "retroactive nature" of the Coal Act[273] arguably limits their respective positions to the area of retroactive legislation.[274] That distinction, however, is weak because the Supreme Court has consistently upheld legislation that changes the consequences of past actions.[275] Consequently, the retroactivity distinction may be vulnerable to later revision by the Court. Any legislation that affects the economic value of property is retroactive in the sense that the purchaser of the property in question acquired it with certain expectations that are now being altered.[276]

What does appear clear is that six members of the Court—Justices O'Connor, Scalia, Thomas, Kennedy, Breyer, and Chief Justice Rehnquist—seem to be willing to give substantive due process a closer look with respect to economic regulation.[277] Justice Stevens prefers to maintain the "hands off" approach and defers to congressional judgment.[278] Justices Souter and Ginsburg, however, have not provided any indication of their true feelings, inasmuch as they have joined the opinions of both Justices Breyer and Stevens.[279] The dissenters leave us wondering whether they truly agree with Justice Kennedy, disagreeing merely on Kennedy's interpretation of the facts, or whether they intend to maintain the status quo of deference to Congress.

In conclusion, this shift in the Court's treatment of economic rights could significantly impact future analysis, including the

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discrepancy in applying substantive due process in the personal rights area, but not in the economic area).

273. *See Eastern Enters.*, 524 U.S. at 532-33; *id.* at 538-39 (Thomas, J., concurring); *id.* at 547-48 (Kennedy, J., concurring in the judgment and dissenting in part).

274. *See* Leading Cases, *supra* note 224, at 219-20 (focusing on the retroactivity concerns expressed by the Court).

275. *See* Laitos, *Legislative Retroactivity*, *supra* note 246, at 81-83 & n.1 (demonstrating that the Supreme Court has consistently upheld retroactive legislation that changed the legal effects of past actions).

276. *See id.* at 84-87 (arguing that all economic legislation retroactively changes the legal significance of past action).

277. *See* Krent, *supra* note 210, at 6; *cf.* Michael J. Phillips, *How Many Times Was* Lochner*-Era Substantive Due Process Effective?*, 48 MERCER L. REV. 1049, 1090 (1997) (contending that the *Lochner* Court was not as extreme as some historians allege and that the Supreme Court should not hesitate to review economic regulation under the substantive due process doctrine).

278. *See Eastern Enters.*, 524 U.S. at 553 (Stevens, J., dissenting).

279. *See id.* at 550 (Stevens, J., dissenting); *id.* at 553 (Breyer, J., dissenting).

Court's review of lower court decisions denying full recovery of stranded costs.[280] Although it is unclear whether the Court will invoke the Due Process Clause, the Takings Clause, or a combination of the two in future cases, it does seem clear that the Fifth and Fourteenth Amendments will become increasingly significant elements of the Court's analysis of economic legislation.

V. DEREGULATED UTILITIES: DOES *EASTERN ENTERPRISES* CONTROL?

A. *Utilities Have Protected Property Rights*

The threshold inquiry in any analysis of economic legislation under the Fifth or Fourteenth Amendment is whether there has been an impairment of a property right.[281] Consequently, the preliminary question that must be addressed before deciding whether stranded costs can be recovered under either constitutional claim is whether the deregulatory scheme deprives the utilities of, or takes from the utilities, a "property right" cognizable under the Fifth or Fourteenth Amendment.[282] Therefore, legislation should be scrutinized for violation of the Due Process or Takings Clauses only after a property interest has been identified.

Assuming that the deregulatory legislation deprives the utilities of a property right, several factors affect the size of the possible recovery, including the market value of the property and the actual price paid by the claimant.[283] Because multiple protected property rights may be implicated—each considered "property" for a different theoretical reason—it is conceivable that one or more of a utility's alleged property interests could trigger a constitutional claim, whereas others may not.[284]

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280. Refer to Part II.E *supra* (explaining that although some state courts have denied full recovery of stranded costs, the more persuasive arguments support full recovery).

281. Refer to note 131 *supra* and accompanying text (explaining that neither the Takings Clause nor the Due Process Clause is triggered unless there is a property interest at issue).

282. Refer to notes 127-37 *supra* and accompanying text.

283. *See* Florida Rock Indus., Inc. v. United States, 21 Cl. Ct. 161, 172-74 (1990) (describing the process for assessing the value and existence of a taken property interest).

284. *See* McArthur, *supra* note 22, at 784 (distinguishing between stranded costs incurred because of the operation of a statute and those costs associated with voluntary investment decisions). Most commentators skim over this possibility, however, lumping all potentially affected property rights into one group and accepting or rejecting the package in its entirety. *See, e.g.*, J. Gregory Sidak &

Potential utility property claims fall along a continuum, ranging from the tangible to the abstract. For example, the most tangible claims arise when a utility asks to be reimbursed for allowing other companies to use "essential" physical and tangible assets, namely, its transmission and distribution lines.[285] When a utility is required to grant other utilities access to its transmission and distribution lines, the physical asset being taken has value both as an infrastructure item and because of its status as a bottleneck.[286] Less tangible claims include utility investments in large coal-burning[287] and nuclear-powered plants[288] and reimbursement for long-term Power Purchase Agreements that were mandated by government regulation.[289] Unlike claims based upon transmission and distribution line use, these less tangible claims represent discrete investments that have lost their value.[290] Although the utilities' original investments can be accurately determined,[291] the utilities base

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Daniel F. Spulber, *Deregulatory Takings and Breach of the Regulatory Contract*, 71 N.Y.U. L. REV. 851, 918-19 (1996) (explaining that under a "breach of the regulatory contract" model, the previously regulated utility should be able to recover its "expectation interest" upon deregulation).

285. *See* 16 U.S.C. § 824j(a) (1994) (mandating that transmission grid access be provided to requesting electricity producers); GTE Northwest, Inc. v. Public Util. Comm'n, 900 P.2d 495, 497-501 (Or. 1995) (holding "collocation" rules, those which required local exchanges to allow other telecommunications providers to occupy portions of their property, effected an unconstitutional taking).

286. A bottleneck is defined as "a narrow or obstructed section of a highway or pipeline[, a] hindrance to production or progress." AMERICAN HERITAGE DICTIONARY 199 (2d ed. 1982). In the electricity context the transmission grid is a bottleneck because it is the only means to transfer power from the generating station to the consumer. *See* Otter Tail Power Co. v. United States, 410 U.S. 366, 370, 377, 379 (1973) (finding that electric power transmission lines are facilities which provide a utility with "strategic dominance").

287. *See* Federal Energy Regulatory Commission Order No. 888, 61 Fed. Reg. 21,540, 21,544 & n.28 (1996) (to be codified at 18 C.F.R. pts. 35 & 385) (noting that small natural gas fired plants are the most efficient generators of electricity today and further noting larger coal-fired generators are economically obsolete); *Recovering Transition Costs*, *supra* note 38 (explaining that utilities built large coal-fired plants in the 1970s and early 1980s as a response to the energy crisis and that utilities are still recovering these costs from consumers).

288. *See* Federal Energy Regulatory Commission Order No. 888, 61 Fed. Reg. at 21,544 (noting the economic obsolescence of nuclear-powered generators).

289. *See* 16 U.S.C. § 2621(d)(10)(A) (1994) (permitting states to require utilities to "purchase long-term wholesale power supplies"). Congress felt that requiring utilities to purchase power produced from alternate sources would help create a robust and diverse electrical industry. *See id.* § 2601.

290. *See Recovering Transition Costs*, *supra* note 38 (explaining that many investments made in the 1970s and 1980s, amidst fears of domestic power shortages, were designed to be recovered over 30 years).

291. *See* Duquesne Light Co. v. Barasch, 488 U.S. 299, 309 (1989) (explaining that one way to compensate a utility is by the actual cost or "historical" cost of all prudent investments).

these takings claims upon a theoretical expectancy value,[292] determined by the estimated profit that the asset would have produced in a regulated market.[293] Because of the inherent uncertainty of these expectations, a claim for lost investment value is more difficult to characterize as a property interest than would be a claim for the loss of a physical asset.[294] Whereas a takings claim for mandated wheeling attaches to a physical asset that has current value—the transmission grid[295]—a request for

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292. *See* SIDAK & SPULBER, *supra* note 24, at 394-96. Professors Sidak and Spulber assert that utilities should be entitled to recover the value that the asset would have retained under regulation on the basis of an expectation damage theory. *See id.* at 438-40. They also argue that based upon the efficient market hypothesis, a taking should be found at the time that the government passes the regulation. *See id.* (reasoning that because "an efficient market values an asset today on the basis of the expectation of the discounted net profit that the asset will generate in the future," the market's anticipation of a taking significantly affects the property value of the regulated company). Accepting this view would strengthen the takings claim because, prior to the legislative act of deregulation, the asset had a market value based upon the continuation of the regulatory regime. *See id.* The Supreme Court, however, has ruled that a taking does not occur until the actual deprivation happens. *See* Pennell v. City of San Jose, 485 U.S. 1, 10 (1988) (declining to consider a takings claim when there had not yet been an actual deprivation). As a result, the value at the time of deprivation is far below the pre-deregulation market value. *See* SIDAK & SPULBER, *supra* note 24, at 439.

In theory, there exists another possible category of utility claims encompassing expected profits not yet linked to a specific asset or memorialized in a contractual agreement. For example, a claim to recover an investment based on a projection that the population in a utility's area will increase by a given percentage represents a purely speculative expectancy; it is an expectancy of future profits that have not been quantified. It seems that this third type of expectancy is too speculative to qualify as a protected property interest.

293. *See* SIDAK & SPULBER, *supra* note 24, at 439.

294. In *Phillips v. Washington Legal Found.*, 524 U.S. 156, 163-64 (1998)—a case decided ten days before *Eastern Enterprises*—the United States Supreme Court held that interest which accrues on funds held in Lawyers' trust accounts is the property of the owner of the principal for purposes of the Takings Clause. The Court did not address whether Texas' Interest on Lawyers Trust Account program violated the Takings Clause because that issue had not been ruled on by the Fifth Circuit. *See id.* at 164. The dissenters argued, however, that the Court had failed to consider the only "salient fact," that is, whether the client has any *cognizable* property right which would warrant Takings Clause protection. *See id.* at 173 (Souter, J., dissenting)

At issue in *Phillips*, and in the stranded-cost context as well, was whether a somewhat intangible property right is afforded takings protection. Justice Souter's *Phillips* dissent expressed concern about affording constitutional protection to an "abstract" property right. *See id.* at 178 (Souter, J., dissenting). The Majority, in contrast, decided that the intangible characteristic was not a problem and argued that positive economic value, market value, or tangibility were not essential attributes of property for purposes of the Takings Clause. *See id.* at 169-71 (noting that in previous cases the Court had adopted a liberal reading of the Takings Clause).

295. *See* Mark T. Hoske & Wayne Beaty, *Winners Will Be Small Utilities, IPPs in New World of Transmission Access*, ELECTRIC LIGHT & POWER, Apr. 1994, at 9 (describing how transmission assets remain valuable in deregulation), *available in*

compensation based upon past expectations must rely upon either strong evidence of a contract right[296] or upon a broad interpretation of the Takings Clause.[297]

1. Utility Real Property Interests. The most concrete group of possible property rights are the utilities' real property rights: their interests in generation, transmission, and distribution facilities.[298] Although these facilities are dedicated to the public's use,[299] they remain the property of the utilities.[300] Some of these assets, including the utilities' rights of way, were acquired by the utilities through the regulatory process[301] and, as such, lose certain private property characteristics.[302] Consequently, there is a plausible argument for devaluing these assets in the just compensation prong of takings analysis,[303] but not for determining whether to disregard utility ownership rights.[304]

It appears that the utilities have a significant likelihood of prevailing on a constitutional takings theory with regard to those

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LEXIS, Market & Industry Library, Energy & Utilities File.

296. *See* Lynch v. United States, 292 U.S. 571, 579 (1934) (holding that contracts are property for purposes of the Takings Clause); RICHARD A. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 88-92 (1985) (discussing constitutional protection of contract rights); Margaret Howard, *Equipment Lessors and Secured Parties in Bankruptcy: An Argument for Coherence*, 48 WASH. & LEE L. REV. 253, 299 (1991) (arguing that the takings protection afforded contract rights is weaker than that afforded to property rights).

297. *Compare* Eastern Enters. v. Apfel, 524 U.S. 498, 540 (Kennedy, J., concurring in the judgment and dissenting in part) (asserting that a takings claim is cognizable only if it attaches to an identifiable asset), *with id.* at 522-23 (allowing the assertion of a takings claim when "'interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good'" (quoting Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 124 (1978))).

298. *See, e.g.*, GTE Northwest, Inc. v. Public Util. Comm'n, 900 P.2d. 495, 500 (Or. 1995) (recognizing an unconstitutional taking in a similarly situated telecommunications scenario).

299. *See* Munn v. Illinois, 94 U.S. 113, 125-26 (1876) (explaining that property "become[s] clothed with a public interest when used in a manner to make it of public consequence").

300. *See* Gulf, Colo. & Santa Fe Ry. Co. v. State, 120 S.W. 1028, 1037 (Tex. Civ. App. 1909, writ ref'd) (stating that, although a railroad is "controlled by the law in its operation in the interest of the public, . . . [its] property does not belong to the people, but is as much [its] own as is the property of any citizen of the government").

301. *See* Public Service Co. v. Andrus, 433 F. Supp. 144, 147 (D. Colo. 1977) (describing the application process for obtaining a right of way under regulation).

302. *See Munn*, 94 U.S. at 126 (declaring that property affected with a public interest loses some of its private property characteristics *a fortiori*).

303. *See* Duquesne Light Co. v. Barasch, 488 U.S. 299, 308-12 (1989) (explaining that under the just compensation analysis, a utility may be compensated according to the "prudent investment" rule, which establishes the constitutional minimum compensation as the actual cost of all prudent investments made by the utility).

304. *See Gulf, Colo. & Santa Fe Ry. Co.*, 120 S.W. at 1037 (noting that even if property is "acquired and held" for public duties, the property is still privately owned).

tangible assets that have current market value.[305] Moreover, utility bottleneck assets should be valued according to their unique importance, namely as the linchpin of the utilities' profit-making enterprise.[306] Accordingly, the utilities' measure of recovery for a taking of their transmission lines should arguably be based upon an evaluation of the utilities' replacement costs for those assets and not upon the book value of the individual transmission cables.[307]

2. The Regulatory Contract. Recovery of utility expectations linked to intangible rights requires either an expansive view of utilities' property rights[308] or a liberal reading of the Takings Clause.[309] Many proponents of stranded-costs recovery assert the existence, in electric utility regulation, of a regulatory compact[310] or regulatory contract.[311] These proponents argue that the utilities are entitled to full recovery of their expectation damages for the state's breach of the regulatory contract[312] that results from deregulation.[313]

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305. *See* GTE Northwest, Inc. v. Public Util. Comm'n, 900 P.2d. 495, 503 (Or. 1995) (noting that requiring a utility to permit other providers to install equipment on its property is equivalent to a governmental taking and compensation is required).

306. *See* WILLIAM J. BAUMOL & J. GREGORY SIDAK, TOWARD COMPETITION IN LOCAL TELEPHONY 106 & n.4 (1994) (arguing that the value of an asset includes the "(social) marginal opportunity" benefit associated with owning the key to dominance in a market).

307. *See* William J. Baumol & Thomas W. Merrill, *Deregulatory Takings, Breach of the Regulatory Contract, and the Telecommunications Act of 1996*, 72 N.Y.U. L. REV. 1037, 1063 (1997) (noting that such an evaluation would be "forward-looking, not historical"). The Constitution is "neutral" as to whether a historical-costs method or fair-value method is required to assess utility values. *See id.* at 1042-45 (discussing methods for evaluating utility assets and cost recovery).

308. Refer to notes 285-97 *supra* and accompanying text (indicating that property rights could include not only tangible assets, but also an expectation of return on that which would have been acquired under continued regulation).

309. Refer to note 290-97 *supra* and accompanying text (comparing different views of when a takings claim is effected).

310. The terms "regulatory compact" and "regulatory contract" are often used interchangeably. *See* Green v. Biddle, 21 U.S. (8 Wheat.) 1, 92 (1823) ("In fact, the terms compact and contract are synonymous.").

311. *See* SIDAK & SPULBER, *supra* note 24, at 101-17 (opining that the regulatory contract is an essential feature of utility regulation); William J. Baumol & Thomas W. Merrill, *Does the Constitution Require that We Kill the Competitive Goose? Pricing Local Phone Services to Rivals*, 73 N.Y.U. L. REV. 1122, 1129 (1998) (asserting the existence of a regulatory contract to the extent that public utilities were promised the recovery of their costs).

312. *See* SIDAK & SPULBER, *supra* note 24, at 102-04 (noting that "[u]tilities would not have undertaken the extensive investments required to provide regulated service . . . without the opportunity to recover their costs").

313. *See* Sidak & Spulber, *Givings, Takings*, *supra* note 52, at 1147-51 (characterizing electric utility deregulation as a breach of contract).

The regulatory compact, as alleged, was formed by the commitments made by the utility industry and its regulators, which were, in turn, supported by consideration that was exchanged for those commitments. In consideration of an exclusive right to supply electricity, the utilities promised to supply a steady and reliable flow of electricity to their respective service areas.[314] The utilities were then subject to cost of service rate regulation.[315] As a result, regulators prevented utilities from charging excessive rates[316] while guaranteeing utilities the ability to achieve a return that adequately compensated them for their investments.[317]

The regulators, in turn, promised the utilities a fair return on their investment.[318] This return was usually achieved by guaranteeing the regulated utility an exclusive right to service a given geographic area.[319] In theory, administrative agencies could have ensured the utilities a fair return on their investment in some other manner. Alternate forms of compensation can be found in various proposals aimed at solving the stranded-cost problem, including the securitization of stranded costs[329] and the creation of a national wires tax.[321]

Unfortunately for the utilities, the regulatory contract was never formally memorialized.[322] As a result, the strongest

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314. *See Recovering Transition Costs*, *supra* note 38.

315. *See* Alabama Power Co. v. FERC, 160 F.3d 7, 9 (D.C. Cir. 1998) (noting that under the Federal Power Act, utilities must gain approval for costs that are to be included in their rate base and that costs associated with capital investments are recovered through depreciation charges); JEAN-JAC QUES LAFFON & JEAN TIROLE, A THEORY OF INCENTIVES IN PROCUREMENT AND REGULATION 54 (1998) (explaining that cost of service regulation is premised on investors' ability to recover a competitive rate of return).

316. *See Recovering Transition Costs*, *supra* note 38.

317. *See* SIDAK & SPULBER, *supra* note 24, at 113 (noting that the state commission allows a utility's investors the opportunity to earn a "fair" rate of return on their investment). Refer to note 13 *supra* and accompanying text (describing the rate-making process).

318. *See* SIDAK & SPULBER, *supra* note 24, at 108-09 (asserting, as a matter of economic theory, that the utilities would not have made capital investments unless the regulator's offer of a fair rate of return was credible).

319. *See id.* at 109.

320. *See, e.g.*, 66 PA. CONS. STAT. § 2801 (1997) (providing the statutory framework for the securitization of Pennsylvania utilities' stranded costs); Act of June 18, 1999, 76th Leg., R.S., ch. 405, § 39.201, 1999 Tex. Gen. Laws 2543, 2574-2575) (allowing securitization of 75% of stranded costs); *see also* Walter R. Hall II, *Securitization and Stranded Cost Recovery*, 18 ENERGY L.J. 363, 363-81 (1997).

321. *See* Marc Christensen, *Cracking the Stranded Assets Nut: The Case for a National Wires Charge*, PUB. UTIL. FORT., Apr. 1, 1997, at 31-32 (explaining that a uniformly charged national wires tax would distribute the stranded costs equally among consumers).

322. *See* SIDAK & SPULBER, *supra* note 24, at 202 (noting that, as an unwritten

arguments supporting the existence of such a contract are based upon course of performance[323] and relational contracting.[324]

For years, utilities undertook massive projects to fulfill their obligations to regulators,[325] including the construction of power plants[326] and transmission and distribution lines,[327] and established long-term purchase and supply contracts.[328] All of these investments were undertaken in reliance upon the commitments made by regulators.[329]

In contrast, some scholars argue that no such regulatory contract exists.[330] These opponents view electric utility regulation as an exercise of the government's sovereign or police power.[331] According to this perspective, deregulation is no different than any change in an existing law, and just as the government has the ability to change tax laws upon which investors make decisions, the government should have the ability to regulate and deregulate entire industries without the fear of prompting costly litigation.[332]

The debate over the existence of a regulatory contract fundamentally influences the resolution of the stranded-costs issue. In general, the government can regulate industries pursuant to two possible models: *by sovereignty*[333] or *by*

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contract that can not be performed within a year, the regulatory contract theoretically violates the Statute of Frauds and should be unenforceable).

323. *See id.* at 110-11 (explaining that although no single document embodies all of the terms of the regulatory contract, there is a plethora of subsidiary-written, formal agreements to show that a contract was in fact formed).

324. *See id.* at 110-13 (describing the relational contract between the utility and the regulated firm as consisting of multiple contracts that involve a continuing relationship).

325. *See Recovering Transition Costs*, *supra* note 38.

326. *See id.* (describing the importance of recovering these costs during the transition to a deregulated marketplace).

327. *See id.*

328. *See id.* (explaining that utilities were required to sign long-term contracts by PURPA).

329. *See* SIDAK & SPULBER, *supra* note 24, at 109 (explaining that the regulated utilities relied upon the regulators' contractual assurances in planning and carrying out their investment and service plans).

330. *See, e.g.*, Michaels, *supra* note 60, at 21 (asserting that the regulatory contract is fictitious and is a recent intellectual invention).

331. *See, e.g.*, Munn v. Illinois, 94 U.S. 113, 125 (1876) (explaining that inherent in every sovereignty is the power to govern and that this police power is simply the power to regulate the conduct of the people and their property for the public good).

332. *See* Jim Rossi, Book Review, *The Irony of Deregulatory Takings*, 77 TEX. L. REV. 297, 319 (1998) (explaining that characterizing deregulation as a taking would turn modern government "on its head").

333. A government regulates by sovereignty when it enacts a statute or imposes a rule by virtue of its sovereign powers. *See, e.g.*, *Munn*, 94 U.S. at 125 (upholding state grain elevator regulation that was unilaterally imposed on an existing business

contract.[334] Governmental regulation *by sovereignty* unilaterally imposes the relationship: the government dictates and the regulated party complies.[335] In contrast, governmental regulation *by contract* establishes the relationship bilaterally, utilizing a quid pro quo framework[336] whereby the regulator and regulated entity negotiate the terms of the regulation together.[337]

In the typical scenario, the government regulates through the use of its sovereign police power.[338] Examples of sovereign police power-based regulation include EPA enforcement of the Clean Air Act[339] and FDA enforcement of the Pure Food and Drugs Act.[340] Although it is certainly true that the government, when regulating *by sovereignty*, will often open its decision-making process for comment,[341] in the final analysis, regulation *by sovereignty* proceeds unilaterally, with the government imposing its will on the regulated party, with or without the latter's consent.[342]

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and establishing that the government, as sovereign, is entitled to regulate private businesses that are devoted to public use). As used in this Comment, the term "regulation by sovereignty" describes the power of government to regulate private businesses that are devoted to public use, such as utilities. *See* Hovenkamp, *supra* note 69, at 809, 819 (describing the two different forms of regulation and arguing that, although early regulatory regimes were often contractual in nature, most post-Civil-War regulation has been *by sovereignty* and not *by contract*).

334. *See, e.g.*, United States v. Winstar Corp., 518 U.S. 839, 867-68 (1996) (recognizing the government's regulation *by contract* of banks' capital reserve requirements and the subsequent breach of that contract resulting from the enactment of federal legislation forbidding certain practices provided for in the contract); Proprietors of Charles River Bridge v. Proprietors of Warren Bridge, 36 U.S. (11 Pet.) 420, 429-31 (1837) (recognizing the government's contractual obligation to honor various terms of a transaction).

335. *See, e.g.*, *Munn*, 94 U.S. at 133 (upholding the state's power to unilaterally impose regulation on industries affected with a public interest).

336. *See, e.g.*, *Proprietors of the Charles River Bridge*, 36 U.S. at 427 (describing how the Charles River Bridge Company was allowed to collect tolls in exchange for a charter).

337. *See* Hovenkamp, *supra* note 69, at 812 (noting that the Supreme Court in *Charles River Bridge* interpreted the Contract Clause of the Constitution to allow only the owners to retain what they had obtained through their negotiations).

338. *See id.* at 819 (pointing out that most post-Civil War regulation has been by sovereignty and not by contract).

339. *Cf.* Arnold W. Reitze, Jr., *The Legislative History of U.S. Air Pollution Control*, 36 HOUS. L. REV. 679, 689, 698, 703 (asserting that the protection of public health is a valid use of local police power and recalling that the failure of local governments to protect the public health was the fundamental reason for federal environmental laws).

340. *See* Lino A. Graglia, United States v. Lopez: *Judicial Review Under the Commerce Clause*, 74 TEX. L. REV. 719, 735 (1996) (characterizing the Pure Food and Drug Act as a form of police-power regulation).

341. *See* 5 U.S.C. § 553(c) (1994) (mandating that federal agencies provide interested persons the opportunity to participate in the rule-making process).

342. The regulation is, of course, subject to judicial review. *See* 5 U.S.C. § 706

On occasion, however, the government will regulate *by contract*,[343] utilizing the rules of private contract law.[344] This type of regulation is demonstrated in *United States v. Winstar Corp.*[345] *Winstar* involved the Federal Home Loan Bank Board's (FHLBB) efforts to encourage healthy Savings and Loan Associations to merge with failing ones during the savings and loan crisis of the 1980s.[346] In an effort to promote these mergers, the FHLBB signed agreements with healthy thrifts,[347] in which the FHLBB agreed to circumvent capital reserve requirements[348] required of the larger merged entity.[349] Although the FHLBB might have regulated by fiat,[350] that is *by sovereignty*, it chose instead to regulate *by contract* and entered into agreements with the healthy thrifts. The FHLBB's choice of private law regulation was not without consequence. When Congress subsequently enacted legislation that prohibited the thrifts from circumventing the capital requirements, the thrifts successfully sued the FHLBB for breach of contract.[351]

Whether electric utilities possess property rights born of the regulatory contract is a question of legislative and administrative intent.[352] However, the nature of the regulatory process, with its

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(1994) (governing the scope of judicial reveiw of federal administrative agency action).

343. *See* Hovenkamp, *supra* note 69, at 812 (noting that regulation *by contract* was the primary form of regulation during the early development of the regulatory state).

344. *See id.* at 815-22 (analyzing case law involving regulatory contracts and demonstrating that courts resorted to traditional principles of contract law to intrepret these contracts).

345. 518 U.S. 839 (1996).

346. *See id.* at 845 (detailing the efforts taken by the FHLBB to induce the merger of strong thrifts institutions with those which were failing and describing the origins of the savings and loan crisis).

347. *See id.* at 850-55; *see also* Sidak & Spulber, *Givings, Takings, supra* note 52, at 1147 (describing the negotiating process between the government and the thrifts).

348. *See Winstar*, 518 U.S. at 850 (explaining how the FHLBB agreed to classify the portion of the S&L's purchase price that was in excess of its fair market value as a "supervisory goodwill" credit, which could be used towards maintaining required reserves).

349. *See id.* (noting that allowing the acquiring institutions to apply supervisory goodwill toward their capital reserve requirements was necessary in making the transaction possible; without the credit, the merged thrift would have been insolvent under federal standards).

350. *See, e.g.*, City of St. Louis v. United Rys. Co., 210 U.S. 266, 280 (1908) (holding that state regulation of rights and privileges does not create binding contractual rights unless the government intends to be bound).

351. *See Winstar*, 518 U.S. at 839.

352. *See* Hovenkamp, *supra* note 69, at 814-17 (describing various government contracts that have been narrowly construed, thereby resulting in enforcement of only explicit terms).

notice, written comments, and hearing requirements, makes assessing this intent a difficult task.[353]

Historical utility regulation does not fit neatly into either paradigm.[354] On the one hand, electric utility regulation contains attributes of regulation *by sovereignty*.[355] At the same time, elements of regulation *by contract* are arguably present as well.[356] The existence of regulation *by sovereignty* in historical electric utility regulation is evidenced by court decisions that allow for unilateral impositions on utilities. For example, in *Duquesne Light Co. v. Barasch*,[357] the United States Supreme Court held that regulators can unilaterally decide how to evaluate the fairness of a rate recovery.[358] In a more recent case, the Michigan Court of Appeals endorsed the use of regulation *by sovereignty* when it found that physical occupation of utilities' facilities by third-party wheelers does not trigger a takings claim.[359]

The regulatory-compact theory, however, posits that electric utility regulation contains significant aspects of regulation *by contract*. Some commentators argue that the property rights born of the regulatory compact are analogous to the contract rights embraced by the Court in *Winstar*[360] and that the utilities should

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353. *See* 5 U.S.C. § 553 (1994) (detailing administrative procedures). The inquiry into the existence or nature of the regulatory contract is hindered in two ways, one internal and one external. Internally, even if a regulatory contract exists, the contract terms may moot the takings question if, for example, a term provides that the sovereign is permitted to deregulate the industry. In fact, "deregulation" is a misnomer in that it implies a total absence of governmental regulation of public utilities. In reality, the government will still regulate utility companies, but in manner that promotes competition as opposed to one that forces standardization of services on all end-users. The new process is better described as a "transformation of regulation" rather than "deregulation." *See* Joseph D. Kearney & Thomas W. Merrill, *The Great Transformation of Regulated Industries*, 98 COLUM. L. REV. 1323, 1323-26, 1405 (1998).

354. Refer to notes 335-37 *supra* and accompanying text (describing the two paradigms of regulation, regulation *by contract* and regulation *by sovereignty*).

355. Refer to note 335 *supra* and accompanying text.

356. Refer to note 336 *supra* and accompanying text.

357. 488 U.S. 299 (1989).

358. *See id.* at 310 (affirming the rejection of Smyth v. Ames, 169 U.S. 466 (1898), which had required that rates be determined on the basis of fair market value, and upholding historical cost valuations).

359. *See In re* Retail Wheeling Tariffs, 575 N.W.2d 808, 815-16 (Mich. Ct. App. 1998) (holding that mandated retail wheeling does not violate the Takings or Contract Clauses). *In re Retail Wheeling Tariffs* was later reversed by the Supreme Court of Michigan on other grounds. *See* Consumers Power Co. v. Michigan Public Serv. Comm'n, 596 N.W. 2d 126 (1999). The Supreme Court of Michigan found that the Public Utility Commission did not have the statutory authority to authorize the taking. *See id.* at 154 (finding that the Commission only has the authority bestowed upon it by the legislature). The *legislature's* ability to authorize the *Commission* was implicit to the court's argument.

360. *Cf.* Sidak & Spulber, *Givings, Takings*, *supra* note 52, at 1149 (comparing

be awarded the full measure of their expectations as damages.[361] Others, however, have distinguished *Winstar* on the basis of the unmistakability doctrine.[362] This doctrine stands for the proposition that federal legislation will create contract rights only when the legislation explicitly grants those rights.[363] These commentators argue that no such explicit formation of contract is evident in utility regulatory history.[364]

The truth may lie somewhere in between these two positions.[365] On the one hand, the utilities do not have an explicit contract.[366] On the other hand, the government and the utilities have engaged in a course of performance over the past fifty years that implicitly evidences something more than mere regulation.[367] Although *Winstar* may not control because of the unmistakability doctrine,[368] the argument set forth by some critics that utility regulations are analogous to completely unilateral regulations issued by the Internal Revenue Service,[369] is equally difficult to accept.[370] In sum, utility recovery on the basis of a contract theory

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the electric utility regulatory contract to the contract in *Winstar*).

361. *See id.* at 1145 (explaining that because the regulated company's expected revenues reflect embedded costs, lost revenues should be included in the company's compensation).

362. *See, e.g.*, Rossi, *supra* note 332, at 309 (interpreting the availability of breach of contract claims against the government much narrower than professors Sidak and Spulber suggest).

363. *See id.*; *see also* Bowen v. Public Agencies Opposed to Soc. Sec. Entrapment, 477 U.S. 41, 52 (1986) (explaining that under the unmistakability doctrine, a surrender of sovereign authority must be explicitly granted in unmistakable terms to be enforceable against the government).

364. *See* Rossi, *supra* note 332, at 309 (stating that the presumption that general language in regulations merely declares a policy to be pursued until the legislature decides otherwise, not an intent to create contractual rights).

365. *See* Kahn, *supra* note 36, at 35 (suggesting a compromise position between the two extremes).

366. Refer to notes 322-24 *supra* and accompanying text.

367. *See* IRSTON R. BARNES, THE ECONOMICS OF PUBLIC UTILITY REGULATION, 14 (1942) (stating that "the basis for the distinction between those businesses whose prices are subject to governmental control and those that are free from such control is to be found in the implied contract that may be assumed to exist when the business enjoys peculiar rights or privileges from the government").

368. *See* United States v. Winstar Corp., 518 U.S. 839, 920-24 (1996) (Scalia, J., concurring) (asserting that the regulatory contract in *Winstar* satisfied unmistakability doctrine requirements); Michael P. Malloy, *When You Wish Upon* Winstar*: Contract Analysis and the Future of Regulatory Action*, 42 ST. LOUIS U. L.J. 409, 414-26 (1998) (analyzing the unmistakability doctrine and its application in *Winstar*).

369. *See, e.g.*, Rossi, *supra* note 332, at 297 (pointing out that if the Internal Revenue Service were to abolish tax benefits for certain investment activities it would affect the revenue of those who had made investments with expectations based upon previous rules).

370. Refer to notes 388-401 *infra* and accompanying text (presenting arguments that support finding a regulatory contract).

remains an open issue that the Supreme Court may resolve through various other means.[371]

3. Duquesne Light Co. v. Barasch. The United States Supreme Court has already strongly suggested that utilities do have a protected property interest of some sort in their right to charge a reasonable service rate. In *Duquesne Light Co. v. Barasch*, the concurring Justices recognized utilities' entitlement to a fair return on their investment[372] and that the absence of such a return would violate the Takings Clause.[373]

In *Duquesne*, the Court upheld a Pennsylvania statute that did not allow the inclusion of unfinished plants into the rate base.[374] The Court focused on the utilities' total return and found that the Takings Clause had not been violated because the total effect of the rate order was not unjust or unreasonable; the utility was ultimately receiving just compensation.[375] The concurring Justices, Scalia, O'Connor, and White, emphasized that a more significant deprivation would likely trigger constitutional scrutiny of a particular rate-making methodology.[376]

In the deregulation context, utilities permanently lose their property rights.[377] Moreover, investment-backed expectations are more seriously damaged than in the rate-making context,[378] thus making it more probable that the Court would view the deprivations as being unconstitutional takings.[379]

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371. In the event that utilities are unable to prevail on a contract theory, they may be able to recover reliance damages on a promissory estoppel theory. *See* SIDAK & SPULBER, *supra* note 24, at 210-12.

372. *See* Duquesne Light Co. v. Barasch, 488 U.S. 299, 307-08 (1989) (stating that, although the Constitution does not mandate any particular method for determining which electric utility rate structures are legitimate and which are unconstitutional takings, "if the rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments").

373. *See id.*

374. *See* 66 PA. CONS. STAT. ANN. § 1315 (West 1992).

375. *See Duquesne*, 488 U.S. at 312 (ruling that a reduction in annual revenue of 0.5% did not turn an otherwise fair rate-making decision into an unconstitutional taking and affirming the longstanding precedent of judicial indifference towards a commission's methodology so long as the result is not "unjust").

376. *See id.* at 317 (Scalia, J., concurring) (clarifying that "'prudent investment[s] . . . may need to be taken into account in assessing the constitutionality of the particular consequences produced by those [rate-making] formulas. . . . [T]hat question is not presented in the present suit, which challenges techniques rather than consequences").

377. *See generally* Kranhold, *Current Event*, *supra* note 20, at R4 (noting the permanent changes that are occuring as a result of deregulation).

378. *See id.* (reporting that most investors and consumers are unprepared for the drastic change).

379. *See Duquesne*, 488 U.S. at 312 (stating that "[n]o argument has been made

B. The Eastern Enterprises *Plurality's Three Takings Factors Support Stranded-Cost Recovery*

As previously demonstrated, identification of a protected property right, whether it is a well-recognized tangible asset, a reliance interest, or an expectation interest, is the first step in a constitutional takings inquiry.[380] A court will then subject the regulation in question to an "ad hoc and fact intensive" analysis to determine whether the legislation is constitutional.[381]

Analysis of the fundamental property rights at stake in the stranded-costs context,[382] using the "traditional" three-factor framework[383]—economic impact,[384] interference with investment backed expectations,[385] and the nature of governmental action[386]—leads to the conclusion that the *Easter Enterprises* plurality would likely find that legislation denying just compensation for deprivation of these property rights effects an unconstitutional taking.[387] It is also quite probable that Justice Kennedy,[388] and possibly several of the *Eastern Enterprises* dissenters,[389] would concur in this judgment because they would prefer to invalidate the denial of stranded-cost recovery on substantive due process grounds.

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that these slightly reduced rates jeopardize the financial integrity of the companies, either by leaving them insufficient operating capital or by impeding their ability to raise future capital" thereby implying that a more serious deprivation would be treated differently).

380. *See* Phillips v. Washington Legal Found., 524 U.S. 156, 163 (1998) (noting that the district court granted summary judgment on the ground that a property interest had not been identified).

381. *See* Eastern Enters. v. Apfel, 524 U.S. 498, 523 (1998).

382. Refer to Part V.A *supra* and accompanying text for a discussion of which stranded costs would most likely viewed as fundamental property interests.

383. *See Eastern Enters.*, 524 U.S. at 529.

384. *See id.*

385. *See id.* at 532.

386. *See id.* at 537.

387. Refer to Parts V.B.1-B.3 *infra*.

388. It is not clear whether there is a substantive difference between the takings "fairness" standard employed by the plurality and the substantive due process "fairness" standard adopted by Justice Kennedy and the dissenters. *Compare Eastern Enters.*, 524 U.S. at 523-24, *with id.* at 545-47. If the standards are different, then application of the three-factor standard to the stranded-costs context would not necessarily yield the same result that would be reached under a substantive due process analysis. Refer to notes 217-27 *supra* and accompanying text (discussing the differences between the Justices' various approaches).

389. *See Eastern Enters.*, 524 U.S. at 554 (Breyer, J., dissenting) (adopting Justice Kennedy's "legal lens").

1. The Economic Impact Factor.[390] In *Eastern Enterprises*, the Court held that requiring Eastern to pay fifty to one hundred million dollars in health insurance premiums for its retired miners would have an unacceptable economic impact on the company's financial viability.[391] The denial of stranded costs imposes an equally significant financial burden.[392] According to a study conducted by a leading energy information service, one half of all estimated stranded costs are concentrated in twenty utilities.[393] Although a thorough comparison of the financial strength of Eastern to that of utilities faced with the stranded-costs problem exceeds the scope of this Comment, 200 billion dollars[394] distributed among twenty companies seems to qualify as a severe economic impact. Furthermore, the fact that utilities, as well as independent analysts, warn that denial of stranded costs may force some utilities into bankruptcy supports the proposition that deprivation of this property right would impose a "considerable economic burden."[395]

2. The Investment Expectation Factor. The second factor in the plurality's anaylsis assesses whether the legislation "substantially interferes with . . . reasonable investment-backed expectations."[396] The stability of utilities and their "guaranteed rate of return" have been the subject of a Wall Street cliche for years.[397] Investors knew that regulation and its accompanying guarantees of a fair rate of return formed the back bone of the utility structure.[398] Even the Supreme Court, when discussing the risks faced by utility investors, did not discuss the possibility that regulation would be abolished, but instead focused on the risks associated with the different methods of assessing the rate

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390. *See id.* (Breyer, J., dissenting).

391. *See id.* at 529.

392. *See* Hall, *supra* note 320, at 373-74 (noting that the magnitude of stranded costs is estimated to be as high as $150 billion).

393. *See* McArthur, *supra* note 22, at 793 n.53 (citing a 1997 study by Research Data International (RDI)); *see also Resource Data International Home Page* (visited Oct. 23, 1999) <http://hood.resdata.com/resource/default.asp>.

394. Refer to notes 50, 69-72 *supra* and accompanying text (analyzing estimates valuing utilities' stranded costs).

395. *See Eastern Enters.*, 524 U.S. at 533-34.

396. *See id.* at 532.

397. *See* Linda Sandler, *Beyond Dividends: The Utility Business Just Got a Lot More Complicated. So Did Investing in It*, WALL ST. J., Sept. 14, 1998, at R15 (noting that the "Wall Street cliche" that utility stocks are conservative and dependable investments because of their monopoly status is no longer true due to deregulation); Maggie Topkis, *Utilities Funds Get Racy: Managers Now Add Unlikely Investments to Bolster Light, Power, and Water Stocks*, INT'L HERALD TRIB., Mar. 30, 1998, at F13, *available in* LEXIS, News Library, Int'l Herald Trib. File.

398. *See* Sandler, *supra* note 397, at R15.

base.[399] Thus, it seems logical that if the Court found an interference with investment-backed expectations in *Eastern Enterprises*, it would find a similar deprivation of property rights in the utility deregulation context.

3. The Nature of the Governmental Action Factor. In *Eastern Enterprises*, the Court held that the governmental action at issue "implicate[d the] fundamental principles of fairness underlying the Takings Clause"[400] because it

> single[d] out certain employers to bear a burden that [was] substantial in amount, based on the employers' conduct far in the past, and unrelated to any commitment that the employers made or to any injury they caused.[401]

Analyzing the nature of the governmental action in the stranded-cost situation under the above-quoted factors compels the conclusion that the Takings Clause's fundamental principles of fairness are implicated. First, in the stranded-costs context, certain utilities are being singled out and asked to shoulder substantial burdens. Twenty utilities are saddled with one half of all the stranded costs.[402] Furthermore, eighty-six percent of stranded costs are located in ten states, which together account for only forty-three percent of the electricity being generated in the United States.[403] This disparity results from the different regulatory regimes that were in place in each state and the various investment decisions made by different utilities.[404]

As to the second element, the utilities are presently being forced to bear burdens originating from conduct "far in the past." The costs associated with these investment choices, such as the utilities' decisions to build coal-burning and nuclear-powered plants, are similar to the stranded costs contemplated by the plurality in *Eastern Enterprises*.[405] With respect to costs directly linked to regulatory requirements, the utilities' position is even stronger. These costs are not based upon the *utilities'* conduct far in the past, but instead are based upon *regulators'* conduct and should certainly be recoverable.

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399. *See* Duquesne Light Co. v. Barasch, 488 U.S. 299, 314-15 (1989) (recognizing that the primary risks associated with investment in a utility are related to the regulators' ability to switch their method of determining rates).

400. *Eastern Enters.*, 524 U.S. at 537.

401. *Id.*

402. *See* McArthur, *supra* note 2, at 793 n.53 (citing RDI's 1997 study).

403. *See id.* at 793 n.53 (same).

404. *See id.* at 794 n.55.

405. Refer to notes 358-60 *supra* and accompanying text.

Finally, as to the last element expressed by the plurality, stranded-cost losses are not "related to past commitments" made by *utilities*. In *Eastern Enterprises*, the plurality held that although Eastern might have intimated that it would provide lifetime benefits to its employees,[406] the absence of a formal commitment meant that they were not liable for providing those benefits.[407] In the electric utility context, a forced absorption of stranded costs would also not be linked to past commitments—the utilities never agreed to bear the full burden of those costs.[408] Although stranded costs result from past commitments in the sense that they stem from past business decisions, Eastern's costs also stemmed from its past decisions, such as the decision to enter into the mining business.

Thus, the utilities should be able to satisfy all of the elements of this third, "nature of governmental action", factor. Moreover, the nature of deregulation warrants recovery because of the extended length of time during which the utilities operated under regulation.[409]

The *Eastern Enterprises* Justices all emphasized that the Coal Act was retroactive.[410] Some commentators have argued that, consequently, *Eastern* is not relevant in other contexts.[411] Even if one were to assume that a bright line exists that separates retroactive economic legislation from prospective legislation, legislation that deprives electric utilities of their pre-existing property rights is retroactive. It changes the import of the utilities past activities.[412] Just as the Coal Act's retroactive

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406. *See Eastern Enters.*, 524 U.S. at 535 (reasoning that "the fact that plaintiffs never contractually agreed to provide lifetime benefits does not rebut the rationality of finding that they contributed to the expectation").

407. *See id.* at 537 (noting that Eastern was being asked to bear a burden unrelated to any commitment it had made or to any injury it had caused).

408. Refer to Part II.B *supra*.

409. *Cf.* Kranhold, *Current Event*, *supra* note 20, at R4.

410. *See Eastern Enters.*, 524 U.S. at 537; *id.* at 538 (Thomas, J., concurring); *id.* at 547 (Kennedy, J., concurring in the judgment and dissenting in part). *But see id.* at 553-54 (Stevens, J., dissenting); *id.* at 559-60 (Breyer, J., dissenting) (asserting that the retroactive nature of the Coal Act is not problematic).

411. *See* Leading Cases, *supra* note 224, at 218-20.

412. *See* Laitos, *Legislative Retroactivity*, *supra* note 246, at 84-87 (distinguishing between primary and secondary retroactivity). Statutes that are primarily retroactive "alter the past legal consequences of past private actions," whereas statutes that are secondarily retroactive alter the future significance of the past private action. *See id.* at 84-85. For example, if the Coal Act had required Eastern to pay past health care costs it would have been primarily retroactive. However, Eastern was only assessed costs prospectively. As such, the legislation was secondarily retroactive. Professor Laitos argues that economic legislation that alters the significance of past actions prospectively is commonplace and usually upheld by the courts. *See id.*

attachment of new legal significance to the act of employing miners offends the constitutional protections,[413] legislation that retroactively alters the legal significance of past utility activities, such as purchases of real property, investments in infrastructure, and contractual commitments, should also be found unconstitutional. Application of the plurality's three-factor test to the electric utility stranded costs issue demonstrates that the *Eastern Enterprises* plurality should find constitutional protection for electric utilities' property interests under the Takings Clause.

C. *Justice Kennedy's Due Process Framework Supports Full Recovery of Stranded Costs*

In *Eastern Enterprises*, Justice Kennedy concluded that economic legislation violates the Due Process Clause if the law is "arbitrary and irrational."[414] In his concurrence, Justice Kennedy identified three inquiries that indicate whether a given statute is unconstitutionally arbitrary. They are: (1) whether the statute destroys "reasonable certainty and security, which are the very objects of property ownership";[415] (2) the degree of retroactive effect;[416] and (3) whether the legislation imposes an "'actual, measurable cost'" that results from the activity at issue.[417]

These factors all seem to focus on whether the deprivation at issue was a foreseeable cost of doing business. Under Justice Kennedy's framework, deregulated utilities should be entitled to full recovery of their stranded costs. These losses were not a foreseeable cost of doing business.[418] The pervasiveness and lengthiness of the regulatory scheme created an assumption of continuity upon which companies and regulators justifiably relied.[419] This point is borne out by a statement in the Supreme Court's opinion in *Duquesne Light Co. v. Barasch*.[420] In assessing the impact of a change in rate structure, the Court noted:

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413. Refer to Parts III.B-C *supra*.

414. *See Eastern Enters.*, 524 U.S. at 539-50 (Kennedy, J., concurring in the judgment and dissenting in part).

415. *See id.* at 548-49 (Kennedy, J., concurring in the judgment and dissenting in part).

416. *See id.* at 549 (Kennedy, J., concurring in the judgment and dissenting in part).

417. *See id.* at 549-50 (Kennedy, J., concurring in the judgment and dissenting in part) (quoting Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 19 (1976)).

418. *See* Baumol & Sidak, *Stranded Costs*, *supra* note 49, at 843-47.

419. *See id.*

420. For a discussion on *Duquesne*, refer to Part V.A.3 *supra*.

> The risks a utility faces are in large part defined by the rate methodology because utilities are virtually always public monopolies dealing in an essential service, and so relatively immune to the usual market risks. Consequently, a State's decision to arbitrarily switch back and forth between methodologies . . . would raise serious constitutional questions.[421]

The Court's risk analysis focused on the question of rate methodology and did not contemplate the possibility of the utility losing its monopoly completely.[422]

Strict application of Justice Kennedy's three factors consequently mirrors the underlying forseeability inquiry and leads to the same conclusion that depriving deregulated electric utilities of their stranded costs would be arbitrary and irrational. The first factor isolated by Justice Kennedy asks whether the statute destroys the "reasonable certainty and security which are the very objects of property ownership."[423] As the Court's comments in *Duquesne* demonstrate, the continuance of the regulatory scheme and its accompanying reimbursement mechanisms, were almost universally accepted assumptions.[424] Justice Kennedy would similarly find that changing the electric utility regulatory scheme after such a long period of acceptance would destroy all certainty and security once enjoyed by the utilities.

The second factor focuses on the degree of retroactive effect.[425] Denial of stranded-cost recovery has retroactive effects. The government is changing the significance of investments that were entered into in reliance upon the regulatory contract and the continuance of the regulatory scheme.[426] The electric utilities are being asked to pay now for investment decisions made in the past under a different set of rules.

Justice Kennedy's third inquiry focuses on whether the legislation in question imposes an "actual measurable cost" attributable to the liability-inducing activity.[427] On the one hand, the losses associated with electric utility deregulation stem

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421. Duquesne Light Co. v. Barasch, 488 U.S. 299, 315 (1989).

422. *See id.*

423. *See Eastern Enters.*, 524 U.S. at 548 (Kennedy, J., concurring in the judgment and dissenting in part).

424. *See Duquesne Light Co.*, 488 U.S. at 315.

425. *See Eastern Enters.*, 524 U.S. at 548-49 (Kennedy, J., concurring in the judgment and dissenting in part).

426. Refer to notes 314-19 *supra* and accompanying text.

427. *See Eastern Enters.*, 524 U.S. at 549 (Kennedy, J., concurring in the judgment and dissenting in part).

directly from the activities of the electric utilities, which would seem to indicate that the third factor is not satisfied. However, in truth, this third factor is concerned with the equities of the transaction. As Justice Kennedy argued, the Coal Act inequitably required companies to pay for healthcare costs that were not directly linked to their employment of these workers.[428] Efforts to deny the recovery of stranded costs impose a similarly inequitable liability on utility companies. Deregulation without stranded-cost recovery imposes costs on companies in flagrant disregard of the regulatory contract, reasonable expectations, and the most basic sense of equity embodied in the Due Process Clause.

VI. CONCLUSION

The federal government and the states will continue to grapple with the issue of stranded-cost recovery. Litigation over stranded-cost recovery is likely to increase as well. Although only a few of these cases have reached the courts, the sheer magnitude of interests at stake makes litigation almost inevitable.

To date, the utilities have been relatively successful in achieving their goal of full stranded-cost recovery through the political process. That may change, however, and the Court's failure to define a recognizable standard for assessing takings and substantive due process claims will make any litigation in this area time-consuming and inefficient.

The utilities have a constitutional right to full stranded-cost recovery because their losses are the direct result of governmental deregulation measures. To deny recovery in such circumstances would offend the objective of "fundamental fairness" embodied in the Fifth and Fourteenth Amendments.

The United States Supreme Court could find for the utilities based upon either a takings theory, as did the plurality in *Eastern Enterprises*, or a substantive due process theory, following Justice Kennedy's *Eastern Enterprises* concurrence. Whereas the takings analysis is proper, a strong argument can be made that the Justices should adopt Justice Kennedy's approach.

First, adopting Justice Kennedy's approach would help alleviate the tension in the Court's jurisprudence, which has been brought about as a result of the imbalance between the Court's application of substantive due process theory in the personal

428. *See id.* (Kennedy, J., concurring in the judgment and dissenting in part).

rights area and its application in the economic area. Second, adopting Justice Kennedy's framework would put an end to the plurality's "torturing" of the Takings Clause, which has expanded beyond precedent.

Finally, reliance upon the Due Process Clause would afford the Court the flexibility to reconsider its embrace of the public use element in its Takings Clause jurisprudence. Although it is not likely that the Court will beat a wholesale retreat from *Penn Central* and its progeny, the availability of another remedy may give the Court pause over its public use takings analyses.

Bentzion S. Turin