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The Hope Case and Recent Federal Decisions

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former client is not privileged; the client is not protected in the perpetration of a fraud; an attorney on the stand may be required to show the amount of his fee as a test of his interest in the action. The privilege may be waived by the client if he places his attorney on the stand or if the nature of the communication would cause its own disclosure. However, there is no waiver where the attorney betrays the confidence in the presence of the client and without protest from the client under circumstances where he would not be expected to protest.

C. M. H.

THE HOPE CASE AND RECENT FEDERAL DECISIONS.—For nearly a decade, the courts in their review of public utility rate cases have been confronted with the enigma of Federal Power Comm'n v. Hope Natural Gas Co.1 This note, while avoiding a critique2 of the Hope case itself, will attempt an analysis of recent federal cases3 in an effort to ascertain how the federal courts have subsequently applied the doctrine of the Hope case in respect to the rate base4 and a rate of return thereon.5 Judicial determination of public utility rate regulations6 was

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1 320 U.S. 591 (1944).
4 Rate base is the amount on which a return should be earned. The discussion in this note shall be confined to the major component of the rate base, e.g., whether the value of the utility property included in the rate base should be based on the present value of the property or the money originally invested in the utility.
5 The Hope case is also salient as approving accounting depreciation method. Besse, Should Depreciation be Deducted? 45 P.U. FORUM 822 (1950).
6 Munn v. Illinois, 94 U.S. 113 (1876) (legislative fixed rates); Smyth v. Ames, 169 U.S. 466 (1898) (judicial rate approval); F.P.C. v. Hope Natural Gas Co., 320 U.S. 591 (1944) (administrative determination); See Nemmers, Hope Case—Pandora's Box, 45 ILL. L. REV. 460 (1950).
predicated on the "fair value" rule enunciated in Smyth v. Ames.  
There the Supreme Court first required that for the purpose of judicial review utility rates were to be computed so as to yield a reasonable return over and above the expenses incident to the business. By subsequent adjudications, the same court laid down rules affecting the policies of the regulatory commission in the most minute detail.

This policy of intensive judicial inquiry prevailed until the advent of Federal Power Comm'n v. Natural Gas Pipeline Co., when the Supreme Court held that neither the Constitution nor the federal statute bound the rate-making agency to use any single formula or any combination of formulae and that the court would not intercede unless it was conclusively shown that the failure to give consideration to the "fair value" would prevent the utility from operating successfully as a public utility.

In the Hope case, the Federal Power Commission, while fixing rates pursuant to the Natural Gas Act, used the actual legitimate cost of the utility's property as the rate base. The circuit court of appeals set aside the order of the commission because it did not use the "fair value" rate base. On certification, the Supreme Court upheld the commission stating that "fair value" is merely the end product of the rate-making process and not the starting point; that the commission is not bound to use any single formula or combination of formulae in determining the rate base; that the fact that the method employed may contain infirmities is not im-

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Footnotes:
7 Fair value or reproduction cost is concerned with the reconstruction of an identical or similar plant under present conditions.
8 169 U.S. 466 (1898).
10 315 U.S. 575 (1942).
11 52 Stat. 821, 15 U.S.C. 717 (1938): 19 (b) "... finding of ... fact, if supported by substantial evidence, shall be conclusive." 4 (a) "All rates ... shall be just and reasonable. ..." 5 (a) "... the Commission shall determine the just and reasonable rates, ... to be thereafter observed ... and shall fix the same by orders." 6 (a) "The commission may investigate and ascertain the actual legitimate cost of property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the the determination of such cost or depreciation and the fair value of such property."
12 Actual legitimate cost or prudent investment is the amount honestly invested by the owner in the utility's properties used and useful in public service.
portant and that the various permissible ways of arriving at any rate base, on which the return is computed, are unimportant so long as the end result or rate of return will allow the company to operate successfully, maintain its financial integrity, attract new capital, and compensate its investors for the risk assumed. Justice Jackson dissented on the ground that "fair value" had been previously disapproved as the rate base in the Pipeline case, supra, and further, that the natural gas industry was not suitable to regulation by the rate base method.

The probable effect of the Hope decision upon the judicial determination of public utility earnings was the subject of extensive comment and conjecture. It was variously suggested that the Supreme Court had either: (1) abolished "fair value" and adopted "prudent investment" as the rate base; (2) conceded the commission the prerogative of ascertaining the rate base or (3) propounded a concept of rate-making which vitiated the rate base method itself. These suggestions will serve as points of inquiry in the following analysis.

Although it was contended that "fair value" was no longer permissible as the rate base because of the Hope decision, the more prevalent view was that "fair value" had merely been disapproved as a rate base because of the infirmities inherent in it. Recent decisions appear to have resolved this issue. In Market Street Ry. v. Railroad Comm'n of Cal., supra, the commission used as a rate base the price at which the utility had offered to sell its properties.

13 Reed's dissent was based upon the idea that in a speculative field such as the natural gas industry the realization from the investor's dollar should be reflected in the present fair value.

Frankfurter's dissent was based upon the end result rule approved in the case. He felt the commission should set forth with explicitness the criteria by which the commission was guided in determining the rate or judicial review would be a mere formality.

14 F.P.C. v. Nat. Gas Pipeline Co., 315 U.S. 575, 602: "While the opinion of the court erases much which has been written in rate cases during the last half century, we think this is an appropriate occasion to lay the ghost of Smyth v. Ames, ... which has haunted utility regulation since 1898. This is especially desirable lest the reference by the majority to 'constitutional requirement' and to 'the limit of due process' be deemed to perpetuate the fallacious 'fair value' theory or rate-making in the limited judicial review provided by the Act."

15 See dissent in Colorado Interstate Co. v. F.P.C., 324 U.S. 581 (1945).

16 See Harbeson, The Demise of Fair Value, 42 Mich. L. Rev. 1049 (1944); Baver, The Establishment and Administration of a Prudent Investment Rate Base, 53 Yale L.J. 495 (1944); The Scope of Judicial Review of Rate Regulation, 39 Ill. L. Rev. 160 (1944); Hankin, Effect of the Hope Natural Gas Case on the Future of Rate Regulation, 33 P.U. Fort. 135 (1944); Kushing & Wirick, Answers to Inflations Dilemma in Rate Making, 46 P.U. Fort. 3 (1950); see also note 2, supra.

17 324 U.S. 548 (1945).
utility contended that it had been deprived of due process because there was a capitalization of earning power, a method of valuation which had been condemned by the *Hope* case in the assertion that "rates cannot be made to depend upon 'fair value' when value of the going enterprise depends on earnings under whatever rates may be anticipated." After noting that prior decisions were not applicable since the financial condition of the utility was such that it could not have made a profit even in the absence of regulation, Justice Jackson, speaking for an unanimous court, asserted that the utility investor cannot be said to suffer if the rate fixed will probably produce a fair return on the present "fair value" of their property. A similar problem was before the Supreme Court again in *Federal Power Comm'n v. Panhandle Eastern Pipeline Co.*

There the commission sought to enjoin a holding company from selling leases to its subsidiary which had previously been included in the rate base. The majority of the court, while conceding producing facilities and costs of gas were weighty factors in rate-making, held that the Natural Gas Act did not envisage federal regulation to the limit of constitutional power but rather only the exercise of federal power specified in the act. Saliently, the dissent of Justice Black, concurred in by Justices Douglas and Rutledge, stressed the fact that the reserves which had cost $160,000 had sold for $10,000,000 and it was not at all clear that after such decision the new purchaser could be prevented from basing rates on the new cost. In *Cities Service Gas Co. v. Federal Power Comm'n* the commission was challenged by the utility for applying prudent investment as the rate base rather than "fair value". Here, a circuit court of appeals held that it would not intercede unless it was conclusively shown that the failure to give consideration to "fair value" of the utility property would prevent the utility from operating successfully. However, the court noted specifically that "fair value" was no longer an essential ingredient of the rate-making process but rather the end result of such process.

From these three decisions it would appear that although the Supreme Court itself has applied "fair value" as a rate base, a circuit court of appeals by application of the *Hope* case no longer considers it an essential ingredient of the rate base.

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18 *337* U.S. 498 (1949).
19 *155* F.2d 694 (10th Cir. 1946).
20 The sale price of any property usually approximates fair value or is arrived at by capitalizing the earnings. *Pichotta v. City of Skagway,* 78 F. Supp. 999 (D. Alaska 1949).
Apparently no federal decision has yet construed the *Hope* case as a mandate for the prudent investment theory. However, the courts seem unable to view rate-making as anything other than a mere alternative between the prudent investment or the "fair value" rate base. The most interesting of the preponderance of decisions negating the idea that prudent investment is mandatory is *Pichotta v. City of Skagway*. There the district court of Alaska refused the utility's request that the rate base be the capital invested by the last purchaser. When the utility asked that the prudent investment rate base include at its original cost property built by the Army, the court refused the request on the basis that the theory of original cost was never intended to cover gratuitous contributions to capital at government expense.

One phase of the *Hope* case as to which the weight of opinion is preponderantly in accord is that the Supreme Court there recognized the commission's prerogative of adopting any rate base which the exigencies of the situation may require. In *Colorado Interstate Co. v. Federal Power Comm'n* the commission included in the rate base the original cost of production and gathering properties. The court, affirming the inclusion, noted that it could not say that putting these elements in the rate base was error since the commission was not bound to use any single formula. In *Panhandle Eastern Pipe Line Co. v. Federal Power Comm'n* the court stated that considering "fair value" would have been a useless formality since the commission need not consider it in determining the rate and that except for procedural due process and jurisdiction a reviewing court may only interest itself in the effect of the order and not concern itself with formula or method of reaching its conclusion. In the recent case of *Public Utility Comm'n v. Washington Gas & Light Co.* a consumer protested the inclusion in the rate base of cost of conversion of customer appliances because the cost reflected no tangible property. In construing a power commission act in *pari materia* with that of the Natural Gas Act, the Circuit Court of Appeals of the District of Columbia held that under the *Hope* case the commission might adopt any method of valuation, even using some method of calculating rates other

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22 324 U.S. 581 (1945).
23 143 F.2d 488 (8th Cir. 1944).
24 188 F.2d 11 (D.C. Cir. 1950).
than the traditional ones which depend upon the finding of a rate base since rate-making is but one method of price-fixing.

Even where the court concedes the prerogative of the commission in rate base selection, the explicitness with which the commission must define its *modus operandi* varies in each instance with the particular court. Illustrative of this variance are *Colorado-Wyoming v. Federal Power Comm'n*\(^2\)\(^5\) and *Interstate Natural Gas Co. v. Federal Power Comm'n*\(^2\)\(^6\). In the *Colorado-Wyoming* case the court, without reference to the *Hope* case, asserted that it could neither understand the method used by the commission nor resolve ambiguities in the record and reversed the commission. Effective review, the court asserted, necessitates a complete finding of fact by a well defined method of analysis. Conversely, in the *Interstate Natural Gas* case the court held that even though the method employed may contain infirmities it is not important so long as the total effect of the rate order is just and reasonable.\(^2\)\(^7\)

The most salient factor in public utility rate regulation is the end result test set forth in the *Hope* case. There the court pronounced for the first time a concept whereby the commission could use a method of calculating what the company should earn on a basis other than the traditional rate base method. In the *Hope* case, the court held it would suffice if the end result provided for enough revenue for operating expenses, capital cost and sufficient return to the equity owner to assure financial integrity of the enterprise, so as to maintain its credit and attract capital.

It is apparent that the end result test is concerned not with a rate base but a rate of return. For its application any method of calculating earnings may suffice. Its vagueness has led to diverse application in the federal courts. To some the test is mere verbiage and a formula is still a prerequisite for judicial review. *Mississippi River Fuel Corp. v. Federal Power Comm'n*\(^2\)\(^8\) is illustrative of this approach. There the court was called upon to review the commission's application of a demand-commodity theory of costs rather than a rate base. The utility contended that the court was limited in its review to a consideration of the end result of the rate fixed. In response to the contention that it had no power to examine the

\(^{25}\) 324 U.S. 626 (1945).
\(^{26}\) 156 F.2d 949 (5th Cir. 1946).
\(^{27}\) Cf. Safe Harbor Water Power Corp. v. F.P.C., 179 F.2d 179, 201 (3d Cir. 1949).
several elements which together constitute the rate, the court responded that the rate has always been determined in law by its relationship to the sum of a number of components, principally expense of operation, an allowance for depreciation or depletion and a proper return to the company. The Hope case, the court asserted, discussed end result in terms of expense and capital costs and even when it discussed end result in relation to the return of the company it spelled out in terms the required components of the return. A similar construction of the end result test is that typified by the Washington Gas case;29 there, after conceding that it could not prevent the commission from including abandoned plant in the prudent investment rate base, the court decided that in order to protect the consumer there must be a diminution of the rate of return on the rate base. Asserting that to the extent that the size of the investor's dollar is reflected neither in original cost nor present "fair value" adjustment can be made in the allowable rate of return, the court utilized the end result test to obviate the rate base method itself. It is clear from a perusal of the decision that had a standard other than a rate base method been utilized the court would have reached the same result. An approach probably most attuned to the Hope case is that of Safe Harbor Water Power Corp. v. Federal Power Comm'n.30 There the utility sought an undepreciated rate base but the court required that there be a reasonable deduction for depreciation. A salient part of the decision was the court's recognition that the problem of rate base and rate of return thereon were both questions purely within the administrative capacity of the commission. By attributing to the Hope case a mandate for a narrow scope of judicial review and by analogy to a Supreme Court decision involving the Securities Exchange Commission which asserted that findings of valuation were not subject to re-examination on judicial review, this court has apparently given the most liberal application to the end result test of any federal court to date.

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29 188 F.2d 11 (D.C. Cir. 1950).