Supplementary Material

Chapter 7: The Republican Era—Individual Rights/Property/Due Process

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Smyth v. Ames, 169 U.S. 466 (1898)

At the end of his opinion in Munn v. Illinois *(1877), Chief Justice Waite declared that "For protection against abuses by legislatures the people must resort to the polls, not to the courts." By 1890 the court had reconsidered this hands-off approach, ruling that federal judges were obligated under the due process clause to protect the property rights of investors or corporations by reviewing, and if necessary second-guessing, the reasonableness of any rates set by state authorities. In* Smyth v. Ames *the Court ruled that regulated industries (in this case, railroads) were constitutionally entitled to earn a "fair return" on their investment. Justice Harlan, who wrote for a unanimous Court, was a judicial moderate on property rights. . Are there nevertheless similarities between Justice Harlan's analysis and Justice Field's dissent in* Munn*? Differences? What are the advantages and disadvantages of having courts engage in the sort of economic analysis displayed in* Smyth v. Ames*? Are judges best suited to decide what constitutes a "fair return"?* Smyth *established the constitutional limits of rate regulation until the case was overruled in* Federal Power Commission v. Hope Natural Gas Co. *(1944).*

JUSTICE HARLAN delivered the opinion of the Court.

. . .

By the fourteenth amendment it is provided that no state shall deprive any person of property without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws. That corporations are persons within the meaning of this amendment is now settled. Santa Clara Co. v. Southern Pac. R. Co. *(1886).* What amounts to deprivation of property without due process of law, or what is a denial of the equal protection of the laws, is often difficult to determine, especially where the question relates to the property of a quasi public corporation, and the extent to which it may be subjected to public control. But this court, speaking by Chief Justice Waite, has said that . . . "under pretense of regulating fares and freights, the state cannot require a railroad corporation to carry persons or property without reward, neither can it do that which in law amounts to the taking of private property for public use without just compensation, or without due process of law." *Railroad Commission Cases* (1886). . . . In *Chicago, M. & St. P. Ry. Co. v. Minnesota* (1890), . . . it was said: "If the company is deprived of the power of charging reasonable rates for the use of its property, and such deprivation takes place in the absence of an investigation by judicial machinery, it is deprived of the lawful use of its property, and thus, in substance and effect, of the property itself, without due process of law, and in violation of the constitution of the United States; and, in so far as it is thus deprived, while other persons are permitted to receive reasonable profits upon their invested capital, the company is deprived of the equal protection of the laws." . . . In *Budd v. New York* (1892), . . .the court, while sustaining the power of New York by statute to regulate charges to be exacted at grain elevators and warehouses in that state, took care to state, as a result of former decisions, that such power was not one "to destroy or a power to compel the doing of the services without reward, or to take private property for public use without just compensation or without due process of law." . . .

In view of the adjudications these principles must be regarded as settled:

1. A railroad corporation is a person within the meaning of the fourteenth amendment declaring that no state shall deprive any person of property without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws.

2. A state enactment, or regulations made under the authority of a state enactment, establishing rates for the transportation of persons or property by railroad that will not admit of the carrier earning such compensation as, under all the circumstances, is just to it and to the public, would deprive such carrier of its property without due process of law, and deny to it the equal protection of the laws, and would, therefore, be repugnant to the fourteenth amendment of the constitution of the United States.

3. While rates for the transportation of persons and property within the limits of a state are primarily for its determination, the question whether they are so unreasonably low as to deprive the carrier of its property without such compensation as the constitution secures, and therefore without due process of law, cannot be so conclusively determined by the legislature of the state, or by regulations adopted under its authority, that the matter may not become the subject of judicial inquiry.

The cases before us directly present the important question last stated. . . .

What are the considerations to which weight must be given when we seek to ascertain the compensation that a railroad company is entitled to receive, and a prohibition upon the receiving of which may be fairly deemed a deprivation by legislative decree of property without due process of law? Undoubtedly, that question could be more easily determined by a commission composed of persons whose special skill, observation, and experience qualifies them to so handle great problems of transportation as to do justice both to the public and to those whose money has been used to construct and maintain highways for the convenience and benefit of the people. But, despite the difficulties that confessedly attend the proper solution of such questions, the court cannot shrink from the duty to determine whether it be true, as alleged, that the Nebraska statute invades or destroys rights secured by the supreme law of the land. No one, we take it, will contend that a state enactment is in harmony with that law simply because the legislature of the state has declared such to be the case, for that would make the state legislature the final judge of the validity of its enactment, although the constitution of the United States and the laws made in pursuance thereof are the supreme law of the land, anything in the constitution or laws of any state to the contrary notwithstanding. Article 6. The idea that any legislature, state or federal, can conclusively determine for the people and for the courts that what it enacts in the form of law, or what it authorizes its agents to do, is consistent with the fundamental law, is in opposition to the theory of our institutions. The duty rests upon all courts, federal and state, when their jurisdiction is properly invoked, to see to it that no right secured by the supreme law of the land is impaired or destroyed by legislation. This function and duty of the judiciary distinguishes the American system from all other systems of government. The perpetuity of our institutions, and the liberty which is enjoyed under them, depend, in no small degree, upon the power given the judiciary to declare null and void all legislation that is clearly repugnant to the supreme law of the land.

We turn now to the evidence in the voluminous record before us for the purpose of ascertaining whether—looking at the cases in the light of the facts as they existed when the decrees were rendered—the Nebraska statute, if enforced, would, by its necessary operation, have deprived the companies, whose stockholders and bondholders here complain, of the right to obtain just compensation for the services rendered by them.

The first and most important contention of the plaintiffs is that, if the statute had been in force during any one of the three years preceding its passage, the defendant companies would have been compelled to use their property for the public substantially without reward, or without the just compensation to which it was entitled. We think this mode of calculation for ascertaining the probable effect of the Nebraska statute upon the railroad companies in question is one that may be properly used.

The conclusion reached by the circuit court was that the reduction made by the Nebraska statute in the rates for local freight was so unjust and unreasonable as to require a decree staying the enforcement of such rates against the companies named in the bill. That conclusion was based largely upon the figures presented by Mr. Dilworth while he was a secretary of the state board of transportation, as well as a defendant and one of the solicitors of the defendants in these causes. He was a principal witness for that board. His general fairness and his competency to speak of the facts upon which the question before us depends are apparent on the record. He stated that the average reduction made by the statute on all the "commodities of local rates" was 29.50 per cent., and this estimate seems to have been accepted by the parties as correct. He estimated that the percentage of operating expenses on local

business would exceed the percentage of operating expenses on all business by at least 10 per cent., and that it might go as high as 20 per cent., or higher. And this view is more than sustained by the evidence of witnesses possessing special knowledge of railroad transportation and of the cost of doing local business as compared with what is called "through business." . . . Mr. Dilworth stated that he had prepared himself with an estimate showing the number of tons of freight commonly spoken of as "local freight" hauled on the respective railways in Nebraska, and the amount received by the railway companies by way of tariff on tons of freight hauled, including through as well as local freight, and was qualified to speak as to the amount received by the companies for both passengers and freight within the state, and the reduction that would take place in rates under the statute in question. He presented various tables showing the results of his investigations. . . . *[Elaborate review of financial tables and figures deleted.]*

In view of the reduction of 29.50 in rates prescribed by the statute and of the extra cost of doing local business, as compared with other business, what do these facts show?

Take the case of the Burlington road from July 1, 1890, to June 30, 1891. Looking at the entire business done on it during that period within the limits of the state, we find that the percentage of operating expenses to earnings on all business—which, as stated, does not include the extra cost of local business—was 66.24. Add to this the extra cost of local business, estimated at least 10 per cent., and the result is that, under the rates charged during the period stated, the cost to the Burlington Company of earning $100 would have been $76.24. Now, if the reduction of 29 1/2 per cent. made by the act of 1893 had been in force prior to July 1, 1891, the company would have received $70.50 as against $100 for the same service, showing that in that year the operating expenses would have exceeded the earnings by $5.74 in every $100 of the amount actually received by it. . . .

During the year ending June 30, 1893, that company received $1,242, 416 for tons carried locally, whereas under the 29 1/2 per cent. reduction prescribed by the statute of that year it would have received only $875, 905; that is, less by $366,512 than it did receive. The percentage of its expenses to earnings in that year, including the extra cost of local business, was 75.51; that is, under the statutory rates $875,905 would have been earned at a cost of $938,147, which would have been a loss of $ 62,243. By the same mode of calculation, it will be found that, if the statute of 1893 had been enforced during the years ending the 30th days of June, 1891, 1892, and 1893, respectively, the other companies would have lost—that is, their expenses would have exceeded their earnings—during those years by the following amounts: The St. Paul Company, $11,403, $6, 716, and $5,814; the Fremont Company, $34,377 for the year ending June 30, 1892; the Union Pacific Company, $23,480 for the year ending June 30, 1891; the Omaha Company, $45,166, $28,813, and $27,085; the St. Joseph Company, $ 7,840, $4,256, and $523; and the Kansas City Company, $2,627, $974, and $1,510; while the earnings of the Union Pacific Company would have exceeded its expenses for the years ending the 30th days of June, 1892 and 1893, respectively, by $16,170 and $8,234, and those of the Fremont Company by $ 37,037 and $29,036 for the years ending the 30th days of June, 1891 and 1893, respectively. . . .

It is further said, in behalf of the appellants, that the reasonableness of the rates established by the Nebraska statute is not to be determined by the inquiry whether such rates would leave a reasonable net profit from the local business affected thereby, but that the court should take into consideration, among other things, the whole business of the company; that is, all its business, passenger and freight, interstate and domestic. If it be found upon investigation that the profits derived by a railroad company from its interstate business alone are sufficient to cover operating expenses on its entire line, and also to meet interest, and justify a liberal dividend upon its stock, may the legislature prescribe rates for domestic business that would bring no reward, and be less than the services rendered are reasonably worth? Or must the rates for such transportation as begins and ends in the state be established with reference solely to the amount of business done by the carrier wholly within the state, to the cost of doing such local business, and to the fair value of the property used in conducting it, without taking into consideration the amount and cost of its interstate business, and the value of the property employed in it? If we do not misapprehend counsel, their argument leads to the conclusion that the state of Nebraska could legally require local freight business to be conducted even at an actual loss, if the company earned on its interstate business enough to give it just compensation in respect of its entire line and all its business, interstate and domestic. We cannot concur in this view. In our judgment, it must be held that the

reasonableness or unreasonableness of rates prescribed by a state for the transportation of persons and property wholly within its limits must be determined without reference to the interstate business done by the carrier, or to the profits derived from it. The state cannot justify unreasonably low rates for domestic transportation, considered alone, upon the ground that the carrier is earning large profits on its interstate business, over which, so far as rates are concerned, the state has no control. Nor can the carrier justify unreasonably high rates on domestic business upon the ground that it will be able only in that way to meet losses on its interstate business. So far as rates of transportation are concerned, domestic business should not be made to bear the losses on interstate business, nor the latter the losses on domestic business. . . .

[T]he plaintiffs contended that a railroad company is entitled to exact such charges for transportation as will enable it at all times not only to pay operating expenses, but also to meet the interest regularly accruing upon all its outstanding obligations, and justify a dividend upon all its stock; and that to prohibit it from maintaining rates or charges for transportation adequate to all those ends will deprive it of its property without due process of law, and deny to it the equal protection of the laws. . . . In our opinion, the broad proposition advanced by counsel involves some misconception of the relations between the public and a railroad corporation. It is unsound, in that it practically excludes from consideration the fair value of the property used, omits altogether any consideration of the right of the public to be exempt from unreasonable exactions, and makes the interests of the corporation maintaining a public highway the sole test in determining whether the rates established by or for it are such as may be rightfully prescribed as between it and the public. A railroad is a public highway, and none the less so because constructed and maintained through the agency of a corporation deriving its existence and powers from the state. Such a corporation was created for public purposes. It performs a function of the state. Its authority to exercise the right of eminent domain and to charge tolls was given primarily for the benefit of the public. . . . It cannot, therefore, be admitted that a railroad corporation maintaining a highway under the authority of the state may fix its rates with a view solely to its own interests, and ignore the rights of the public. But the rights of the public would be ignored if rates for the transportation of persons or property on a railroad are exacted without reference to the fair value of the property used for the public, or the fair value of the services rendered, but, in order simply that the corporation may meet operating expenses, pay the interest on its obligations, and declare a dividend to stockholders . . .

We hold . . . that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And, in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth. . . .

[I]t may be added that the conditions of business, so far as railroad corporations are concerned, have probably changed for the better since the decree below, and that the rates prescribed by the statute of 1893 may now afford all the compensation to which the railroad companies in Nebraska are entitled as between them and the public. In anticipation, perhaps, of such a change of circumstances, and the exceptional character of the litigation, the circuit court wisely provided in its final decree that the defendant members of the board of transportation might, "when the circumstances have changed so that the rates fixed in the said act of 1893 shall yield to the said companies reasonable compensation for the services aforesaid," apply to the court, by bill or otherwise, as they might be advised, for a further order in that behalf. . . .

Perceiving no error on the record in the light of the facts presented to the circuit court, the decree in each case must be affirmed.

It is so ordered.

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